FIRST RELIANCE BANCSHARES INC
Form 10-Q
August 13, 2010
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2010

OR

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

For the Transition Period from _________to_________

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.
(Exact name of small business issuer as specified in its charter)

South Carolina (State or other jurisdiction of incorporation or organization)	80-0030931 (I.R.S. Employer Identification No.)

2170 West Palmetto Street
Florence, South Carolina
29501
(Address of principal executive offices, including zip code)

(843) 656-5000
(Issuer's telephone number, including area code)

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

4,109,968 shares of common stock, par value $0.01 per share, as of July 31, 2010

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No.

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 o No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

(Do not check if a 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 o No x

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FIRST RELIANCE BANCSHARES, INC

Condensed Consolidated Balance Sheets

Assets	June 30, 2010 (Unaudited)	December 31, 2009
Cash and cash equivalents:		
Cash and due from banks	$ 2,196,978	$ 2,942,295
Interest-bearing deposits with other banks	30,637,573	50,356,191
Total cash and cash equivalents	32,834,551	53,298,486
Time deposits in other banks	503,644	502,089
Securities available-for-sale	122,201,795	121,948,744
Nonmarketable equity securities	4,812,100	4,812,100
Total investment securities	127,013,895	126,760,844
Mortgage loans held for sale	579,266	5,100,609
Loans receivable	375,344,297	406,627,401
Less allowance for loan losses	(7,048,764)	(9,800,746)
Loans, net	368,295,533	396,826,655
Premises and equipment, net	26,190,857	26,469,436
Accrued interest receivable	2,537,500	2,661,030
Other real estate owned	12,268,366	8,954,214
Cash surrender value life insurance	11,618,284	11,409,937
Other assets	11,007,722	13,525,073
Total assets	$ 592,849,618	$ 645,508,373
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 43,696,640	$ 44,298,626
Interest-bearing transaction accounts	36,764,075	47,733,229
Savings	108,369,143	103,604,793
Time deposits $100,000 and over	183,128,203	195,346,191
Other time deposits	130,963,221	161,780,140
Total deposits	502,921,282	552,762,979
Securities sold under agreement to repurchase	545,647	598,342
Advances from Federal Home Loan Bank	26,000,000	34,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	592,527	680,880
Other liabilities	2,195,047	1,932,345
Total liabilities	542,564,503	600,284,546
Shareholders' Equity		
Preferred stock, no par value, authorized 10,000,000 shares:		
Series A cumulative perpetual preferred stock 15,349 issued and outstanding at June 30, 2010 and December 31, 2009	14,632,649	14,536,176
Series B cumulative perpetual preferred stock 767 shares issue and outstanding at June 30, 2010 and December 31, 2009	827,775	835,960
Series C cumulative mandatory convertible preferred stock		

2,293 shares issue and outstanding at June 30, 2010	2,293,000	-
Common stock, $0.01 par value; 20,000,000 shares authorized, 4,109,968 and 3,582,691 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively	41,100	35,827
Capital surplus	28,121,138	26,181,576
Treasury stock at cost at 12,090 and 11,535 shares at June 30, 2010 and December 31, 2009, respectively	(168,266)	(163,936)
Nonvested restricted stock	(856,860)	(206,004)
Retained earnings	4,790,734	5,269,463
Accumulated other comprehensive income (loss)	603,845	(1,265,235)
Total shareholders' equity	50,285,115	45,223,827
Total liabilities and shareholders' equity	$ 592,849,618	$ 645,508,373

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Operations
(Unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
Interest income:				
Loans, including fees	$ 12,066,213	$ 13,838,054	$ 5,853,126	$ 6,870,317
Investment securities:				
Taxable	1,193,184	1,002,970	583,191	471,654
Nontaxable	1,306,871	745,799	653,973	432,381
Federal funds sold	-	1,332	-	349
Other interest income	55,472	36,720	26,599	27,121
Total	14,621,740	15,624,875	7,116,889	7,801,822
Interest expense:				
Time Deposits over $100,000	2,903,397	2,575,302	1,447,695	1,382,735
Other deposits	2,598,035	3,433,801	1,245,226	1,810,957
Other interest expense	781,052	1,576,970	392,253	722,421
Total	6,282,484	7,586,073	3,085,174	3,916,113
Net interest income	8,339,256	8,038,802	4,031,715	3,885,709
Provision for loan losses	2,065,899	4,855,822	1,879,810	3,555,442
Net interest income after provision for loan losses	6,273,357	3,182,980	2,151,905	330,267
Noninterest income:				
Service charges on deposit accounts	911,690	935,094	443,469	474,486
Gain on sales of mortgage loans	380,463	1,214,537	170,421	554,038
Income from bank owned life insurance	208,347	208,155	103,690	103,005
Other charges, commissions and fees	323,995	267,903	171,011	140,904
Gain on sale of securities	1,602	1,029,459	-	1,029,459
Gain (loss) on sale of other real estate owned	482,681	(15,892)	240,560	-
Gain on sale of fixed assets	-	86,810	-	-
Other non-interest income	175,000	280,768	70,221	11,825
Total	2,483,778	4,006,834	1,199,372	2,313,717
Noninterest expenses:				
Salaries and employee benefits	4,663,675	5,322,773	2,267,609	2,595,624
Occupancy expense	777,915	710,032	378,381	354,175
Furniture and equipment expense	598,356	562,569	288,130	276,704
Other operating expenses	3,390,843	2,883,428	1,554,713	1,527,420
Total	9,430,789	9,478,802	4,488,833	4,753,923
Loss before income taxes	(673,654)	(2,288,988)	(1,137,556)	(2,109,939)
Income tax benefit	(724,635)	(1,148,239)	(658,403)	(955,325)
Net income (loss)	50,981	(1,140,749)	(479,153)	(1,154,614)
Preferred stock dividends	454,801	268,132	250,227	208,547
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	88,288	57,072	44,388	44,388
Net loss available to common shareholders	$ (492,108)	$ (1,465,953)	$ (773,768)	$ (1,407,549)

Average common shares outstanding, basic		3,760,792		3,546,386		3,935,610		3,567,533
Average common shares outstanding, diluted		3,760,792		3,546,386		3,935,610		3,567,533
Basic loss per share	$	(0.13)	$	(0.41)	$	(0.20)	$	(0.40)
Diluted loss per share	$	(0.13)	$	(0.41)	$	(0.20)	$	(0.40)

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss)
For the Six Months Ended June 30, 2010 and 2009
(Unaudited)

	Preferred Stock	Common Stock	Capital Surplus	Treasury Stock	Nonvested Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	$ -	$ 35,250	$ 26,120,460	$ (159,777)	$ (207,653)	$ 11,839,005	$ (201,527)	$ 37,425,758
Issuance of Series A preferred stock, net of issuance cost of $116,786	14,375,740							14,375,740
Issuance of Series B preferred stock, net of issuance cost of $6,902	849,572							849,572
Net loss						(1,140,749)		(1,140,749)
Other comprehensive loss, net of tax benefit of $583,818							(1,133,294)	(1,133,294)
Comprehensive loss								(2,274,043)
Preferred stock dividends						(160,325)		(160,325)
Accretion of Series A Preferred stock discount	62,363					(62,363)		-
Amortization of Series B Preferred stock premium	(5,291)					5,291		-
Issuance of stock to employee		2	998					1,000
Non-vested restricted stock		622	139,377		(62,139)			77,860

Purchase of treasury stock				(4,130)				(4,130
Balance, June 30, 2009	$ 15,282,384	$ 35,874	$ 26,260,835	$ (163,907)	$ (269,792)	$ 10,480,859	$ (1,334,821)	$ 50,291,432
Balance, December 31, 2009	$ 15,372,136	$ 35,827	$ 26,181,576	$ (163,936)	$ (206,004)	$ 5,269,463	$ (1,265,235)	$ 45,223,827
Issuance of Series C	2,293,000							2,293,000
Issuance of common stock net of issuance cost of $329,390		3,401	1,197,861					1,201,262
Net income						50,981		50,981
Other comprehensive gain, net of tax expense of $953,641							1,869,080	1,869,080
Other comprehensive income								1,920,061
Preferred Stock Dividend						(441,422)		(441,422
Accretion of Series A Preferred stock discount	96,473					(96,473)		-
Amortization of Series B Preferred stock premium	(8,185)					8,185		-
Issuance Restricted Stock		1,872	741,701		(650,856)			92,717
Purchase of treasury stock				(4,330)				(4,330
Balance, June 30, 2010	$ 17,753,424	$ 41,100	$ 28,121,138	$ (168,266)	$ (856,860)	$ 4,790,734	$ 603,845	$ 50,285,115

See notes to condensed consolidated financial statements

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FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cash flows from operating activities:		
Net income (loss)	$ 50,981	$ (1,140,749)
Adjustments to reconcile net income (loss) to net cash		
Provided (used) by operating activities:		
Provision for loan losses	2,065,899	4,855,822
Depreciation and amortization expense	492,979	542,760
Gain on sale of premises	-	(86,810)
Gain on sale of available-for-sale securities	(1,602)	(1,029,459)
Impairment loss on available-for sale securities	18,750	-
Loss (gain) on sale of other real estate owned	(482,681)	15,892
Write down of other real estate owned	187,582	-
Discount accretion and premium amortization	139,438	38,766
Disbursements for loans held-for-sale	(15,693,549)	(119,138,851)
Proceeds from loans held-for-sale	20,216,509	113,572,405
Net increase (decrease) in valuation allowance for loans held-for-sale	(1,617)	229,782
Decrease in interest receivable	123,530	321,610
Increase in cash surrender value of life insurance	(208,347)	(208,155)
Increase (decrease) in interest payable	(88,353)	17,049
Amortization of deferred compensation on restricted stock	92,717	77,860
Increase (decrease) in other liabilities	(39,151)	1,076,966
(Increase) decrease in other assets	1,813,998	(2,847,259)
Net cash provided (used) by operating activities	8,687,083	(3,702,371)
Cash flows from investing activities:		
Increase in time deposits	(1,555)	-
Net decrease in loans receivable	19,165,193	12,054,022
Purchases of securities available-for-sale	(2,888,381)	(61,714,944)
Proceeds on sales of securities available-for-sale	3,117,545	40,506,377
Maturities of securities available-for-sale	2,183,920	7,187,809
Purchase of nonmarketable equity securities	-	(237,400)
Proceeds from sales of other real estate owned	4,430,093	6,608
Improvements to other real estate owned	(149,116)	-
Proceeds from disposal of premises, furniture, and equipment	-	2,286,810
Purchases of premises and equipment	(162,835)	(736,200)
Net cash provided (used) by investing activities	25,694,864	(646,918)
Cash flows from financing activities:		
Net increase (decrease) in demand deposits, interest-bearing and savings accounts	(6,806,790)	5,720,879
Net increase (decrease) in certificates of deposit and other time deposits	(43,034,907)	108,409,294
Net decrease in securities sold under agreements to repurchase	(52,695)	(7,072,086)
Decrease in advances from the Federal Home Loan Bank	(8,000,000)	(21,500,000)
Repayment of note payable	-	(6,950,000)
Net proceeds from issuance of preferred stock	2,293,000	15,225,312
Net proceeds from issuance of common stock	1,201,262	-
Issuance of shares to employee	-	1,000

Preferred stock dividends paid	(441,422)	(160,325)
Purchase of treasury stock	(4,330)	(4,130)
Net cash used by financing activities	(54,845,882)	(93,669,944)
Net increase (decrease) in cash and cash equivalents	(20,463,935)	89,320,655
Cash and cash equivalents, beginning of period	53,298,486	5,708,607
Cash and cash equivalents, end of period	$ 32,834,551	$ 95,029,262
Cash paid during the period for		
Income taxes	$ -	$ 4,257
Interest	$ 6,370,837	$ 7,569,024
Supplemental noncash investing and financing activities		
Foreclosures on loans	$ 7,300,030	$ 3,544,350

See notes to condensed consolidated financial statements

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FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures, which would appear in audited annual consolidated financial statements. The consolidated financial statements as of June 30, 2010 and for the interim periods ended June 30, 2010 and 2009 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The consolidated financial information as of December 31, 2009 has been derived from the audited consolidated financial statements as of that date. For further information, refer to the consolidated financial statements and the notes included in First Reliance Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2009.

Note 2 - Recently Issued Accounting Pronouncements

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

Income Tax guidance was amended in April 2010 to reflect an SEC Staff Announcement after the President signed the Health Care and Education Reconciliation Act of 2010 on March 30, 2010, which amended the Patient Protection and Affordable Care Act signed on March 23, 2010. According to the announcement, although the bills were signed on separate dates, regulatory bodies would not object if the two Acts were considered together for accounting purposes. This view is based on the SEC staff's understanding that the two Acts together represent the current health care reforms as passed by Congress and signed by the President. The amendment had no impact on the financial statements.

In July 2010, the FASB issued Accounting Standard Codification Update No. 2010-20 concerning disclosures about the credit quality of financing receivables and the allowance for credit losses. Update No. 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. Update No. 2010-20 requires companies to (1) provide enhanced disclosures around the nature of credit risk inherent in the entity's portfolio of financing receivables; (2) explain how that risk is analyzed and assessed in arriving at the allowance for credit losses; and (3) explain the changes and reasons for changes in the allowance for credit losses. The provisions of Update No. 2010-20 concerning disclosures for the end of a period are effective for interim and annual periods ending on or after December 15, 2010, or December 31, 2010 for the Company. The provisions of Update No. 2010-20 concerning disclosures about activity that occurs during a reporting period are applicable to the Company for interim and annual periods beginning on or after December 15, 2010, the interim period ending on March 31, 2011. The adoption of Update No. 2010-20 is expected to provide the reader of the Company's financial statements with expanded and enhanced disclosure surrounding the allowance for credit losses.

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

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 3 - Reclassifications

Certain captions and amounts in the financial statements in the Company's Form 10-Q for the quarter ended June 30, 2009 were reclassified to conform to the June 30, 2010 presentation.

Note 4 - Comprehensive Income

Comprehensive Income - Accounting principles generally require that recognized income, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	Pre-tax Amount	Tax (Expense) Benefit	Net-of-tax Amount
For the Six Months Ended June 30, 2010:			
Unrealized gains on securities available-for-sale	$ 2,824,323	$ (954,186)	$ 1,870,137
Reclassification adjustment for gains (losses) in net income	1,602	(545)	1,057
	$ 2,822,721	$ (953,641)	$ 1,869,080
For the Six Months Ended June 30, 2009:			
Unrealized gains on securities available-for-sale	$ (687,653)	$ 233,802	$ (453,851)
Reclassification adjustment for gains (losses) in net income	1,029,459	(350,016)	679,443
	$ (1,717,112)	$ 583,818	$ (1,133,294)
For the Three Months Ended June 30, 2010:			
Unrealized gains on securities available-for-sale	$ 1,955,376	$ (658,744)	$ 1,296,632
Reclassification adjustment for gains (losses) realized in net income	-	-	-
	$ 1,955,376	$ (658,744)	$ 1,296,632
For the Three Months Ended June 30, 2009:			
Unrealized gains on securities available-for-sale	$ (1,084,399)	$ 368,696	$ (715,703)
Reclassification adjustment for gains (losses) realized in net income	1,029,459	(350,016)	679,443
	$ (2,113,858)	$ 718,712	$ (1,395,146)

Note 5 – Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized	Gross Unrealized		Estimated
	Cost	Gains	Losses	Fair Value

June 30, 2010				
U.S. Government agencies	$ 2,733,345	$ 52,341	$ -	$ 2,785,686
Mortgage-backed securities	57,330,574	1,173,526	-	58,504,100
Municipals	61,032,177	607,944	762,112	60,878,009
Other	200,000	-	166,000	34,000
	$ 121,296,096	$ 1,833,811	$ 928,112	$ 122,201,795

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 5 – Investment Securities – (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2009				
U.S. Government agencies	$ 3,021,782	$ 751	$ 11,167	$ 3,011,366
Mortgage-backed securities	59,324,978	-	1,192,307	58,132,671
Municipals	61,300,256	460,262	1,023,326	60,737,192
Other	218,750	-	151,235	67,515
	$ 123,865,766	$ 461,013	$ 2,378,035	$ 121,948,744

The following is a summary of maturities of securities available-for-sale as of June 30, 2010. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Securities Available-For-Sale Amortized Cost	Securities Available-For-Sale Estimated Fair Value
Due after one year but within five years	$ 4,509,267	$ 4,451,490
Due after five years but within ten years	28,385,805	28,264,267
Due after ten years	30,870,450	30,947,938
	63,765,522	63,663,695
Mortgage-backed securities	57,330,574	58,504,100
Other	200,000	34,000
Total	$ 121,296,096	$ 122,201,795

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2010 and December 31, 2009.

	June 30, 2010 Fair Value	June 30, 2010 Unrealized Losses	December 31, 2009 Fair Value	December 31, 2009 Unrealized Losses
Less Than 12 Months				
U.S. government agencies and corporations	$ -	$ -	$ 2,995,629	$ 11,167
Mortgage-backed securities	-	-	58,132,671	1,192,307
Municipals	22,054,362	441,050	27,850,269	688,885
	22,054,362	441,050	88,978,569	1,892,359
12 Months or More				
Municipals	4,323,550	321,062	4,314,797	334,441
Other	34,000	166,000	67,515	151,235
	4,357,550	487,062	4,382,312	485,676

Total securities available-for-sale	$ 26,411,912	$ 928,112	$ 93,360,881	$ 2,378,035

At June 30, 2010, securities classified as available-for-sale are recorded at fair market value. Approximately 52.48% of the unrealized losses, or nine individual securities, consisted of securities in a continuous loss position for twelve months or more. The Company believes that the deterioration in value is attributable to changes in market interest rates and not in credit quality and considers these losses temporary. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized costs. Management evaluates investment securities in a loss position based on length of impairment, severity of impairment and other factors.

An impairment loss of $18,750 was recognized during the second quarter of 2010. Management determined that the Company's investment in Beach First National Bancshares, Inc. was worthless, since practically all of the assets of Beach First National were taken into receivership by the Federal Deposit Insurance Corporation.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 5 – Investment Securities – (continued)

During the first six months of 2010 and 2009, gross proceeds from the sale of available-for-sale securities were $3,117,545 and $40,506,377, respectively. Gains on available-for-sale securities totaled $1,602 and $1,029,459 for the first six months of 2010 and 2009, respectively.

Note 6 – Shareholders' Equity

On April 9, 2010, the Company issued 340,145 shares of its common stock at $4.50 per share and 2,293 shares of its newly created Series C Preferred Stock at $1,000. The gross proceeds from the issuance and sale of these securities was $3,823,653. Of the shares issued, 119,179 shares of common stock and 335 shares of Series C Preferred Stock were issued to related parties.

Common Stock – The following is a summary of the changes in common shares outstanding for the six months ended June 30, 2010 and 2009.

	Six Months Ended June 30,	
	2010	2009
Common shares outstanding at beginning of the period	3,582,691	3,525,004
Issuance of common stock	340,145	-
Issuance of non-vested restricted shares	187,765	62,222
Forfeiture of non-vested restricted shares	(633)	-
Issuance of stock to employee	-	200
Common shares outstanding at end of the period	4,109,968	3,587,426

Preferred Stock - On February 24, 2009, the Company's Articles of Incorporation were amended to authorize the issuance of a class of 10,000,000 shares of preferred stock, having no par value. Subject to certain conditions, the amendment authorizes the Company's Board of Directors to issue preferred stock without shareholders' approval. Under this amendment, the Board is authorized to determine the terms of one or more series of preferred stock, including the preferences, rights, and limitations of each series.

On March 6, 2009, the Company completed a transaction with the United States Treasury ("Treasury") under the Troubled Asset Relief Program Capital Purchase Program ("TARP CPP"), which was amended by the enactment of the American Recovery and Reinvestment Act of 2009 on February 17, 2009. Under the TARP CPP, the Company sold 15,349 shares of its Series A Cumulative Perpetual Preferred Stock. In addition, the Treasury received a warrant to purchase 767 shares of the Company's Series B Cumulative Perpetual Preferred Stock, which was immediately exercised by the Treasury for a nominal exercise price. The preferred shares issued to the Treasury qualify as tier 1 capital for regulatory purposes.

The Series A Preferred Stock is a senior cumulative perpetual preferred stock that has a liquidation preference of $1,000 per share, pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. Dividends are payable quarterly. At any time, the Company may, at its option and with regulatory approval, redeem the Series A Preferred Stock at par value plus accrued and unpaid dividends. The Series A Preferred Stock is generally non-voting. Prior to March 6, 2012, unless the Company has redeemed the Series A Preferred Stock or the Treasury has transferred the Series A Preferred Stock to a third party, the consent of the Treasury will be required for the Company to increase its common stock dividend or repurchase its common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practices and certain other circumstances. A consequence of the Series A Preferred Stock purchase includes certain restrictions on executive compensation that could limit the tax deductibility of compensation the Company pays to executive management.

The Series B Preferred Stock is a cumulative perpetual preferred stock that has the same rights, preferences, privileges, voting rights and other terms as the Series A Preferred Stock, except that dividends will be paid at the rate of 9% per year and may not be redeemed until all the Series A Preferred Stock has been redeemed.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 6 – Shareholders' Equity – (continued)

The Series C Preferred Stock consists of 7% cumulative mandatory convertible preferred stock, which will be convertible into common shares for up to three years at the lesser of $6.50 per share or tangible common equity per share as of the calendar quarter ending on or before the conversion date and will mandatorily and automatically convert on July 31, 2013 under the same terms. Dividends are payable quarterly on March 1, June 1, September 1, and December 1 of each year. The Series C Preferred Stock ranks on par with the Company's Series A and Series B Preferred Stock and senior to the common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution, and winding up of the Company. The Series C Preferred Stock is non-voting, except as required by law.

The proceeds from the issuance of the Series A and Series B were allocated based on the relative fair value of each series based on a discounted cash flow model. As a result of the valuations, $14,492,526 and $856,474 was allocated to the Series A Preferred Stock and Series B Preferred Stock, respectively. This resulted in a discount of $973,260 for the Series A stock and a premium of $82,572 for the Series B stock. The discount and premium will be accreted and amortized, respectively, through retained earnings over a five-year estimated life using the effective interest method.

The following is a summary of the accretion of the Series A discount and the amortization of the Series B premium for the six months and three months ended June 30, 2010 and 2009.

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
Accretion of Series A preferred stock discount	$ 96,473	$ 62,363	$ 48,503	$ 48,503
Amortization of Series B preferred stock premium	(8,185)	(5,291)	(4,115)	(4,115)
Accretion net of amortization	$ 88,288	$ 57,072	$ 44,388	$ 44,388

The net amount of the accretion and amortization was treated as a deemed dividend to preferred shareholders in the computation of earnings per share.

Note 7 - Earnings (Loss) Per Share

Net income (loss) available to common shareholders represents net income (loss) adjusted for preferred dividends including dividends declared, accretions of discounts and amortization of premiums on preferred stock issuances and cumulative dividends related to the current dividend period that have not been declared as of period end.

The following is a summary of the earnings (loss) per share calculations for the six months and three months ended June 30, 2010 and 2009.

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
Earnings (loss) available to common shareholders				
Net income (loss)	$ 50,981	$ (1,140,749)	$ (479,153)	$ (1,154,614)
Preferred stock dividends	454,801	268,132	250,227	208,547

Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	88,288	57,072	44,388	44,388
Net loss available to common shareholders	$ (492,108)	$ (1,465,953)	$ (773,768)	$ (1,407,549)
Basic earnings (loss) per share:				
Net loss available to common shareholders	$ (492,108)	$ (1,465,953)	$ (773,768)	$ (1,407,549)
Average common shares outstanding - basic	3,760,792	3,546,386	3,935,610	3,567,533
Basic loss per share	$ (0.13)	$ (0.41)	$ (0.20)	$ (0.40)

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 7 - Earnings Per Share – (continued)

Diluted earnings per share:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
Net loss available to common shareholders	$ (492,108)	$ (1,465,953)	$ (773,768)	$ (1,407,549)
Average common shares outstanding - basic	3,760,792	3,546,386	3,935,610	3,567,533
Dilutive potential common shares	-	-	-	-
Average common shares outstanding - diluted	3,760,792	3,546,386	3,935,610	3,567,533
Diluted earnings (loss) per share	$ (0.13)	$ (0.41)	$ (0.20)	$ (0.40)

Note 8 - Equity Incentive Plan

On January 19, 2006, the Company adopted the 2006 Equity Incentive Plan, which provides for the granting of dividend equivalent rights options, performance unit awards, phantom shares, stock appreciation rights and stock awards, each of which shall be subject to such conditions based upon continued employment, passage of time or satisfaction of performance criteria or other criteria as permitted by the plan. The plan, as amended on June 17, 2010, allows granting up to 950,000 shares of stock, to officers, employees, and directors, consultants and service providers of the Company or its affiliates. Awards may be granted for a term of up to ten years from the effective date of grant. Under this Plan, our Board of Directors has sole discretion as to the exercise date of any awards granted. The per-share exercise price of incentive stock awards may not be less than the market value of a share of common stock on the date the award is granted. Any awards that expire unexercised or are canceled become available for re-issuance.

The Company can issue the restricted shares as of the grant date either by the issuance of share certificate(s) evidencing restricted shares or by documenting the issuance in uncertificated or book entry form on the Company's stock records. Except as provided by the Plan, the employee does not have the right to make or permit to exist any transfer or hypothecation of any restricted shares. When restricted shares vest the employee must either pay the Company within two business days the amount of all tax withholding obligations imposed on the Company or make an election pursuant to Section 83(b) of the Internal Revenue Code to pay taxes at grant date.

Restricted shares may be subject to one or more objective employment, performance or other forfeiture conditions as established by the Plan Committee at the time of grant. Any shares of restricted stock that are forfeited will again become available for issuance under the Plan. An employee or director has the right to vote the shares of restricted stock after grant until they are forfeited or vested. Compensation cost for restricted stock is equal to the market value of the shares at the date of the award and is amortized to compensation expense over the vesting period. Dividends, if any, will be paid on awarded but unvested stock.

During the six months ended June 30, 2010 and 2009 the Company issued 187,765 and 62,222, respectively, of restricted stock pursuant to the 2006 Equity Incentive Plan. The shares cliff vest in three years and are fully vested in 2012 and 2011, respectively. The weighted-average fair value of restricted stock issued during the six months ended June 30, 2010 and 2009 was $4.00 and $2.25 per share, respectively. Compensation cost associated with the issuance for 2010 and 2009 was $751,091 and $139,999, respectively. There were 633 shares of restricted stock that were forfeited during the first six months of 2010 at a weighted-average fair value of $11.88 per share. There were no forfeitures during 2009. Deferred compensation expense of $92,717 and $77,860, relating to restricted stock, was amortized to income during six months ended June 30, 2010 and 2009, respectively.

The 2006 Equity Incentive Plan allows for the issuance of Stock Appreciation Rights ("SARs"). The SARs entitle the participant to receive the excess of (1) the market value of a specified or determinable number of shares of the stock at the exercise date over the fair value at grant date or (2) a specified or determinable price which may not in any event be less than the fair market value of the stock at the time of the award. Upon exercise, the Company can elect to settle the awards using either Company stock or cash. The shares start vesting after five years and vest at 20% per year until fully vested. Compensation cost for SARs is amortized to compensation expense over the vesting period.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 8 - Equity Incentive Plan – (continued)

The SARs compensation expense for both the six months ended June 30, 2010 and 2009 was $36,917.

A summary of the status of the Company's SARs as of June 30, 2010 and 2009 and changes during the period then ended is presented below.

	2010		2009	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	89,293	$ 14.95	93,981	$ 14.95
Forfeited	(794)	15.00	-	-
Outstanding at end of period	88,499	$ 14.95	93,981	$ 14.95

Note 9 – Stock-Based Compensation

The Company terminated its 2003 Employee Stock Option Plan and replaced it with the 2006 Equity Incentive Plan. No stock options have been granted since 2005 and none were exercised during 2010 or 2009. The 206,547 options outstanding at December 31, 2009 were forfeited during the six months ended June 30, 2010.

Note 10 – Fair Value Measurements

The current accounting literature requires the disclosure of fair value information for financial instruments, whether or not they are recognized in the consolidated balance sheets, when it is practical to estimate the fair value. The guidance 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, accrued interest receivable and payable, and other assets and liabilities.

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

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, which 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 values presented.

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

Cash and Due from Banks and Interest-bearing Deposits with Other Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Time Deposits in other Banks - The carrying amount is a reasonable estimate of fair value.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

Securities Available-for-Sale - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable - The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is 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. 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 June 30, 2010, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. 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 records 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 records the impaired loan as nonrecurring Level 3.

Other Real Estate Owned - Other real estate owned ("OREO") is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset 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 records the OREO as nonrecurring Level 3.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company’s current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures - The carrying value of the junior subordinated debentures and note payable approximates their fair value since they were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance Sheet Financial Instruments - Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

The carrying values and estimated fair values of the Company's financial instruments were as follows:

	June 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 2,196,978	$ 2,196,978	$ 2,942,295	$ 2,942,295
Interest-bearing deposits with other banks	30,637,573	30,637,573	50,356,191	50,356,191
Time deposits in other banks	503,644	503,644	502,089	502,089
Securities available-for-sale	122,201,795	122,201,795	121,948,744	121,948,744
Nonmarketable equity securities	4,812,100	4,812,100	4,812,100	4,812,100
Loans, including loans held for sale	375,923,563	374,857,000	411,728,010	410,265,000
Accrued interest receivable	2,537,500	2,537,500	2,661,030	2,661,030
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	$ 188,829,858	$ 188,829,858	$ 195,636,648	$ 195,636,648
Certificates of deposit	314,091,424	318,643,000	357,126,331	352,318,000
Securities sold under agreements to repurchase	545,647	545,647	598,342	598,342
Advances from Federal Home Loan Bank	26,000,000	26,334,000	34,000,000	33,992,000
Junior subordinated debentures	10,310,000	10,310,000	10,310,000	10,310,000
Accrued interest payable	592,527	592,527	680,880	680,880

	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:				
Commitments to extend credit	$ 37,679,207	$ -	$ 39,873,440	$ -
Standby letters of credit	2,102,497	-	2,583,466	-

In determining appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to fair value disclosures. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

Assets and liabilities that are carried at fair value are classified in one of the following three categories based on a hierarchy for ranking the quality and reliability of the information used to determine fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities.
Level 2 — Observable market based inputs or unobservable inputs that are corroborated by market data.
Level 3 — Unobservable inputs that are not corroborated by market data.

The table below presents the balances of assets measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, aggregated by the level in the fair value hierarchy within which those measurements fall.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

	Total	Level 1	Level 2	Level 3
June 30, 2010				
Available for-sale-securities:				
U.S. Government agencies	$ 2,785,686	$ -	$ 2,785,686	$ -
Mortgage-backed securities	58,504,100	-	58,504,100	-
Municipals	60,878,009	-	60,878,009	-
Other	34,000	-	34,000	-
	122,201,795	-	122,201,795	-
Mortgage loans held for sale (1)	579,266	-	579,266	-
	$ 122,781,061	$ -	$ 122,781,061	$ -
December 31, 2009				
Available for-sale-securities:				
U.S. Government agencies	$ 3,011,366	$ -	$ 3,011,366	$ -
Mortgage-backed securities	58,132,671	-	58,132,671	-
Municipals	60,737,192	-	60,737,192	-
Other	67,515	-	67,515	-
	121,948,744	-	121,948,744	-
Mortgage loans held for sale (1)	5,100,609	-	5,100,609	-
	$ 127,049,353	$ -	$ 127,049,353	$ -

(1) Carried at the lower of cost or market.

There were no liabilities carried at fair value at June 30, 2010 and December 31, 2009 on a recurring basis.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of June 30, 2010 and 2009, for which a nonrecurring change in fair value has been recorded during the three months and the year ended June 30, 2010 and December 31, 2009, respectively.

June 30, 2010	Total	Level 1	Level 2	Level 3
Impaired loans receivable	$ 18,837,598	$ -	$ 18,837,598	$ -
Other real estate owned	12,268,366	-	12,268,366	-
Total assets at fair value	$ 31,105,964	$ -	$ 31,105,964	$ -
December 31, 2009				