

GREENVILLE FIRST BANCSHARES INC
Form 10-Q
May 10, 2007

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 March 31, 2007

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

Greenville 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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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: 2,936,068 shares of common stock, \$.01 par value per share, were issued and outstanding as of May 1, 2007.

**GREENVILLE FIRST BANCSHARES, INC.
PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

The financial statements of Greenville First Bancshares, Inc. and Subsidiary are set forth in the following pages.

**GREENVILLE FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS**

| | March 31, 2007 (Unaudited) | December 31, 2006 (Audited) |
|--|---|--|
| Assets | | |
| Cash and due from banks | \$ 7,506,701 | \$ 9,112,675 |
| Federal funds sold | 19,136,368 | 7,466,458 |
| Investment securities available for sale | 58,475,542 | 50,199,513 |
| Investment securities held to maturity- (fair value \$16,244,506 and \$16,576,673) | 16,658,135 | 17,044,531 |
| Other investments, at cost | 7,617,500 | 7,060,100 |
| Loans, net | 427,000,563 | 397,233,829 |
| Property and equipment, net | 5,135,517 | 6,450,854 |
| Property held for sale | 2,410,373 | - |
| Accrued interest receivable | 2,668,216 | 2,381,336 |
| Other real estate owned | 731,712 | 1,012,030 |
| Bank owned life insurance | 8,238,947 | 8,142,947 |
| Other assets | 2,075,937 | 3,239,678 |
| Total assets | \$ 557,655,511 | \$ 509,343,951 |
| Liabilities | | |
| Deposits | \$ 383,930,111 | \$ 345,504,076 |
| Official checks outstanding | 2,572,243 | 4,131,107 |
| Federal Home Loan Bank advances | 118,500,000 | 108,500,000 |
| Junior subordinated debentures | 13,403,000 | 13,403,000 |
| Accrued interest payable | 3,069,219 | 2,278,154 |
| Accounts payable and accrued expenses | 547,170 | 944,168 |
| Total liabilities | 522,021,743 | 474,760,505 |
| Commitments and contingencies | | |
| Shareholders' equity | | |
| Preferred stock, par value \$.01 per share, 10,000,000 shares authorized, no shares issued | - | - |
| Common stock, par value \$.01 per share 10,000,000 shares authorized, 2,933,868 issued and outstanding at March 31, 2007 and December 31, 2006, respectively | 29,339 | 29,339 |
| Additional paid-in capital | 30,851,044 | 30,846,538 |

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| | | |
|---|----------------|----------------|
| Accumulated other comprehensive gain (loss) | 71,295 | (16,465) |
| Retained earnings | 4,682,090 | 3,724,034 |
| Total shareholders' equity | 35,633,768 | 34,583,446 |
| Total liabilities and shareholders' equity | \$ 557,655,511 | \$ 509,343,951 |

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

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

| | For the three months ended March 31, | |
|---|---|--------------|
| | 2007 | 2006 |
| | (Unaudited) | |
| Interest income | | |
| Loans | \$ 7,765,104 | \$ 6,146,049 |
| Investment securities | 1,034,147 | 431,690 |
| Federal funds sold | 161,834 | 48,391 |
| Total interest income | 8,961,085 | 6,626,130 |
| Interest expense | | |
| Deposits | 3,640,488 | 2,112,958 |
| Borrowings | 1,536,891 | 1,153,369 |
| Total interest expense | 5,177,379 | 3,266,327 |
| Net interest income | 3,783,706 | 3,359,803 |
| Provision for loan losses | 460,000 | 400,000 |
| Net interest income after provision for loan losses | 3,323,706 | 2,959,803 |
| Noninterest income | | |
| Loan fee income | 37,379 | 30,801 |
| Service fees on deposit accounts | 75,478 | 62,071 |
| Income from bank owned life insurance | 96,000 | - |
| Real estate owned activity | 328,593 | - |
| Other income | 55,950 | 62,703 |
| Total noninterest income | 593,400 | 155,575 |
| Noninterest expenses | | |
| Compensation and benefits | 1,422,532 | 1,033,741 |
| Professional fees | 124,520 | 90,437 |
| Marketing | 105,598 | 121,070 |
| Insurance | 51,336 | 43,034 |
| Occupancy | 395,947 | 174,777 |
| Data processing and related costs | 258,346 | 197,870 |
| Telephone | 34,767 | 15,882 |
| Other | 114,487 | 112,733 |
| Total noninterest expenses | 2,507,533 | 1,789,544 |
| Income before income taxes expense | 1,409,573 | 1,325,834 |
| Income tax expense | 451,517 | 483,930 |
| Net income | \$ 958,056 | \$ 841,904 |
| Earnings per common share | | |
| Basic | \$.33 | \$.29 |
| Diluted | \$.30 | \$.25 |
| Weighted average common shares outstanding | | |
| Basic | 2,933,868 | 2,927,250 |
| Diluted | 3,245,226 | 3,245,837 |

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

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**GREENVILLE FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006
(Unaudited)**

| | Common stock | | Additional | Accumulated | | Retained | Total |
|---|--------------|-----------|---------------|---------------|----|-----------|---------------|
| | Shares | Amount | paid-in | other | | earnings | share- |
| | | | capital | comprehensive | | | holders' |
| | | | | income (loss) | | | equity |
| December 31, 2005 | 2,659,719 | \$ 26,597 | \$ 25,626,740 | \$ (150,602) | \$ | 4,970,012 | \$ 30,472,747 |
| Net income | - | - | - | - | | 841,904 | 841,904 |
| Comprehensive income, net of tax - | | | | | | | |
| Unrealized holding loss on securities available for sale | - | - | - | (31,435) | | - | (31,435) |
| Comprehensive income | - | - | - | - | | - | 810,469 |
| Proceeds from exercise of stock options and warrants | 4,400 | 40 | 26,640 | - | | - | 26,680 |
| March 31, 2006 | 2,664,119 | \$ 26,637 | \$ 25,653,380 | \$ (182,037) | \$ | 5,811,916 | \$ 31,309,896 |
| December 31, 2006 | 2,933,868 | \$ 29,339 | \$ 30,846,538 | \$ (16,465) | \$ | 3,724,034 | \$ 34,583,446 |
| Net income | - | - | - | - | | 958,056 | 958,056 |
| Comprehensive income, net of tax - | | | | | | | |
| Unrealized holding loss on securities available for sale | - | - | - | 87,760 | | - | 87,760 |
| Comprehensive income | - | - | - | - | | - | 1,045,816 |
| Compensation expense related to stock options, net of tax | - | - | 4,506 | - | | - | 4,506 |
| March 31, 2007 | 2,933,868 | \$ 29,339 | \$ 30,851,044 | \$ 71,295 | \$ | 4,682,090 | \$ 35,633,768 |

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

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

| | For the three months ended | |
|-----------------------------|----------------------------|------|
| | 2007 | 2006 |
| | March 31, | |
| | (Unaudited) | |
| Operating activities | | |

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| | | | | |
|--|----|--|----|--------------|
| Net income | \$ | 958,056 | \$ | 841,904 |
| Adjustments to reconcile net income to cash | | | | |
| provided by (used for) operating activities: | | | | |
| Provision for loan losses | | 460,000 | | 400,000 |
| Depreciation and other amortization | | 117,583 | | 87,447 |
| Accretion and amortization of securities discounts and premium, net | | 18,171 | | 24,412 |
| Loss on sale of real estate | | 51,791 | | - |
| Increase in market value of property held for sale | | (375,000) | | - |
| Compensation expense related to stock options | | 4,506 | | - |
| Increase in cash surrender value of bank owned life insurance | | (96,000) | | - |
| (Increase) decrease in deferred tax asset | | 839,288 | | (510,288) |
| (Increase) decrease in other assets, net | | 37,573 | | (211,584) |
| Decrease in other liabilities, net | | (1,254,339) | | (9,062,785) |
| | | Net cash provided by (used for) | | (8,430,894) |
| | | operating activities | | |
| Investing activities | | | | |
| Increase (decrease) in cash realized from: | | | | |
| Origination of loans, net | | (30,226,734) | | (28,073,924) |
| Purchase of property and equipment | | (837,619) | | (126,969) |
| Purchase of investment securities: | | | | |
| Available for sale | | (10,090,812) | | (1,995,000) |
| Other investments | | (917,400) | | (1,472,200) |
| Payments and maturity of investment securities: | | | | |
| Available for sale | | 1,982,672 | | 365,501 |
| Held to maturity | | 377,638 | | 509,524 |
| Other investments | | 360,000 | | 1,215,000 |
| Proceeds from sale of real estate acquired in settlement of loans | | 228,527 | | - |
| | | Net cash used for investing activities | | (29,578,068) |
| Financing activities | | | | |
| Increase in deposits, net | | 38,426,035 | | 21,658,802 |
| Decrease in short-term borrowings | | - | | (448,000) |
| Proceeds from the exercise of stock options | | - | | 26,680 |
| Increase (decrease) in Federal Home Loan Bank advances | | 10,000,000 | | (500,000) |
| | | Net cash provided by financing | | 20,737,482 |
| | | activities | | |
| | | Net increase (decrease) in cash and | | (17,271,480) |
| | | cash equivalents | | |
| Cash and cash equivalents at beginning of the period | | 16,579,133 | | 25,604,152 |
| Cash and cash equivalents at end of the period | \$ | 26,643,069 | \$ | 8,332,672 |
| Supplemental information | | | | |
| Cash paid for | | | | |
| Interest | \$ | 4,386,314 | \$ | 3,253,046 |
| Income taxes | \$ | 35,186 | \$ | 978,000 |
| Schedule of non-cash transactions | | | | |
| Transfer of property and equipment to property held for sale | \$ | 2,035,373 | | - |
| Foreclosure of real estate | \$ | - | \$ | 1,837,849 |
| Unrealized gain (loss) on securities, net of income taxes | \$ | 87,760 | \$ | (31,435) |
| See notes to consolidated financial statements that are an integral part of these consolidated statements. | | | | |

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

Note 1 - Nature of Business and Basis of Presentation

Business activity

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Greenville First Bancshares, Inc. is a South Carolina corporation that owns all of the capital stock of Greenville First Bank, N.A. and all of the stock of Greenville First Statutory Trust I and Trust II (collectively the "Trusts"). 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, and providing commercial, consumer and mortgage loans to the general public. The bank owns all of the capital stock of JB Properties. This subsidiary is for the purpose of owning real estate acquired in loan foreclosures. The Trusts are special purpose subsidiaries 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-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. 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, 2006 (Registration Number 000-27719) as filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Greenville First Bancshares, Inc., and its wholly owned subsidiary Greenville First Bank, N.A. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46, 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.

Note 2 - Property Held for Sale

In February 2007, we decided to actively market the sale of our former main office and corporate headquarters building. We accordingly, reclassified the building from property and equipment to property held for sale, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for the Impairment and Disposal of Long-Lived Assets," and ceased depreciation of the building. In March 2007 we received a sales contract on the building. Based on the sales contract, adjusted for estimated commissions and other selling costs, we recorded a \$375,000 gain in the carrying value of the building at the end of the first quarter of 2007. The \$375,000 gain was partially offset by other unrelated real estate operating expenses of \$46,407. The net gain on real estate operations recorded in the three months ended March 31, 2007 was \$328,593.

On April 13, 2007, we completed the sale of the former main office building. Based on the higher carrying value established at March 31, 2007, we anticipate a loss of approximately \$55,000 will be recorded on the sale in the second quarter of 2007.

Note 3 - Note Payable

The company has an unused \$4.5 million revolving line of credit with another bank that matured on March 20, 2007. As of March 31, 2007, the company was in the process of renewing this line of credit. The company anticipates that this line of credit will be renewed under similar terms and conditions. The company anticipates that the line of credit will bear interest at a rate of three-month labor plus 2.00%, which at March 31, 2007 was 7.35%. The company will pledge the stock of the bank as collateral for this line of credit. The company is not aware of any circumstances that would prevent this line of credit from being renewed, however no assurance can be given that the renewal will be granted or be granted under similar terms and conditions.

Note 4 - Earnings per Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three months ended March 31, 2007 and 2006. 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. The 2006 numbers of shares and the earnings per share have been adjusted for the 10 percent stock dividend in 2006.

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At March 31, 2007, 13,000 options were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value.

| | Three months ended March 31, | |
|--------------------------------|------------------------------|------------|
| | 2007 | 2006 |
| Basic Earnings Per Share | | |
| Average common shares | 2,933,868 | 2,927,250 |
| Net income | \$ 958,056 | \$ 841,904 |
| Earnings per share | \$ 0.33 | \$ 0.29 |
| Diluted Earnings Per Share | | |
| Average common shares | 2,933,868 | 2,927,250 |
| Average dilutive common shares | 311,358 | 318,587 |
| Adjusted average common shares | 3,245,226 | 3,245,837 |
| Net income | \$ 958,056 | \$ 841,904 |
| Earnings per share | \$ 0.30 | \$ 0.25 |

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 SFAS No. 123(R), "Accounting for Stock-Based Compensation," to account for compensation costs under its stock option plan. On December 20, 2005, the Board of Directors approved accelerating the vesting of 45,813 unvested stock options effective December 28, 2005. The decision to accelerate vesting of these options was made so as to reduce compensation expense upon the adoption of SFAS No. 123(R) by approximately \$68,000 and \$52,000 in the years ended December 31, 2006 and 2007, respectively, and \$4,000 in each of the years ended December 31, 2008 and 2009.

In adopting SFAS No. 123(R), 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 6.76% for 2007 and 2006, risk-free interest rate of 4.60% for 2007 and 4.02% for 2006, expected lives of the options 10 years, and the assumed dividend rate was zero.

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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. 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, 2006 under Item 1A- Risk Factors and the following:

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;

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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 level of 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;

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

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

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 undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Overview

We were incorporated in March 1999 to organize and serve as the holding company for Greenville First Bank, N.A. Since we opened our bank in January 2000, we have experienced consistent growth in total assets, loans, deposits, and shareholders' equity, which has continued during the first three months of 2007.

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.

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, 2006, as filed in our annual report on Form 10-K.

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.

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, the assumptions about cash flow, determination of loss factors for estimating credit losses, the impact of current events, and 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.

Effect of Economic Trends

Beginning in July 2004 and through the first three months of 2007, our rates on both short-term or variable rate interest-earning assets and interest-bearing liabilities increased as the Federal Reserve began to increase short-term rates as the economy showed signs of strengthening following an economic decline and historically low interest rates. During this period, the Federal Reserve increased rates 17 times for a total of 425 basis points. The last rate increase occurred in July 2006, and the Federal Reserve allowed short-term rates to remain unchanged during the remainder of 2006 and the first quarter of 2007, leading many economists to believe that the Federal Reserve is nearing the end of this cycle of rate increases. The momentum of the 17 rate increases resulted in higher interest-earning assets and higher interest-bearing liabilities; subsequently, as fixed rate loans, deposits, and borrowings have matured they are repriced at higher interest rates. The following discussion includes our analysis of the effect that we anticipate changes in interest rates will have on our financial condition. However, no assurance can be given related to future actions that the Federal Reserve may choose to take or that the results we anticipate will actually occur.

Results of Operations

Income Statement Review

Summary

Our net income was \$958,056 and \$841,904 for the three months ended March 31, 2007, and 2006, respectively, an increase of \$116,152, or 13.8%. The \$116,152 increase in net income resulted primarily from increases of \$423,903 in net interest income and \$437,825 in noninterest income, partially offset by an increase of \$60,000 in the provision for loan losses, and \$717,989 of additional noninterest expense. Our efficiency ratio increased due to higher operating costs related to additional infrastructure in Greenville County, our expansion into the Columbia, SC market, and a lower net margin. Our efficiency ratio was 57.3% and 50.9% for the three months ended March 31, 2007 and 2006, respectively.

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. The continuous growth in our loan portfolio is the primary driver of the increase in net interest income. During the three months ended March 31, 2007, our average loan portfolio increased \$66.0 million compared to the average for the three months ended March 31, 2006. The growth in the first three months of 2007 was \$30.2 million. We anticipate the growth in loans will continue to drive the growth in assets and the growth in net interest income. However, no assurance can be given that we will be able to continue to increase loans at the same levels we have experienced in the past.

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Our decision to grow the loan portfolio at the current pace created the need for a higher level of capital and the need to increase deposits and borrowings. This loan growth strategy also resulted in a significant portion of our assets being in higher earning loans than in lower yielding investments. At March 31, 2007, net loans represented 76.6% of total assets. However, as described below, we have also increased our level of deposits significantly. While we plan to continue our focus on increasing the loan portfolio, as rates on investment securities rose during the past twelve months and we obtained additional deposits, we increased the size of the investment portfolio. As a result, net loans as a percentage of total assets has actually decreased from the 86.1% amount at March 31, 2006 to 76.6% at March 31, 2007. Our investment portfolio increased by \$45.3 million from March 31, 2006 to March 31, 2007. At March 31, 2007, investments and federal funds sold represented 18.3% of total assets.

The historically low interest rate environment in the last four years allowed us to obtain short-term borrowings and wholesale certificates of deposit at rates that were lower than certificate of deposit rates being offered in our local market. Therefore, we decided not to begin our retail deposit office expansion program until the beginning of 2005. This funding strategy allowed us to continue to operate in one location until 2005, maintain a smaller staff, and not incur marketing costs to advertise deposit rates, which in turn allowed us to focus on the fast growing loan portfolio.

In anticipation of rising interest rates, we opened one retail deposit office in March 2005 and a second in November 2005. Our focus for these two locations has been to obtain low cost transaction accounts that we believe will be less impacted by changing market rates. Our goal is to increase both the percentage of assets being funded by "in market" retail deposits and to increase the percentage of low-cost transaction accounts to total deposits. The two additional retail deposit offices are assisting us in meeting these objectives. We anticipate these two additional retail offices opened in 2005 will have little impact on earnings in 2007. However, we believe that these two strategies will provide additional clients in our local market and will eventually provide a lower alternative cost of funding. At March 31, 2007, retail deposits represented \$255.6 million, or 45.8% of total assets, borrowings represented \$131.9 million, or 23.7% of total assets, and wholesale out-of-market deposits represented \$128.3 million, or 23.0% of total assets.

As more fully discussed in the - "Market Risk" and - "Liquidity and Interest Rate Sensitivity" sections below, at March 31, 2007, 46.4% of our loans had variable rates. Given our high percentage of rate-sensitive loans, our primary focus during the past three years has been to obtain short-term liabilities to fund our asset growth. This strategy improves our ability to manage the impact on our earnings resulting from anticipated changes in market interest rates.

At March 31, 2007, 84.8% of our interest-bearing liabilities had a maturity of less than one year. Therefore, we believe that we are positioned to benefit from future decreases in short-term rates. Conversely, future increases in short-term rates would likely have a negative effect on our earnings. At March 31, 2007, we had \$129.2 million more liabilities than assets that reprice within the next twelve months. Based on a review of our deposit portfolio, 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.

We intend to maintain a capital level for the bank that exceeds the OCC requirements to be classified as a "well capitalized" bank. To provide the additional capital needed to support our bank's growth in assets, in 2003 we issued \$6.2 million in junior subordinated debentures in connection with our trust preferred securities offering. During 2004, we issued 920,000 additional shares of common stock (1,012,000 adjusted for the 10 percent stock dividend in 2006) that resulted in \$14.9 million of additional capital. In 2005, we issued an additional \$7.2 million in junior subordinated debentures in a second trust preferred securities offering. The company also has a \$4.5 million unused short-term holding company line of credit that could be utilized to provide additional capital for the bank if deemed necessary. As of March 31, 2007, the company's regulatory capital levels were over \$19.8 million in excess of the various well capitalized requirements.

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In addition to the growth in both assets and liabilities, and the timing of repricing of our assets and liabilities, net interest income is also affected by the ratio of interest-earning assets to interest-bearing liabilities and the changes in interest rates earned on our assets and interest rates paid on our liabilities.

Our net interest income margin for the three months ended March 31, 2007 exceeded our net interest spread because we had more interest-earning assets than interest-bearing liabilities. Average interest-earning assets exceeded average interest-bearing liabilities by \$48.0 million, and \$46.5 million for the three months ended March 31, 2007 and 2006, respectively.

During the three months ended March 31, 2007, our yields on interest earning assets and the rates that we paid for our deposits and borrowings continued to increase primarily as a result of the actions taken by the Federal Reserve prior to March 31, 2007 to raise short-term rates. Our fixed rate loans are being originated or renewed at higher rates, while the rates on new or maturing interest-bearing liabilities are also higher than in the past. Our net interest spread declined since more of our rate-sensitive liabilities repriced than our rate-sensitive assets during the twelve month period ended March 31, 2007. Given the fact that the Federal Reserve has increased short-term rates by 425 basis points since July 2004, we believe that short-term interest rates are currently at or near their peak. Therefore, we have chosen to increase the amount of fixed rate loans in our loan portfolio and targeted to have a significant portion of our liabilities to reprice within a twelve month period.

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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" 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 months ended March 31, 2007 and 2006. 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. A review of these tables shows that as short-term rates continue to rise, the increase in net interest income is more effected by the changes in rates than in prior years. 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 table sets forth information related to our average balance sheets, average yields on assets, and average costs of liabilities. 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 periods ended March 31, 2007 and 2006, we had no interest-bearing deposits in other banks or any securities purchased with agreements to resell. All investments were owned at 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.

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Average Balances, Income and Expenses, and Rates
For the Three Months Ended March 31,

| | Average Balance | 2007 Income/ Expense | Yield/ Rate(1) | Average Balance | 2006 Income/ Expense | Yield/ Rate(1) |
|---|--------------------|----------------------------|-------------------|--------------------|----------------------------|-------------------|
| (Dollars in thousands) | | | | | | |
| Earnings | | | | | | |
| Federal funds sold | \$ 12,984 | \$ 162 | 5.06% | \$ 3,888 | \$ 48 | 5.01% |
| Investment securities, taxable | 74,723 | 998 | 5.42% | 34,505 | 419 | 4.92% |
| Investment securities, nontaxable (2) | 3,746 | 53 | 5.73% | 1,276 | 20 | 6.03% |
| Loans | 417,754 | 7,765 | 7.54% | 351,727 | 6,146 | 7.09% |
| Total earning-assets | 509,207 | 8,978 | 7.15% | 391,396 | 6,633 | 6.87% |
| Non-earning assets | 23,769 | | | 10,745 | | |
| Total assets | \$ 532,976 | | | \$ 402,141 | | |
| Interest-bearing liabilities | | | | | | |
| NOW accounts | \$ 33,480 | 140 | 1.70% | 32,983 | 147 | 1.81% |
| Savings & money market | 84,073 | 735 | 3.55% | 60,071 | 428 | 2.89% |
| Time deposits | 216,844 | 2,765 | 5.17% | 147,761 | 1,538 | 4.22% |
| Total interest-bearing deposits | 334,397 | 3,640 | 4.41% | 240,815 | 2,113 | 3.56% |
| FHLB advances | 113,400 | 1,286 | 4.60% | 75,594 | 753 | 4.04% |
| Other borrowings | 13,404 | 251 | 7.59% | 28,465 | 400 | 5.70% |
| Total interest-bearing liabilities | 461,201 | 5,177 | 4.55% | 344,874 | 3,266 | 3.84% |
| Non-interest bearing liabilities | 36,546 | | | 26,007 | | |
| Shareholders' equity | 35,229 | | | 31,260 | | |
| Total liabilities and shareholders' equity | \$ 532,976 | | | \$ 402,141 | | |
| Net interest spread | | | 2.60% | | | 3.03% |
| Net interest income (tax equivalent) / margin | \$ 3,801 | | 3.03% | \$ 3,367 | | 3.49% |
| Less: tax-equivalent adjustment (2) | | 17 | | | 7 | |
| Net interest income | \$ 3,784 | | | \$ 3,360 | | |

(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 spread, on a tax-equivalent basis, was 2.60% for the three months ended March 31, 2007 as compared to 3.03% for the three months ended March 31, 2006. 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 43 basis point reduction in our net interest spread resulted primarily from the \$117.8 million growth in average earning assets in the first quarter 2007 compared to the same period in 2006. The additional earning assets and liabilities yielded a lower than historical net spread of 1.95%, which caused the overall net interest spread to decline by 28 basis points. The remaining 15 basis point reduction in net interest spread resulted from the impact of liabilities repricing over a longer period than the related assets that repriced. Therefore, once short-term market rates stopped increasing, certain short-term liabilities such as one year certificates of deposit continued to slowly reprice to the current market rates as they matured. Management believes that substantially all of our variable rate assets and short-term liabilities have been repriced to current market rates as of March 31, 2007.

During 2006 and the first quarter of 2007, management determined that the bank had excess capital and given the flat interest rate environment, both earnings and return on equity could be increased with additional assets and liabilities even if the net interest spreads were at less than historical levels. Accordingly, \$51.8 million or 44.0% of the total growth in earning assets occurred in investments and federal funds, yielding a combined weighted rate of 5.38% for the first quarter of 2007. The remaining growth in earning assets of \$66.0 million, or 56.0% of the total growth, occurred in loans which yielded a weighed rate of 7.54% in the first quarter of 2007. This combination of investments, federal funds, and loans together yielded a weighted rate of 6.59%.

The \$117.8 million of growth in earning assets was funded primarily with \$24.5 million in transaction accounts with a weighted rated of 3.02% for the three months ended March 31, 2007. The remaining balance was funded mostly with certificates of deposit and other borrowings totaling \$91.8 million with a weighted rate of 5.08%. Since 78.9% of the total growth in earning assets was funded with higher borrowing and certificate of deposit rates compared to the 21.1% funded with lower costing transaction accounts, the combined funding cost was 4.64%.

Although, substantially all of the variable rate assets and the short-term and variable rate liabilities have repriced to market rates, our net spread may continue to decline in future periods, if a substantial portion of growth in earning assets is funded with higher rate borrowings and

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certificates of deposit.

Our net interest margin is calculated as net interest income divided by average interest-earning assets. Our net interest margin, on a tax-equivalent basis, for the three months ended March 31, 2007 was 3.03% as compared to 3.49% for the three months ended March 31, 2006. During the three months ended March 31, 2007, interest-earning assets exceeded interest-bearing liabilities by \$48.0 million and \$46.5 million for the three month periods ended March 31, 2007 and 2006, respectively. During the first quarter of 2007, interest-earning assets averaged \$509.2 million as compared to \$391.4 million in the first quarter of 2006.

Our loan yield increased 45 basis points for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006 as a result of approximately 46% of the loan portfolio having variable rates, combined with the increase in rates over the twelve months ended March 31, 2007. Offsetting the increase in our loan yield was an 85 basis point increase in the cost of our interest-bearing deposits for the first quarter of 2007 compared to the same period in 2006. The increase in the rate on interest-bearing deposits is due to the renewal rates on time deposits being much higher than their original rates as a result of the increases in the prime rate over the past twenty-seven months, combined with our lower costing transaction accounts representing a smaller percentage of our total interest-bearing deposits. In addition, the cost of our savings and money market accounts has increased by 66 basis points as we have increased the rates we offer on these products in relation to the increase in short-term market rates to stay competitive. The 56 basis point increase in FHLB advances and the 189 basis point increase in other borrowed funds in the first quarter of 2007 compared to the same period in 2006 resulted primarily from the impact of the 300 basis point increase in short-term market rates over the past two years. As of March 31, 2007, approximately 42% of our FHLB advances had variable rates, while all of our other borrowings had variable rates.

Net interest income, the largest component of our income, was \$3.8 million and \$3.4 million for the three months ended March 31, 2007 and 2006, respectively. The increase in the first quarter of 2007 related primarily to the net effect of higher levels of both average earning assets and interest-bearing liabilities. Average earning assets were \$117.8 million higher during the three months ended March 31, 2007 compared to the same period in 2006. During the same period, average interest-bearing liabilities increased \$116.3 million. The higher average balances resulted in \$793,000 additional net interest income for the three months ended March 31, 2007, while higher rates on the average balances reduced net interest income by \$315,000.

Interest income for the three months ended March 31, 2007 was \$9.0 million, consisting of \$7.8 million on loans, \$1.0 million on investments, and \$161,834 on federal funds sold. Interest income for the three months ended March 31, 2006 was \$6.6 million, consisting of \$6.1 million on loans, \$431,690 on investments, and \$48,391 on federal funds sold. Interest on loans for the three months ended March 31, 2007 and 2006 represented 86.7% and 92.8%, respectively, of total interest income, while income from investments and federal funds sold represented only 13.3% and 7.2%, 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 82.0% and 89.9% of average interest-earning assets for the three months ended March 31, 2007 and 2006, respectively. Included in interest income on loans for the three months ended March 31, 2007 and 2006 was \$155,627 and \$140,197, respectively, related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense for the three months ended March 31, 2007 was \$5.2 million, consisting of \$3.6 million related to deposits and \$1.5 million related to FHLB advances and other borrowings. Interest expense for the three months ended March 31, 2006 was \$3.3 million, consisting of \$2.1 million related to deposits and \$1.2 million related to FHLB advances and other borrowings. Interest expense on deposits for the three months ended March 31, 2007 and 2006 represented 70.3% and 64.7%, respectively, of total interest expense, while interest expense on FHLB advances and other borrowings represented 29.7% and 35.3%, respectively, of total interest expense for the same three month periods. During the three months ended March 31, 2007, average interest-bearing deposits increased by \$93.6 million over the same period in 2006, while FHLB advances increased \$37.8 million and other borrowings decreased \$15.1 million during the three months ended March 31, 2007 over the same period in 2006. Both the short-term borrowings from the FHLB advances and the sale of securities under agreements to repurchase provide us with the opportunity to obtain low cost funding with various maturities similar to the maturities on our loans and investments.

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Rate/Volume Analysis

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following table sets 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.

| March 31, 2007 vs. 2006 Increase (Decrease) Due to | | | Three Months Ended | | March 31, 2006 vs. 2005 Increase (Decrease) Due to | | | |
|---|------|-----------------|--------------------|--------|---|-----------------|-------|--|
| Volume | Rate | Rate/ Volume | Total | Volume | Rate | Rate/ Volume | Total | |

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(Dollars in thousands)

| | | | | | | | | | |
|----------------------------------|----|-------|---------|--------|----------|--------|--------|--------|----------|
| Interest income | | | | | | | | | |
| Loans | \$ | 1,148 | \$ 390 | \$ 81 | \$ 1,619 | \$ 920 | \$ 857 | \$ 198 | \$ 1,975 |
| Investment securities | | 517 | 39 | 47 | 603 | (11) | 39 | (1) | 27 |
| Federal funds sold | | 111 | 1 | 1 | 113 | 17 | 6 | 19 | 42 |
| Total interest income | | 1,776 | 430 | 129 | 2,335 | 926 | 902 | 216 | 2,044 |
| Interest expense | | | | | | | | | |
| Deposits | | 818 | 508 | 201 | 1,527 | 335 | 479 | 144 | 958 |
| FHLB advances | | 377 | 104 | 52 | 533 | 25 | 183 | 9 | 217 |
| Other borrowings | | (212) | 133 | (70) | (149) | 32 | 137 | 21 | 190 |
| Total interest expense | | 983 | 745 | 183 | 1,911 | 392 | 799 | 174 | 1,365 |
| Net interest income | \$ | 793 | \$(315) | \$(54) | 424 | \$ 534 | \$ 103 | \$ 42 | \$ 679 |
| <i>Provision for Loan Losses</i> | | | | | | | | | |

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.

For the three months ended March 31, 2007 and 2006, we incurred a noncash expense related to the provision for loan losses of \$460,000 and \$400,000, respectively, bringing the allowance for loan losses to \$5.4 million and \$4.5 million respectively. The allowance represented 1.24% of gross loans at both March 31, 2007 and 2006. During the three months ended March 31, 2007 and 2006 we reported net charge-offs of \$57,105 and \$374,384, respectively, which includes \$33,616 of recoveries on loans previously charged off in the 2006 period. The \$57,105 and \$374,384 net charge-offs during the first quarters of 2007 and 2006 represented 0.06% and 0.43% of the average outstanding loan portfolio for the three months ended March 31, 2007 and 2006, respectively. The \$402,895 and \$25,616 increases in the allowance for the three months ended March 31, 2007 and 2006, respectively, related to our decision to increase the allowance in response to the \$30.2 million and the \$25.9 million growth in loans for the three months ended March 31, 2007 and 2006, respectively.

At March 31, 2007, the allowance for loan losses represented 3.3 times the amount of non-performing loans compared to 4.2 times at March 31, 2006. As a result of this level of coverage on non-performing loans, we determined that the provision of \$460,000 for the three months ended March 31, 2007 to be adequate.

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Noninterest Income

The following table sets forth information related to our noninterest income.

| | Three months ended | |
|---------------------------------------|---------------------------|-------------|
| | March 31, | |
| | 2007 | 2006 |
| Loan fee income | \$ 37,379 | \$ 30,801 |
| Service fees on deposit accounts | 75,478 | 62,071 |
| Income from bank owned life insurance | 96,000 | - |
| Real estate owned activity | 328,593 | - |
| Other income | 55,950 | 62,703 |
| Total noninterest income | \$ 593,400 | \$ 155,575 |

Noninterest income in the three month period ended March 31, 2007 was \$593,400, an increase of 281.4% over noninterest income of \$155,575 in the same period of 2006.

Loan fee income consists primarily of late charge fees, fees from issuance of letters of credit and mortgage origination fees we receive on residential loans funded and closed by a third party. Loan fees were \$37,379 and \$30,801 for the three months ended March 31, 2007 and 2006,

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respectively. The \$6,578 increase for the three months ended March 31, 2007 compared to the same period in 2006 related primarily to a \$5,715 increase in mortgage origination fees and a \$3,129 increase in late charge fees which were offset by a \$2,266 decrease in fees received from the issuance of letters of credit. Mortgage origination fees were \$8,600 and \$2,885 for the three months ended March 31, 2007 and 2006, respectively, while late charge fees were \$22,454 and \$19,325 for the first quarter of 2007 and 2006, respectively. Income related to amortization of fees on letters of credit was \$6,325 and \$8,591 for the three months ended March 31, 2007 and 2006, 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 \$75,478 and \$62,071 for the three months ended March 31, 2007 and 2006, respectively. The \$13,407 increase is primarily related to a \$9,649 increase in NSF fees and a \$6,498 increase in overdraft fees, partially offset by a \$3,284 decrease in other deposit related fees. Other deposit related fees were \$18,452 and \$21,736 for the periods ended March 31, 2007 and 2006, respectively. NSF income was \$46,574 and \$36,925 for the three months ended March 31, 2007 and 2006, respectively, representing 61.7% of total service fees on deposits in the 2007 period compared to 59.5% of total service fees on deposits in the 2006 period.

We purchased bank owned life insurance in the third quarter of 2006. Income derived from life insurance was \$96,000 for the three months ended March 31, 2007.

Other real estate owned activity includes income and expenses from property held for sale and other real estate we own. In February 2007, we decided to actively market the sale of our former main office and corporate headquarters building, and accordingly, reclassified the building from property and equipment to property held for sale. As a result, we recorded a pre-tax gain of \$375,000 which is included in other real estate owned activity. In addition, we leased a portion of the building and began to collect monthly rent of \$18,517 in March 2007. The building was sold during April 2007. Also included in other real estate owned activity are income and expenses related to loans that were transferred into other real estate owned. Our cost of owning the real estate exceeded income derived from the property by \$64,924 for the three months ended March 31, 2007. We had no income or expenses on real estate owned for the same period in 2006.

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Other income consisted primarily of fees received on debit card transactions, sale of customer checks, and wire transfers. Other income was \$55,950 and \$62,703 for the three months ended March 31, 2007 and 2006, respectively. The \$6,753 decrease relates primarily to a \$17,889 gain on the sale of fixed assets in 2006, partially offset by a \$7,171 increase in debit card transaction fees, a \$1,200 increase in safe deposit box rentals and a \$2,287 increase in wire transfer fees. Debit card transaction fees were \$38,778 and \$31,607 for the three months ended March 31, 2007 and 2006, respectively and represented 69.3% and 50.4% of total other income for the first quarters of 2007 and 2006, 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 \$15,856 and \$23,198 for the three months ended March 31, 2007 and 2006, respectively. The net impact of the fees received and the related cost of the debit card transactions on earnings for the three months ended March 31, 2007 and 2006 was \$22,922 and \$8,409, respectively.

Noninterest expenses

The following table sets forth information related to our noninterest expenses.

| | Three months ended | |
|-----------------------------------|---------------------------|--------------|
| | March 31, | |
| | 2007 | 2006 |
| Compensation and benefits | \$ 1,422,532 | \$ 1,033,741 |
| Professional fees | 124,520 | 90,437 |
| Marketing | 105,598 | 121,070 |
| Insurance | 51,336 | 43,034 |
| Occupancy | 395,947 | 174,777 |
| Data processing and related costs | 258,346 | 197,870 |
| Telephone | 34,767 | 15,882 |
| Other | 114,487 | 112,733 |
| Total noninterest expense | \$ 2,507,533 | \$ 1,789,544 |

We incurred noninterest expenses of \$2.5 million for the three months ended March 31, 2007 compared to \$1.8 million for the three months ended March 31, 2006. Average interest-earning assets increased 30.1% during this period, while general and administrative expense increased 40.1% due to the additional costs associated with our new main office and headquarters building.

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For the three months ended March 31, 2007, compensation and benefits, occupancy, and data processing and related costs represented 82.8% of the total noninterest expense compared to 78.6% for the same period in 2006.

The following table sets forth information related to our compensation and benefits.

| | Three months ended | |
|------------------------------------|---------------------------|--------------|
| | March 31, | |
| | 2007 | 2006 |
| Base compensation | \$ 938,702 | \$ 725,831 |
| Incentive compensation | 214,000 | 142,000 |
| Total compensation | 1,152,702 | 867,831 |
| Benefits | 306,684 | 206,230 |
| Capitalized loan origination costs | (36,854) | (40,320) |
| Total compensation and benefits | \$ 1,422,532 | \$ 1,033,741 |

Compensation and benefits expense was \$1.4 million and \$1.0 million for the three months ended March 31, 2007 and 2006, respectively. Compensation and benefits represented 56.7% and 57.8% of our total noninterest expense for the three months March 31, 2007 and 2006, respectively. The \$388,791 increase in compensation and benefits in the first quarter of 2007 compared to the same period in 2006 resulted from increases of \$212,871 in base compensation, \$72,000 in additional incentive compensation, and \$100,454 higher 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 \$3,466.

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The \$212,871 increase in base compensation expense related to the cost of 11 additional employees as well as annual salary increases. Five of the new employees relate to the management and staff that we hired to support our expansion into the Columbia, SC market. The remaining six employees were hired primarily to support the growth in both loans and deposit operations. Incentive compensation represented 15.0% and 13.7% of total compensation and benefits for the three months ended March 31, 2007 and 2006, respectively. The incentive compensation expense recorded for the first quarter of 2007 and 2006 represented an accrual of the portion of the estimated incentive compensation earned during the first quarter of the respective year. Benefits expense increased \$100,454 in the first quarter of 2007 compared to the same period in 2006. Benefits expense represented 26.6% and 23.8% of the total compensation for the three months ended March 31, 2007 and 2006, respectively.

The following tables set forth information related to our data processing and related costs.

| | Three months | |
|---|---------------------|-------------|
| | ended | |
| | March 31, | |
| | 2007 | 2006 |
| Data processing costs | \$ 183,274 | \$ 127,086 |
| Debit card transaction expense | 15,856 | 23,198 |
| Courier expense | 24,395 | 23,210 |
| Other expenses | 34,821 | 24,376 |
| Total data processing and related costs | \$ 258,346 | \$ 197,870 |

Data processing and related costs were \$258,346 and \$197,870 for the three months ended March 31, 2007 and 2006, respectively. During the three months ended March 31, 2007, our data processing costs for our core processing system were \$183,274 compared to \$127,086 for the three months ended March 31, 2006. We have contracted with an outside computer service company to provide our core data processing services.

Data processing costs increased \$56,188, or 44.2%, for the three months ended March 31, 2007 compared to the same period in 2006. The increases in costs were caused by the higher number of loan and deposit accounts. 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.

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 \$15,856 and \$23,198 for the three months ended March 31, 2007 and 2006, respectively. The decrease of \$7,342 relates primarily to a change in merchant service card providers, whereby we now receive net fee income related to the service provided to our merchant clients. In prior years, we received a substantially higher fee, but also incurred a higher transaction cost.

Occupancy expense represented 15.8% and 9.8% of total noninterest expense for the three months ended March 31, 2007 and 2006, respectively. Occupancy expense for the three months ended March 31, 2007 and 2006 was \$395,947 and \$174,777, respectively, an increase of \$221,170. The increase is primarily due to the increased costs associated with our new main office and headquarters building such as depreciation and rent

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expense as well as certain moving expenses incurred in January 2007.

The remaining \$47,552 increase in noninterest expense for the three month period ended March 31, 2007 compared to the same period in 2006 resulted primarily from increases of \$34,083 in professional fees, \$8,302 in insurance, and \$18,885 in telephone expenses, partially offset by a \$15,472 decrease in marketing expenses. The increase in professional fees relates primarily to additional legal fees related to new SEC reporting requirements and the proposed name change of our company, while the increased telephone expenses relate primarily to our new office in Columbia, SC.

Income tax expense was \$451,517 for the three months ended March 31, 2007 compared to \$483,930 during the same period in 2006. Our effective tax rate was 32.0% and 36.5%, respectively, for the first quarters of 2007 and 2006. The decrease in the effective tax rate for the 2007 period compared to 2006 results primarily from the tax exempt income on bank owned life insurance which we purchased in the third quarter of 2006.

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Balance Sheet Review

General

At March 31, 2007, we had total assets of \$557.7 million, consisting principally of \$427.0 million in loans, \$82.8 million in investments, \$19.1 million in federal funds sold, and \$7.5 million in cash and due from banks. Our liabilities at March 31, 2007 totaled \$522.0 million, which consisted principally of \$383.9 million in deposits, \$118.5 million in FHLB advances, \$2.6 million of official checks outstanding, and \$13.4 million in junior subordinated debentures. At March 31, 2007, our shareholders' equity was \$35.6 million.

At December 31, 2006, we had total assets of \$509.3 million, consisting principally of \$397.2 million in loans, \$74.3 million in investments, \$7.5 million in federal funds sold, and \$9.1 million in cash and due from banks. Our liabilities at December 31, 2006 totaled \$474.8 million, consisting principally of \$345.5 million in deposits, \$108.5 million in FHLB advances, \$4.1 million of official checks outstanding, and \$13.4 million of junior subordinated debentures. At December 31, 2006, our shareholders' equity was \$34.6 million.

Federal Funds Sold

At March 31, 2007, our federal funds sold were \$19.1 million, or 3.4% of total assets. At December 31, 2006, our \$7.5 million in short-term investments in federal funds sold on an overnight basis comprised 1.5% of total assets.

Investments

Contractual maturities and yields on our investments that are available for sale and are held to maturity at March 31, 2007 are shown in the following table. 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 March 31, 2007.

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| | One to Five Years | | Five to Ten Years | | Over Ten Years | | Total | |
|----------------------------------|------------------------|-------|-------------------|-------|----------------|-------|-----------|-------|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | (Dollars in thousands) | | | | | | | |
| Available for Sale | | | | | | | | |
| Federal agencies | \$ 1,991 | 5.06% | \$ - | - | \$ - | - | \$ 1,991 | 5.06% |
| State and political subdivisions | - | - | - | - | 3,746 | 3.81% | 3,746 | 3.81% |
| Mortgage-backed securities | - | - | 4,315 | 5.32% | 48,424 | 5.70% | 52,739 | 5.67% |
| Total | \$ 1,991 | 5.06% | \$ 4,315 | 5.32% | \$ 52,170 | 5.56% | \$ 58,476 | 5.53% |

Held to Maturity

| | | | | | | | | |
|----------------------------|------|---|-----|-------|-----------|-------|-----------|-------|
| Mortgage-backed securities | \$ - | - | 413 | 3.92% | \$ 16,245 | 4.64% | \$ 16,658 | 4.62% |
|----------------------------|------|---|-----|-------|-----------|-------|-----------|-------|

At March 31, 2007, our investments included securities issued by Federal Home Loan Mortgage Corporation and Federal National Mortgage Association with carrying values of \$20.0 million, and \$60.0 million, respectively.

The amortized costs and the fair value of our investments at March 31, 2007 and December 31, 2006 are shown in the following table.

| | March 31, 2007 | | December 31, 2006 | |
|----------------------------------|------------------------|------------|-------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (Dollars in thousands) | | | |
| Available for Sale | | | | |
| Government sponsored enterprises | \$ 1,996 | \$ 1,991 | \$ 1,996 | \$ 1,989 |
| State and political subdivisions | 3,794 | 3,746 | 3,795 | 3,782 |
| Mortgage-backed securities | 52,578 | 52,739 | 44,478 | 44,429 |
| Total | \$ 58,368 | \$ 58,476 | \$ 50,269 | \$ 50,200 |
| Held to Maturity | | | | |
| Mortgage-backed securities | \$ 16,658 | \$ 16,245 | \$ 17,045 | \$ 16,577 |

Other investments totaled \$7.6 million at March 31, 2007 and consisted of Federal Reserve Bank stock with a cost of \$968,700, investments in Greenville First Statutory Trust I and Trust II of \$186,000 and \$217,000, respectively, and Federal Home Loan Bank stock with a cost of \$6.3 million.

At March 31, 2007, we had \$82.8 million in our investment securities portfolio which represented approximately 14.8% of our total assets. We held U.S. Government agency securities, municipal securities, and mortgage-backed securities with a fair value of \$74.7 million and an amortized cost of \$75.0 million for an unrealized loss of \$305,606. We believe, based on industry analyst reports and credit ratings that the deterioration in value is attributed to changes in market interest rates and not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary. We have the ability and intent to hold these securities until such time as the value recovers or the securities mature.

At December 31, 2006, the \$74.3 million in our investment securities portfolio represented approximately 14.6% of our total assets. We held Government sponsored enterprise securities, municipal securities, and mortgage-backed securities with a fair value of \$66.8 million and an amortized cost of \$67.3 million for an unrealized loss of \$537,138. As a result of the strong growth in our loan portfolio and the historically low fixed rates that were available during the last two and one-half years, through December 31, 2005, we had maintained a lower than normal level of investments. During 2006, as rates on investment securities have risen and we have attracted a material amount of additional deposits, we increased the size of our investment portfolio.

Contractual maturities and yields on our available for sale and held to maturity investments at December 31, 2006 are shown in the following table. 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, 2006, we had no securities with a maturity of less than one year.

| | One to Five Years | | Five to Ten Years | | Over Ten Years | | Total | |
|--|------------------------|-------|-------------------|-------|----------------|-------|--------|-------|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | (Dollars in thousands) | | | | | | | |

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Available for Sale

| | | | | | | | | | | | | |
|----------------------------------|----|-------|--------|----|-------|--------|----|--------|--------|----|--------|--------|
| Government sponsored enterprises | \$ | 1,989 | 5.06 % | \$ | - | - | \$ | - | - | \$ | 1,989 | 5.06 % |
| State and political subdivisions | | - | - | | - | - | | 3,782 | 3.81 % | | 3,782 | 3.81 % |
| Mortgage-backed securities | | - | - | | 4,608 | 5.33 % | | 39,821 | 5.64 % | | 44,429 | 5.61 % |
| Total | \$ | 1,989 | 5.06 % | \$ | 4,608 | 5.33 % | \$ | 43,603 | 5.48 % | \$ | 50,200 | 5.45 % |

Held to Maturity

| | | | | | | | | | | | | |
|----------------------------|----|---|---|----|-----|--------|----|--------|--------|----|--------|--------|
| Mortgage-backed securities | \$ | - | - | \$ | 441 | 3.92 % | \$ | 16,604 | 4.63 % | \$ | 17,045 | 4.61 % |
|----------------------------|----|---|---|----|-----|--------|----|--------|--------|----|--------|--------|

At December 31, 2006, our investments included securities issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation with carrying values of \$39.5 million and \$12.4 million, respectively.

Other investments totaled \$7.1 million at December 31, 2006. Other investments at December 31, 2006 consisted of Federal Reserve Bank stock with a cost of \$968,700, 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 \$5.7 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 three months ended March 31, 2007 and 2006, average loans were \$417.8 million and \$351.7 million, respectively. Before the allowance for loan losses, total loans outstanding at March 31, 2007 were \$432.4 million. Average loans for the year ended December 31, 2006 were \$375.4 million. Before the allowance for loan losses, total loans outstanding at December 31, 2006 were \$402.2 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.

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The following table summarizes the composition of our loan portfolio at March 31, 2007 and December 31, 2006.

| | March 31, 2007 | | December 31, 2006 | |
|---|----------------|------------|-------------------|------------|
| | Amount | % of Total | Amount | % of Total |
| (Dollars in thousands) | | | | |
| Real estate: | | | | |
| Commercial: | | | | |
| Owner occupied | \$ 95,906 | 22.2 % | 77,668 | 19.3 % |
| Non-owner occupied | 120,136 | 27.8 % | 126,008 | 31.3 % |
| Construction | 27,496 | 6.4 % | 20,466 | 5.1 % |
| Total commercial real estate | 243,538 | 56.4 % | 224,142 | 55.7 % |
| Consumer: | | | | |
| Residential | 57,328 | 13.3 % | 59,187 | 14.7 % |
| Home equity | 37,750 | 8.7 % | 35,986 | 9.0 % |
| Construction | 8,411 | 1.9 % | 8,259 | 2.0 % |
| Total consumer real estate | 103,489 | 23.9 % | 103,432 | 25.7 % |
| Total real estate | 347,027 | 80.3 % | 327,574 | 81.4 % |
| Commercial business | 74,757 | 17.3 % | 65,891 | 16.4 % |
| Consumer-other | 11,422 | 2.6 % | 9,524 | 2.4 % |
| Deferred origination fees, net | (853) | (0.2)% | (806) | (0.2)% |
| Total gross loans, net of deferred fees | 432,353 | 100.0 % | 402,183 | 100.0 % |
| Less-allowance for loan losses | (5,352) | | (4,949) | |
| Total loans, net | \$ 427,001 | | \$ 397,234 | |

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 March 31, 2007.

| | One year or less | | After one but within five years | | After five years | | Total |
|---|------------------------|------------|---------------------------------|------------|------------------|--|-------|
| | (Dollars in thousands) | | | | | | |
| Real estate - mortgage | \$ 67,638 | \$ 205,437 | \$ 38,045 | \$ 311,120 | | | |
| Real estate - construction | 23,695 | 10,395 | 1,817 | 35,907 | | | |
| Total real estate | 91,333 | 215,832 | 39,862 | 347,027 | | | |
| Commercial business | 42,369 | 31,023 | 1,365 | 74,757 | | | |
| Consumer-other | 7,385 | 3,504 | 533 | 11,422 | | | |
| Deferred origination fees, net | (308) | (465) | (80) | (853) | | | |
| Total gross loans, net of deferred fees | \$ 140,779 | \$ 249,894 | \$ 41,680 | \$ 432,353 | | | |
| Loans maturing after one year with: | | | | | | | |
| Fixed interest rates | | | | \$ 156,313 | | | |
| Floating interest rates | | | | \$ 135,261 | | | |

The following table summarizes the loan maturity distribution by type and related interest rate characteristics at December 31, 2006.

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| | One year or less | After one but within five years | After five years | Total |
|---|------------------------|---------------------------------------|---------------------|------------|
| | (Dollars in thousands) | | | |
| Real estate - mortgage | \$ 59,676 | \$ 195,649 | \$ 43,524 | \$ 298,849 |
| Real estate - construction | 18,630 | 9,685 | 410 | 28,725 |
| Total real estate | 78,306 | 205,334 | 43,934 | 327,574 |
| Commercial business | 40,143 | 24,891 | 857 | 65,891 |
| Consumer - other | 4,299 | 4,818 | 407 | 9,524 |
| Deferred origination fees, net | (267) | (454) | (85) | (806) |
| Total gross loans, net of deferred fees | \$ 122,481 | \$ 234,589 | \$ 45,113 | \$ 402,183 |
| Loans maturing after one year with: | | | | |
| Fixed interest rates | | | \$ | 143,291 |
| Floating interest rates | | | \$ | 136,411 |

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 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 rapid 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.

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The following table summarizes the activity related to our allowance for loan losses for the three months ended March 31, 2007 and 2006:

| | 2007 | March 31, 2006 |
|--|------------------------|-------------------|
| | (Dollars in thousands) | |
| Balance, beginning of period | \$ 4,949 | \$ 4,490 |
| Loans charged-off | (57) | (408) |
| Recoveries of loans previously charged-off | - | 33 |
| Net loans (charged-off) recovery | \$ (57) | \$ (375) |
| Provision for loan losses | 460 | 400 |
| Balance, end of period | \$ 5,352 | \$ 4,515 |
| Allowance for loan losses to gross loans | 1.24 % | 1.24 % |
| Net charge-offs to average loans | 0.06 % | 0.43 % |

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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.

Nonperforming Assets

The following table shows the nonperforming assets, percentages of net charge-offs, and the related percentage of allowance for loan losses for the three months ended March 31, 2007 and the year ended December 31, 2006. All loans over 90 days past due are on and included in loans on nonaccrual.

| | | March 31, 2007 | | December 31, 2006 |
|--|----|-----------------------|----|--------------------------|
| (Dollars in thousands) | | | | |
| Loans over 90 days past due | \$ | 1,595 | \$ | 945 |
| Loans on nonaccrual: | | | | |
| Mortgage | | 1,592 | | 1,424 |
| Commercial | | - | | 32 |
| Consumer | | 43 | | 33 |
| Total nonaccrual loans | | 1,635 | | 1,489 |
| Troubled debt restructuring | | - | | - |
| | | | | |
| Total of nonperforming loans | | 1,635 | | 1,489 |
| Other nonperforming assets | | 732 | | 1,012 |
| Total nonperforming assets | \$ | 2,367 | \$ | 2,501 |
| Percentage of total assets | | 0.42 % | | 0.49 % |
| Percentage of nonperforming loans and assets to gross loans | | 0.55 % | | 0.62 % |

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The allowance for loan losses was \$5.4 million and \$4.9 million at March 31, 2007 and December 31, 2006, respectively or 1.24% and 1.23% of outstanding loans, respectively. During the year ended December 31, 2006, we had net charged off loans of \$1.2 million. During the three months ended March 31, 2007 and 2006 we had net charge-offs of \$57,105 and \$374,384, respectively. In the first quarter of 2006, we charged-off \$340,000 related to a group of loans with a common interest.

At March 31, 2007 and December 31, 2006, nonaccrual loans represented 0.38% and 0.37% of total loans, respectively. At March 31, 2007 and December 31, 2006, we had \$1.6 million and \$1.5 million of loans, respectively, on nonaccrual status. 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 income when received.

The amount of foregone interest income on the nonaccrual loans in the first three months of 2007 was approximately \$39,000. The amount of interest income recorded in the first three months of 2007 for loans that were on nonaccrual at March 31, 2007 was \$1,802.

At March 31, 2007, we had a \$4.0 million commercial real estate loan that we considered a performing loan as all terms of the existing loan agreement were being met satisfactorily. Internally, the loan was risk rated substandard, as the primary source of repayment was the developer's ability to liquidate the collateral. While performing a review of the various loans that were rated substandard, doubtful and loss at March 31, 2007, we adjusted our general reserve by \$375,000 for our best estimate of probable losses related to this credit. During the month of April, we continued to monitor this loan and have requested new appraisals to support the carrying value of the loan. Once we receive the new appraisals and have completed our internal evaluation, we will determine if a portion of this loan should be reclassified from substandard to doubtful.

Deposits and Other Interest-Bearing Liabilities

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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. We anticipate that the amount of out-of-market deposits will continue to decline as our new retail deposit offices become established. The amount of out-of-market deposits was \$91.3 million at December 31, 2006 and \$128.3 at March 31, 2007.

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 113% and 116% at March 31, 2007 and December 31, 2006, respectively.

The following table shows the average balance amounts and the average rates paid on deposits held by us for the three months ended March 31, 2007 and 2006.

| | 2007 | | 2006 | |
|--------------------------------------|------------------------|--------|------------|--------|
| | Amount | Rate | Amount | Rate |
| | (Dollars in thousands) | | | |
| Noninterest bearing demand deposits | \$ 30,395 | - | \$ 21,891 | - |
| Interest bearing demand deposits | 33,480 | 1.70 % | 32,983 | 1.81 % |
| Money market accounts | 82,526 | 3.60 % | 58,732 | 2.95 % |
| Saving accounts | 1,547 | 0.67 % | 1,339 | 0.41 % |
| Time deposits less than \$100,000 | 43,064 | 4.64 % | 30,525 | 3.70 % |
| Time deposits greater than \$100,000 | 173,780 | 5.30 % | 117,236 | 4.36 % |
| Total deposits | \$ 365,066 | 4.05 % | \$ 262,706 | 3.26 % |

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The increase in time deposits of \$100,000 or more for the three months ended March 31, 2007 compared to the 2006 period resulted from a \$32.5 million increase in retail time deposits and a \$58.9 million increase in wholesale deposits. A significant portion of the increase in retail time deposits is attributed to the addition of our two new retail branch offices.

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 \$192.2 million and \$197.7 million at March 31, 2007 and December 31, 2006, respectively.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of \$100,000 or more at March 31, 2007 was as follows:

| | March 31, 2007 | |
|--------------------------------|------------------------|---------|
| | (Dollars in thousands) | |
| Three months or less | \$ | 44,751 |
| Over three through six months | | 48,908 |
| Over six through twelve months | | 60,317 |
| Over twelve months | | 37,717 |
| Total | \$ | 191,693 |

Capital Resources

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Total shareholders' equity at March 31, 2007 was \$35.6 million. At December 31, 2006, total shareholders' equity was \$34.6 million. The increase during the first three months of 2007 resulted primarily from the \$958,056 of net income earned.

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) for the three months ended March 31, 2007 and the year ended December 31, 2006. Since our inception, we have not paid cash dividends.

| | March 31, 2007 | December 31, 2006 |
|--------------------------|-----------------------|--------------------------|
| Return on average assets | 0.73 % | 0.85 % |
| Return on average equity | 11.03 % | 11.95 % |
| Equity to assets ratio | 6.61 % | 7.15 % |

Our return on average assets was .73% for the three months ended March 31, 2007, a decrease from .85% for the year ended December 31, 2006. In addition, our return on average equity decreased to 11.03% from 11.95% for the first quarter ended March 31, 2007 and the year ended December 31, 2006, respectively. The decrease in the equity to assets ratio from December 31, 2006 is a function of the \$76.0 million increase in average assets compared to the \$2.6 million increase in average equity.

The following table sets forth the holding company's and the bank's various capital ratios at March 31, 2007 and at December 31, 2006. For all periods, the bank was considered "well capitalized" and the holding company met or exceeded its applicable regulatory capital requirements.

| | March 31, 2007 | | December 31, 2006 | |
|---------------------------|-----------------------|-------------|--------------------------|-------------|
| | Holding | Bank | Holding | Bank |
| | Company | | Company | |
| Total risk-based capital | 14.5 % | 11.6 % | 13.1 % | 12.3 % |
| Tier 1 risk-based capital | 13.3 % | 10.4 % | 11.9 % | 11.1 % |
| Leverage capital | 10.9 % | 8.5 % | 9.4 % | 8.7 % |
| | 24 | | | |

Borrowings

The following table outlines our various sources of borrowed funds during the three months ended March 31, 2007 and the year ended December 31, 2006, the amounts outstanding at the end of each period, at the maximum point for each component during the periods and on average for each period, and the average interest rate that we paid for each borrowing source. The maximum month-end balance represents the high indebtedness for each component of borrowed funds at any time during each of the periods shown.

| | Ending | Period- | Maximum | Average for the Period | |
|---------------------------------------|-------------------------------|-----------------|------------------|-------------------------------|-------------|
| | Balance | End Rate | Month-end | Balance | Rate |
| | (Dollars in thousands) | | | | |
| At or for the Three Months | | | | | |
| <u>ended March 31, 2007</u> | | | | | |
| Federal Home Loan Bank advances | \$ 118,500 | 4.56 % | \$ 118,500 | \$ 113,400 | 4.60 % |
| Junior subordinated debentures | 13,403 | 7.56 % | 13,403 | 13,403 | 7.58 % |
| At or for the Year | | | | | |
| <u>ended December 31, 2006</u> | | | | | |
| Federal Home Loan Bank advances | \$ 108,500 | 4.52 % | \$ 108,500 | \$ 91,525 | 4.35 % |
| Securities sold under agreement to | | | | | |

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| | | | | | |
|--------------------------------|--------|--------|--------|--------|--------|
| repurchase | - | - | 14,434 | 8,362 | 4.92 % |
| Federal funds purchased | - | - | 3,345 | 572 | 5.47 % |
| Junior subordinated debentures | 13,403 | 7.57 % | 13,403 | 13,403 | 7.30 % |

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 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 March 31, 2007, unfunded commitments to extend credit were \$50.7 million, of which \$27.2 million was at fixed rates and \$23.5 million was at variable rates. At December 31, 2006, unfunded commitments to extend credit were \$79.2 million, of which approximately \$40.6 million was at fixed rates and \$38.6 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 March 31, 2007, there was a \$2.3 million commitment under letters of credit. At December 31, 2006, there was a \$2.4 million commitment under a letter 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

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. 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.

We actively monitor and manage our interest rate risk exposure 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.

We were liability sensitive during the latter half of the year ended December 31, 2006 and during the three months ended March 31, 2007. Our variable rate loans and a majority of our deposits reprice over a 12-month period. Approximately 46% and 49% of our loans were variable rate loans at March 31, 2007 and December 31, 2006, respectively. The ratio of cumulative gap to total earning assets after 12 months was (24.6%) because \$129.2 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.

Liquidity and Interest Rate Sensitivity

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 March 31, 2007, our liquid assets, consisting of cash and due from banks and federal funds sold, amounted to \$26.6 million, or 4.8% of total assets. Our investment securities at March 31, 2007 amounted to \$82.8 million, or 14.8% of total assets. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, \$24.5 million 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. At December 31, 2006, our liquid assets amounted to \$16.6 million, or 3.3% of total assets. Our investment securities at December 31, 2006 amounted to \$74.3 million, or 14.6% of total assets. However, substantially all of these securities were pledged against outstanding debt.

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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 \$26.1 million for which there were no borrowings against the lines at March 31, 2007. We are also a member of the Federal Home Loan Bank of Atlanta (FHLB), from which applications for borrowings can be made for leverage purposes. 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 March 31, 2007 was \$8.1 million, based on the bank's \$6.2 million investment in FHLB stock, as well as qualifying mortgages available to secure any future borrowings.

We have a ten-year, five-month lease on our new headquarters and main office. The lease provides for a substantial reduction in the rent rate for the first five months of the lease. Beginning in 2007, the monthly rent expense is approximately \$42,000. 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.

Asset/liability management is the process by which we monitor and control the mix and maturities of our assets and liabilities. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets

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and liabilities in order to minimize potentially adverse impacts on earnings from changes in market interest rates. 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.

The following table sets forth information regarding our rate sensitivity as of March 31, 2007 for each of the time intervals indicated. The information in the table may not be indicative of our rate sensitivity position at other points in time. In addition, the maturity distribution indicated in the table may differ from the contractual maturities of the earning assets and interest-bearing liabilities presented due to consideration of prepayment speeds under various interest rate change scenarios in the application of the interest rate sensitivity methods described above.

| | <u>Within three months</u> | <u>After three but within twelve months</u> | <u>After one but within five years</u> | <u>After five years</u> | <u>Total</u> |
|---|------------------------------------|---|--|---------------------------------|--------------|
| | (Dollars in thousands) | | | | |
| Interest-earning assets: | | | | | |
| Federal funds sold | \$ 19,136 | \$ - | \$ - | \$ - | 19,136 |
| Investment securities | 3,336 | 8,933 | 33,082 | 29,783 | 75,134 |
| Loans | 210,602 | 40,345 | 146,224 | 34,400 | 431,571 |
| Total earning assets | \$ 233,074 | \$ 49,278 | \$ 179,306 | \$ 64,183 | \$ 525,841 |
| Interest-bearing liabilities: | | | | | |
| Money market and NOW | \$ 116,759 | \$ - | \$ - | \$ - | 116,759 |
| Regular savings | 1,572 | - | - | - | 1,572 |
| Time deposits | 59,876 | 138,460 | 36,357 | 366 | 235,059 |
| FHLB advances | 55,000 | 26,500 | 37,000 | - | 118,500 |
| Junior subordinated debentures | 13,403 | - | - | - | 13,403 |
| Total interest-bearing liabilities | \$ 246,610 | \$ 164,960 | \$ 73,357 | \$ 366 | \$ 485,293 |
| Period gap | \$ (13,536) | \$ (115,682) | \$ 105,949 | \$ 63,817 | |
| Cumulative gap | (13,536) | (129,218) | (23,269) | 40,548 | |
| Ratio of cumulative gap total assets total earning assets | (2.6%) | (24.6%) | (4.4 %) | 7.7 % | |

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The following table sets forth information regarding our rate sensitivity, as of December 31, 2006, at each of the time intervals.

| | <u>Within three months</u> | <u>After three but within twelve months</u> | <u>After one but within five years</u> | <u>After five years</u> | <u>Total</u> |
|-------------------------------|------------------------------------|---|--|---------------------------------|--------------|
| | (Dollars in thousands) | | | | |
| Interest-earning assets: | | | | | |
| Federal funds sold | \$ 7,467 | \$ - | \$ - | \$ - | 7,467 |
| Investment securities | 3,159 | 8,588 | 29,940 | 25,557 | 67,244 |
| Loans | 205,316 | 25,828 | 134,035 | 36,321 | 401,500 |
| Total earning assets | \$ 215,942 | \$ 34,416 | \$ 163,975 | \$ 61,878 | \$ 476,211 |
| Interest-bearing liabilities: | | | | | |
| Money market and NOW | \$ 117,538 | \$ - | \$ - | \$ - | 117,538 |
| Regular savings | 1,544 | - | - | - | 1,544 |

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| | | | | | |
|--|-------------|-------------|-----------|-----------|------------|
| Time deposits | 45,443 | 114,940 | 34,995 | 165 | 195,543 |
| FHLB advances | 57,500 | 19,000 | 32,000 | - | 108,500 |
| Junior subordinated debentures | 13,403 | - | - | - | 13,403 |
| Total interest-bearing liabilities | \$ 235,428 | \$ 133,940 | \$ 66,995 | \$ 165 | \$ 436,528 |
| Period gap | \$ (19,486) | \$ (99,524) | \$ 96,980 | \$ 61,713 | |
| Cumulative gap | (19,486) | (119,010) | (22,030) | 39,683 | |
| Ratio of cumulative gap total assets to total earning assets | (4.1 %) | (25.0 %) | (4.6 %) | 8.3 % | |

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 September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard does not require any new fair value measurements, but rather eliminates inconsistencies found in various prior pronouncements. SFAS 157 is effective for the company on January 1, 2008 and is not expected to have a significant impact on the company's financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS 158"), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date - the date at which the benefit obligation and plan assets are measured - is required to be the company's fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The company does not have a defined benefit pension plan. Therefore, SFAS 158 will not impact the company's financial position, results of operations or cash flows.

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In September, 2006, The FASB ratified the consensus reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4 "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements". EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", or Accounting Principles Board ("APB") Opinion No. 12, "Omnibus Opinion-1967". EITF 06-4 is effective for fiscal years beginning after December 15, 2007. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The company is currently analyzing the effects of EITF 06-4 on its financial position, results of operations and cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be

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included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the company on January 1, 2008. Earlier adoption is permitted in 2007 if the company also elects to apply the provisions of SFAS 157, "Fair Value Measurement." The company is currently analyzing the fair value option provided under SFAS 159.

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.

There have been no material changes in our quantitative and qualitative disclosures about market risk as of March 31, 2007 from that presented in our annual report on Form 10-K for the year ended December 31, 2006. See "Market Risk" and "Liquidity and Interest Rate Sensitivity" in Item 2, Management Discussion and Analysis of Financial Condition and Results of Operations for quantitative and qualitative disclosures about market risk, which information is incorporated herein by reference.

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 March 31, 2007. There have been no significant changes in our internal controls over financial reporting during the fiscal quarter ended March 31, 2007 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 1A. Risk Factors.

There were no material changes from the risk factors presented in our annual report on Form 10-K for the year ended December 31, 2006.

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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.

GREENVILLE FIRST BANCSHARES, INC.

Registrant

Date: May 10, 2007

/s/R. Arthur Seaver, Jr.

R. Arthur Seaver, Jr.
Chief Executive Officer

Date: May 10, 2007

/s/James M. Austin, III

James M. Austin, III
Chief Financial Officer

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INDEX TO EXHIBITS

Exhibit

Number

Description

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

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