



**CommerceFirst<sup>®</sup>**

**B A N C O R P**

*Raising Banking to the Power of Business<sup>®</sup>*

**Annual Report**

**2010**

1804 West Street  
Annapolis, MD 21401  
[www.commerce1st.com](http://www.commerce1st.com)



March 30, 2011

To our Fellow Shareholders:

We are pleased to report that we were able to increase our earnings as the result of increased average loans outstanding during the year, the reduction of the cost of deposits due to the re-pricing of certificates of deposit at lower market interest rate levels and higher gains on loan sales. The Company and Bank were challenged during 2010 by the continuing adverse economic environment, nationally and in our market area. We consistently monitored the quality of our loan portfolio, increasing loan loss reserves in recognition of the financial strain experienced by our loan customers during the current economic downturn

We maintained the Company's total assets at a relatively constant level during the year. While loan originations increased during 2010, loans declined as we increased sales of the guaranteed portions of new Small Business Administration loans. We continue to originate loans, focusing on quality borrowers. Key measurements and events for the year ended December 31, 2010 include the following:

- The Company's net income was \$1.4 million for the year ended December 31, 2010 as compared to net income of \$678 thousand for the year ended December 31, 2009, a 109.6% increase, largely resulting from increased net interest income during 2010.
- Net interest income, the Company's main source of income, increased by 28.5% from \$7.3 million in 2009 to \$9.4 million in 2010.
- Total assets increased by 1.4% from \$200.4 million at December 31, 2009 to \$203.1 million at December 31, 2010.
- Net loans outstanding decreased by 0.8% from \$183.1 million at December 31, 2009 to \$181.7 million as of December 31, 2010.
- Deposits increased by 0.8% from \$178.6 million at December 31, 2009 to \$180.1 million at December 31, 2010.

Our stronger earnings resulted from the increase in average earning assets, the careful management of loan pricing, the decline in the cost of funds and close scrutiny of operating expenses. We achieved higher earnings even as our loan loss expense was higher in 2010 as compared to 2009 as the result of the current economic environment's adverse effect on some of our borrowers. We continue to closely monitor our loan portfolio for adverse effects from the weakened economy. At the same time, we continue to search for prudent lending opportunities while managing our growth to stay within well capitalized parameters. We are optimistic that our strong capital base, hands-on management approach to commercial lending, and continued measured growth path, will position us as a strong competitor when the economy recovers.

As always we appreciate your continued support of our bank through your referrals and patronage.

Very truly yours,

Milton D. Jernigan II  
Chairman of the Board

Richard J. Morgan  
President and CEO

## SELECTED CONSOLIDATED FINANCIAL DATA

The following table shows selected historical consolidated financial data for CommerceFirst Bancorp, Inc. You should read it in conjunction with the historical consolidated financial information contained in the Consolidated Financial Statements for the year ended December 31, 2010 included in this Annual Report. Data for all periods are derived from the respective audited consolidated financial statements.

(Dollars in thousands, except per share data.)

	<b>Year Ended December 31,</b>				
	2010	2009	2008	2007	2006
<b>Operation Statement Data:</b>					
Net interest income	\$ 9,430	\$ 7,341	\$ 5,567	\$ 5,895	\$ 5,301
Provision for loan losses	\$ 2,716	\$ 1,616	\$ 647	\$ 45	\$ 225
Noninterest income	\$ 1,094	\$ 720	\$ 569	\$ 620	\$ 633
Noninterest expense	\$ 5,434	\$ 5,315	\$ 5,028	\$ 4,688	\$ 3,652
Federal and state income tax expense	\$ 951	\$ 452	\$ 166	\$ 694	\$ 774
<b>Net income</b>	<b>\$ 1,423</b>	<b>\$ 678</b>	<b>\$ 295</b>	<b>\$ 1,088</b>	<b>\$ 1,283</b>
<b>Per share data and shares outstanding:</b>					
Net income per share, basic	\$ 0.78	\$ 0.37	\$ 0.16	\$ 0.60	\$ 0.71
Net income per share, diluted	\$ 0.78	\$ 0.37	\$ 0.16	\$ 0.59	\$ 0.69
Book value at period end	\$ 12.28	\$ 11.50	\$ 11.16	\$ 11.02	\$ 10.36
Average common shares outstanding during year	1,820,548	1,820,548	1,820,548	1,816,504	1,803,583
Diluted average common shares outstanding during year	1,820,548	1,820,548	1,820,548	1,848,195	1,846,462
Shares outstanding at period end	1,820,548	1,820,548	1,820,548	1,820,548	1,803,583
<b>Financial Condition data:</b>					
Total assets	\$ 203,124	\$ 200,371	\$ 166,569	\$ 148,811	\$ 141,270
Loans receivable (net)	\$ 181,709	\$ 183,102	\$ 151,101	\$ 124,670	\$ 95,081
Allowance for loan losses	\$ 3,174	\$ 2,380	\$ 1,860	\$ 1,665	\$ 1,614
Other interest-earning assets	\$ 12,289	\$ 8,382	\$ 9,227	\$ 18,358	\$ 40,121
Total deposits	\$ 180,110	\$ 178,645	\$ 145,241	\$ 123,408	\$ 112,205
Borrowings	\$ -	\$ -	\$ -	\$ 4,306	\$ 9,579
Stockholders' equity	\$ 22,365	\$ 20,942	\$ 20,311	\$ 20,056	\$ 18,687
<b>Selected performance ratios:</b>					
Return on average earning assets	0.94%	0.51%	0.25%	1.07%	1.23%
Return on average equity	8.61%	4.54%	1.92%	7.47%	7.16%
Net interest margin	4.69%	4.00%	3.59%	4.38%	5.06%
Net interest spread	4.30%	3.32%	2.60%	3.10%	3.83%
Efficiency ratio	51.63%	65.94%	81.94%	72.21%	61.56%
<b>Asset quality ratios:</b>					
Nonperforming loans to gross loans	3.94%	1.47%	3.80%	0.89%	0.65%
Allowance for loan losses to loans	1.72%	1.28%	1.22%	1.32%	1.67%
Allowance for loan losses to nonperforming loans	.44x	.87x	0.32x	1.48x	2.57x
Nonperforming assets to loans and other real estate	5.64%	2.76%	3.80%	0.89%	0.65%
Net loan charge-offs (recoveries) to average loans	1.04%	0.65%	0.33%	0.00%	0.26%
<b>Capital ratios:</b>					
Total risk-based capital ratio	13.06%	12.25%	14.14%	16.48%	19.10%
Tier I risk-based capital ratio	11.80%	10.99%	12.91%	15.23%	17.84%
Leverage ratio	11.03%	10.43%	12.24%	13.91%	15.10%
Average equity to average assets	10.62%	11.03%	12.86%	13.93%	16.63%

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Forward - Looking Statements. Certain information contained in this discussion may include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by words such as "may," "anticipates," "believes," "expects," "plans," "estimates," "potential," "continue," "should," and similar words or phrases. Such forward-looking statements involve known and unknown risks including, but not limited to, changes in general economic and business conditions, interest rate fluctuations, competition within and from outside the banking industry, new products and services in the banking industry, risk inherent in making loans such as repayment risks and fluctuating collateral values, problems with technology utilized by the Company, changing trends in customer profiles and changes in laws and regulations applicable to the Company or the banking industry as a whole. Although the Company believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned against placing undue reliance on any such forward-looking statements. The Company does not undertake to update any forward-looking statements to reflect occurrences or events that may not have been anticipated as of the date of such statements.

This discussion and analysis provides an overview of the financial condition and results of operations of CommerceFirst Bancorp, Inc. (the "Company") and CommerceFirst Bank (the "Bank") for the years 2010 and 2009. It is intended that this discussion and analysis help the readers in their analysis of the accompanying audited Consolidated Financial Statements. You should read this discussion in conjunction with the Consolidated Financial Statements and Notes thereto provided elsewhere in this report.

### General

CommerceFirst Bancorp, Inc. is the bank holding company for CommerceFirst Bank, a Maryland chartered commercial bank headquartered in Annapolis, Maryland. The Bank was capitalized, became a wholly owned subsidiary of the Company and commenced operations on June 29, 2000. The Company maintains five banking offices in Anne Arundel, Howard and Prince George's counties in central Maryland. The Company focuses on providing commercial banking services to small and medium sized businesses in its market areas.

The financial industry experienced significant volatility and stress as economic conditions worsened, unemployment increased and asset values declined during 2009 and 2010. While the Company did not have direct exposure to the upheaval in the residential mortgage loan market and did not invest in mortgage backed securities or the preferred stock of Freddie Mac and Fannie Mae, the slowing economy, declines in housing construction and the related impact on contractors and other small and medium sized businesses, has had an adverse impact on the Company's business. This impact included increased levels of non-performing assets, loan charge-offs and increased loan loss provisions. While the Company believes that it has taken adequate reserves for the problem assets in its loan portfolio at December 31, 2010, there can be no assurance that the Company will not be required to take additional charge-offs or make additional provisions for nonperforming loans, or that currently performing loans will continue to perform. Additionally, there can be no assurance that the steps taken to stimulate the economy and stabilize the financial system will prove successful, or that they will improve the financial condition of the Company's customers or the Company.

### Overview

The Company's assets increased modestly at December 31, 2010 from December 31, 2009, primarily reflecting an increase in cash and cash equivalents as the Company increased its liquidity position. Earnings improved as the result of the growth in average earning assets and the reduction of the cost of certificates of deposits due to re-pricing of these deposits to lower current market interest rates. The provision for loan losses continues to remain relatively high in recognition of the effect of uncertain economic conditions on the Company's borrowers and collateral values as well as loan charge-offs. Key measurements and events for the period include the following:

- The Company's net income was \$1.4 million for the year ended December 31, 2010 as compared to net income of \$678 thousand for the year ended December 31, 2009, a 109.6% increase, largely resulting from increased net interest income during 2010.

- Net interest income, the Company's main source of income, increased by 28.5% from \$7.3 million in 2009 to \$9.4 million in 2010.
- The provision for loan losses increased by 68.1% from \$1.6 million in 2009 to \$2.7 million during 2010.
- Total assets increased by 1.4% from \$200.4 million at December 31, 2009 to \$203.1 million at December 31, 2010.
- Net loans outstanding decreased by 0.8% from \$183.1 million at December 31, 2009 to \$181.7 million as of December 31, 2010.
- Deposits increased by 0.8% from \$178.6 million at December 31, 2009 to \$180.1 million at December 31, 2010.
- Non-interest income increased by 51.9% from \$720 thousand for the year ended December 31, 2009 to \$1.1 million for the year ended December 31, 2010.
- Non-interest expenses increased by 2.2% from \$5.3 million during 2009 to \$5.4 million in 2010.

A detailed discussion of the factors leading to these changes can be found in the discussion below.

Further asset and loan growth by the Company may be limited by its levels of regulatory capital. Increases in the loan portfolio need to be funded by increases in deposits as the Company has limited amounts of on-balance sheet assets deployable into loans. Growth will depend upon Company earnings and/or the raising of additional capital.

### **Critical Accounting Policies**

The Company's Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

The most significant accounting policies followed by the Company are presented in Note 1 to the Consolidated Financial Statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses as the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

The Company believes it has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Company's assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the Consolidated Financial Statements. For additional discussion concerning the allowance for loan losses and related matters, see "*Provision for Loan Losses*" below and Note 1 to the Consolidated Financial Statements.

## Financial Condition

The Company's assets at December 31, 2010 were \$203.1 million, an increase of \$2.8 million or 1.4%, from December 31, 2009. The increase is primarily the result of the increase in cash and cash equivalents of \$3.2 million offset by the decrease in loans of \$1.4 million. Increases in deposits during 2010 were maintained in interest bearing cash deposit accounts at other financial institutions.

### Loan Portfolio

At December 31, 2010, net loans totaled \$181.7 million as compared to \$183.1 million at December 31, 2009. The loan portfolio is comprised of commercial loans and real estate loans. The net decrease in loans is attributable to the \$16 million decline, or 23.4%, in commercial and industrial loans, the increase of \$15.4 million in real estate loans, or 13.2%, as well as a \$0.8 million increase, or 33.4%, in the allowance for loan losses. The changes noted above reflect the effect of reclassifying approximately \$9.5 million of commercial loans to real estate loans during the second quarter of 2010. The reclassification resulted from a review by the Company of the risk profile of the loan portfolio. The majority of the reclassified loans are to entities whose cash flow is directly or indirectly significantly dependent upon the sale, refinance, or management of real estate assets or collections of the entities' financing of real estate. During 2010, the Company continued its efforts to originate real estate loans, where the Company has tangible collateral securing the loans. Real estate retains a value even in down markets unlike other collateral such as accounts receivable and business assets, which are more susceptible to significant declines in value. The real estate portfolio is largely composed of loans secured by commercial real estate. The Company has only approximately \$1 million in acquisition and development loans secured by residential building lots. The Company's residential loans consist of loans to investors in residential property for rental, and are primarily secured by one to four family properties.

The loan portfolio is the largest component of earning assets and accounts for the greatest portion of total interest income. At December 31, 2010, gross loans were \$184.9 million, a 0.3% decline from the \$185.5 million in gross loans outstanding at December 31, 2009. Loans consist of internally generated loans and participation loans purchased from other local community banks. Lending activity is confined to the Bank's market area. The Company continues to seek quality credits. There has been no dilution of credit underwriting standards. The Company does not engage in foreign lending activities.

The following table sets forth information on the composition of the loan portfolio by type at December 31:

	<u>2010</u>		<u>2009</u>		<u>2008</u>	
	<u>Balance</u>	<u>Percentage of Loans</u>	<u>Balance</u>	<u>Percentage of Loans</u>	<u>Balance</u>	<u>Percentage of Loans</u>
<i>(In thousands)</i>						
Commercial and Industrial loans	\$44,645	24.1%	\$63,959	34.5%	\$54,195	35.4%
SBA loans	7,742	4.2%	4,517	2.4%	4,588	3.0%
Real estate loans:						
Owner occupied	85,570	46.3%	73,327	39.5%	61,417	40.1%
Non owner occupied	47,040	25.4%	43,760	23.6%	32,790	21.5%
Total real estate loans	<u>132,610</u>	<u>71.7%</u>	<u>117,087</u>	<u>63.1%</u>	<u>94,207</u>	<u>61.6%</u>
	184,997	100.0%	185,563	100.0%	152,990	100.0%
Unearned loan fees, net	(114)		(81)		(29)	
Allowance for loan losses	<u>(3,174)</u>		<u>(2,380)</u>		<u>(1,860)</u>	
	<u>\$181,709</u>		<u>\$183,102</u>		<u>\$151,101</u>	

<i>(In thousands)</i>	<u>2007</u>		<u>2006</u>	
	<u>Balance</u>	<u>Percentage of Loans</u>	<u>Balance</u>	<u>Percentage of Loans</u>
Commercial and Industrial loans	\$49,596	39.3%	\$42,127	43.5%
SBA loans	3,841	3.0%	3,223	3.3%
Real estate loans:				
Owner occupied	44,967	35.6%	**51,461	**53.2%
Non owner occupied	27,966	22.1%	**	**
Total real estate loans	<u>72,933</u>	<u>57.7%</u>	<u>51,461</u>	<u>53.2%</u>
	126,370	100.0%	96,811	100.0%
Unearned loan fees, net	(35)		(116)	
Allowance for loan losses	<u>(1,665)</u>		<u>(1,614)</u>	
	<u>\$124,670</u>		<u>\$95,081</u>	

\*\* Delineation by use of real estate is not available.

*Note: The loan amounts and percentages for December 31, 2010 above reflect the effect of reclassifying approximately \$9.5 million of commercial and industrial loans to real estate loans during the second quarter of 2010. Without the reclassification, the commercial and industrial loans would have comprised approximately 33.4% of the total loans at December 31, 2010.*

Non owner occupied real estate loans include loans secured by residential property in the amount of \$24.3 million, \$22.1 million, \$19.0 million in 2010, 2009 and 2008, respectively. Delineation as to residential verses commercial property for 2007 and 2006 is not available.

The tables below set forth the maturity and re-pricing distributions of the loan receivable portfolio as of December 31, 2010.

#### LOAN MATURITIES AS OF DECEMBER 31, 2010

<i>(In thousands)</i>	<u>1 year or less</u>	<u>&gt;1-5 years</u>	<u>After 5 years</u>	<u>Total</u>
Commercial and Industrial loans (1)	\$26,030	\$12,316	\$13,978	\$52,324
Real estate loans	33,698	25,888	73,087	132,673
Total loans receivable	<u>\$59,728</u>	<u>\$38,204</u>	<u>\$87,065</u>	<u>\$184,997</u>

(1) Includes SBA loans

#### LOAN RE- PRICING AS OF DECEMBER 31, 2010

<i>(In thousands)</i>	<u>1 year or less</u>	<u>&gt;1-5 years</u>	<u>After 5 years</u>	<u>Total</u>
Loans with:				
Fixed interest rates	\$14,399	\$33,556	\$1,068	\$49,023
Floating and adjustable interest rates	63,838	72,136	-	135,974
Total loans receivable	<u>\$78,237</u>	<u>\$105,692</u>	<u>\$1,068</u>	<u>\$184,997</u>

#### Allowance for Loan Losses

The allowance for loan losses was \$3.2 million, or 1.72% of loans, at December 31, 2010 as compared to \$2.4 million, or 1.28% of loans, at December 31, 2009. At December 31, 2010, non-accrual loans totaled \$7.3 million as compared to \$2.7 million at December 31, 2009. The increase is primarily attributable to increases in non-accrual real estate loans. The majority of the non-accrual loans are commercial real estate loans to businesses occupying the real estate collateral to conduct the borrowers' primary business operations. The long period of reduced economic activity has negatively impacted these businesses resulting in the reduction of resources to make the required payments on the real

estate loans. Loans charged off in 2010 totaled \$1.9 million as compared to \$1.1 million during 2009. Recoveries on charged off loans were \$51 thousand during 2010 and \$5 thousand during 2009.

Of the balance in the allowance account at December 31, 2010, "specific" reserves were \$1.6 million, or 0.89% of gross loans outstanding, and "general" reserves were \$1.5 million, or 0.83% of gross loans outstanding at December 31, 2010. Specific reserves are used to individually allocate an allowance for loans identified as impaired, or which otherwise exhibit adverse characteristics that suggest a heightened risk of non-collection. General reserves are those made with respect to unclassified loans in our portfolio based upon the methodology discussed below in order to maintain the allowance at a level which reflects our best estimate of the losses inherent in the portfolio with respect to such loans. Whether specific or general, amounts in the allowance for credit losses are available to absorb losses with respect to any loan. At December 31, 2009, the allowance for credit losses stood at \$2.4 million, or 1.28% of outstanding gross loans. Of this amount, specific reserves were \$0.9 million and general reserves were \$1.5 million.

The allowance for loan losses is determined based upon various loss ratios applied to categories of loans except for loans rated substandard, doubtful or loss, which are evaluated separately and assigned specific reserve amounts, if necessary, based upon the evaluation. Loss ratios are applied to each category of loan to determine estimated loss amounts. Categories of loans are identified as commercial term or revolving loans, SBA loans, owner occupied real estate loans and non-owner occupied real estate loans. Additional loss ratios are also applied for risks factors identified beyond individual loan risks, such as economic conditions, underwriting exceptions and loan concentrations based upon management's estimations of loss exposure. Loss ratios are determined based upon the Bank's loan loss history adjusted for estimated losses for the effect of current economic conditions (currently stressed), any industry concentration or identified weakness in an industry, and credit management and underwriting policies changes, if any.

The Company monitors its loan portfolio for indications of weaknesses through the review of borrowers' financial condition, cash flows, loan payment delinquencies, economic factors occurring in borrowers' business sectors and other information which may come to the Company through its contacts in the market place. The determination of the effect of the weaknesses noted on the repayment of the loans is an ongoing process as to each borrower. The Company may set aside specific loss reserves during this process in amounts determined on subjective bases until such time as the collectability of the loan from the borrowers' primary repayment source(s) is in doubt. During this time, secondary and tertiary repayment sources, including liquidation of collateral, are evaluated which may result in additional specific loss reserves being established. Independent or internal appraisals and evaluations are performed to determine potential recovery amounts, or range of amounts, from the loan collateral and other payment sources. Collateral values are subject to change depending on market factors, collateral condition and method and timing of liquidation efforts. Loans, or portions of loans, for which the Company does not expect to obtain repayment are charged-off. In most cases, the Company has established specific reserves for the amount of the loans' losses prior to the point of charge-off.

At December 31, 2010, the range of the loss ratios used to determine estimated losses by loan category were: commercial loans – 1.0%; SBA loans – 6.85%; owner occupied mortgage loans - 0.21% and non-owner occupied mortgage loans - 0.69% to 1.50%. Additional losses are estimated based on additional identified risks factors, such as loans with underwriting exceptions, the level and direction of payment delinquencies and the level of unsecured credit. These additional loss estimates are not allocated to the separate loan categories.

The computed allowance for loan losses is tested through the use of the Company's loan risk rating process. Loans are assigned a risk rating at their origination based upon rating criteria consistent with regulatory definitions. The risk ratings are adjusted, as necessary, if loans become delinquent, if significant adverse information is discovered regarding the underlying credit and, in the case of commercial loans and commercial real estate loans, the normal periodic review (usually annually) of the underlying credit indicate that a change in risk rating is appropriate. An estimated "low" and "high" loss percentage is applied to loans in each risk rating. These loss percentages increase as the loan risk rating increases. Estimated losses and reserves for loans rated as substandard, doubtful or loss are derived from the determination of the allowance for loan losses as discussed above as well as estimated losses resulting from risk factors identified beyond individual loan risks, such as economic conditions, underwriting exceptions and loan concentrations. Loss percentages used are generally based upon management's best estimates considering losses incurred. Estimated "low" and "high" allowance for loan loss amounts are derived by accumulating the estimated losses using the "low" and "high" loss percentages for each risk rating and adding losses based upon separate loan evaluations and identified other risks. The actual allowance for loan losses is compared to this range to ascertain that it is situated within the range. At December 31, 2010, the "low" and "high" allowance determination resulted in a "low" allowance of 1.52% of loans and a "high" allowance of 1.77% of loans. The actual allowance for loan losses was 1.72% of loans.

The allowance for loan losses represents 1.72% and 1.28% of loans receivable at December 31, 2010 and December 31, 2009, respectively. The increase in the allowance for loan losses as a percent of loans at December 31, 2010 as compared to December 31, 2009 resulted from increased specific reserves as well as general reserves reflecting the effects of the current economic conditions on the Company's borrowers. During 2010, there were no significant changes made in the estimation methods or assumptions used in the determination of the allowance for loan losses at December 31, 2010 as compared to December 31, 2009 apart from changes to loss factors based on management's perception of economic environmental factors and trends. In addition, on at least a quarterly basis, the recorded allowance for loan losses (as a percent of loans) is compared to peer group levels to ascertain the reasonableness of the estimate. Management believes that the allowance for loan losses is adequate at December 31, 2010.

The activity in the allowance for credit losses for the years ended December 31 is shown in the following table:

<i>(In thousands)</i>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Allowance for loan losses:					
Beginning balance	\$2,380	\$1,860	\$1,665	\$1,614	\$1,615
Charge-offs - Commercial and Industrial loans	(1,140)	(500)	(179)	(72)	(226)
Charge-offs - SBA loans	(447)	(463)	(318)	-	-
Recoveries - Commercial and Industrial loans	26	-	45	78	-
Recoveries - SBA loans	25	5	-	-	-
Real estate loans:					
Charge-offs - Owner occupied	-	(138)	-	-	-
Charge-offs - Non owner occupied	(386)	-	-	-	-
Net recoveries (charge-offs)	<u>(1,922)</u>	<u>(1,096)</u>	<u>(452)</u>	<u>6</u>	<u>(226)</u>
Provision for loan losses	<u>2,716</u>	<u>1,616</u>	<u>647</u>	<u>45</u>	<u>225</u>
Ending balance	<u>\$3,174</u>	<u>\$2,380</u>	<u>\$1,860</u>	<u>\$1,665</u>	<u>\$1,614</u>
Net recoveries (charge-offs) to average loans	(1.04%)	(0.65%)	(0.33%)	0.00%	(0.26)%

During 2010, loans to twelve borrowers and related entities totaling \$1.9 million were determined to be uncollectible and were charged-off. Of this amount, \$447 thousand represented the uninsured portion of SBA loans. The foreclosure of one commercial real estate loan resulted in a charge-off of \$138 thousand in 2009. During 2009 nine commercial loans totaling \$1.1 million, of which \$463 thousand were the uninsured portion of SBA loans, were determined to be uncollectible and charged-off. Recoveries of \$51 thousand and \$5 thousand previously charged-off were realized during 2010 and 2009, respectively.

The following table shows the allocation of the allowance for credit losses at the dates indicated. The allocation of portions of the allowance to specific categories of loans is not intended to be indicative of future losses, and does not restrict the use of the allowance to absorb losses in any category of loans.

#### ALLOWANCE FOR LOAN LOSSES BY CATEGORY

	<u>December 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Allocated Allowance Amount</u>	<u>% of Loans in each Category to Total Loans Receivable</u>	<u>Allocated Allowance Amount</u>	<u>% of Loans in each Category to Total Loans Receivable</u>
<i>(In thousands)</i>				
Commercial and Industrial loans	\$1,023	24.1%	\$1,165	33.9%
SBA loans	627	4.2%	733	3.1%
Real estate loans:				
Owner occupied	682	46.2%	199	39.5%
Non owner occupied	715	25.5%	237	23.5%
Total real estate loans	<u>1,397</u>	<u>71.7%</u>	<u>436</u>	<u>63.0%</u>
Unallocated to loan type	<u>127</u>	<u>-</u>	<u>46</u>	<u>-</u>
	<u>\$3,174</u>	<u>100.0%</u>	<u>\$2,380</u>	<u>100.0%</u>

	<u>December 31, 2008</u>		<u>December 31, 2007</u>	
	<u>Allocated Allowance Amount</u>	<u>% of Loans in each Category to Total Loans Receivable</u>	<u>Allocated Allowance Amount</u>	<u>% of Loans in each Category to Total Loans Receivable</u>
<i>(In thousands)</i>				
Commercial and Industrial loans	\$789	35.2%	\$941	37.9%
SBA loans	749	3.9%	343	4.4%
Real estate loans:				
Owner occupied	212	39.3%	217	44.6%
Non owner occupied	105	21.6%	56	13.1%
Total real estate loans	317	60.9%	273	57.7%
Unallocated to loan type	5	-	108	-
	<u>\$1,860</u>	<u>100.0%</u>	<u>\$1,665</u>	<u>100.0%</u>

	<u>December 31, 2006</u>	
	<u>Allocated Allowance Amount</u>	<u>% of Loans in each Category to Total Loans Receivable</u>
<i>(In thousands)</i>		
Commercial and Industrial loans and SBA loans*	\$ 642	46.8%
Real estate loans*	972	53.2%
Unallocated to loan type	-	-
	<u>\$1,614</u>	<u>100.0%</u>

\* Delineation of loans by specific type not available

The Company has also established a reserve for unfunded commitments that is recorded by a provision charged to other expenses. At December 31, 2010 the balance of this reserve was \$60 thousand. The reserve, based on evaluations of the collectability of loans, is an amount that management believes will be adequate over time to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

### Loan Quality

In its lending activities, the Company seeks to develop sound credits with customers who will grow with the Company. There has not been an effort to rapidly build the portfolio and earnings at the expense of asset quality. At the same time, the extension of credit inevitably carries some risk of non-payment. Loans on which the accrual of interest has been discontinued amounted to \$7.3 million and \$2.7 million at December 31, 2010 and 2009, respectively. During the fourth quarter of 2010, the borrowers of several larger commercial real estate loans experienced significant financial difficulty as the result of declines in their business operations. Most of these loans were owner occupied real estate loans. Interest that would have been accrued under the terms of these loans totaled \$324 thousand and \$164 thousand for the years ended December 31, 2010 and 2009, respectively. No interest was included in income in respect to such loans after being placed in non-accrual status as prior uncollected interest was reversed from income. The Company has no commitments to loan additional funds to the borrowers of impaired or non-accrual loans. The accrual of interest on loans is discontinued when a scheduled loan payment has become over ninety days past due.

Non-accrual loan activity is summarized as follows for the years ended December 31:

<i>(In thousands)</i>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Balance at the beginning of the year	\$2,734	\$5,819	\$1,125	\$628	\$592
New loans placed on non-accrual	7,846	2,427	5,046	569	262
Less:					
Loan restored to interest earning status	-	1,266	-	-	-
Paid-off: sold in foreclosure	-	576	-	-	-
Other real estate owned additions	945	2,462	-	-	-
Charge offs	1,973	1,101	236	72	226
Other including payments received	379	107	116	-	-
Balance at the end of the year	<u>\$7,283</u>	<u>\$2,734</u>	<u>\$5,819</u>	<u>\$1,125</u>	<u>\$628</u>

Comparative information regarding the non-accrual loans at December 31, 2010 and December 31, 2009 follows:

<i>(In thousands)</i>	<u>2010</u>	<u>2009</u>
Loans classified as impaired with specific reserves	\$6,438	\$2,519
Loans classified as impaired with no specific reserves	845	215
Total loans classified as impaired	<u>\$7,283</u>	<u>\$2,734</u>
Allowance for loan losses on impaired loans	\$1,521	\$922
Average balance of impaired loans during year	\$3,419	\$4,559

Non-accrual loans with specific reserves at December 31, 2010 are comprised of \$963 thousand of commercial loans, \$388 thousand of SBA loans, \$3.1 million of owner occupied real estate loans and \$2 million of non-owner occupied real estate loans. All of these loans are in various stages of collection.

The following table shows the amounts of non-performing assets on the dates indicated:

<i>In thousands</i>	<u>December 31:</u>				
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Nonaccrual loans:					
Commercial and Industrial	\$963	\$2,280	\$1,676	\$868	\$628
SBA	388	454	542	257	
Real estate – owner occupied	3,956	-	3,601	-	-
Real estate - non owner occupied	1,976	-	-	-	-
Accrual loans –past due 90 days and over	-	-	-	-	-
Total non-performing loans	<u>7,283</u>	<u>2,734</u>	<u>5,819</u>	<u>1,125</u>	<u>628</u>
Other real estate owned	<u>3,324</u>	<u>2,462</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total non-performing assets	<u>\$10,607</u>	<u>\$5,196</u>	<u>\$5,819</u>	<u>\$1,125</u>	<u>\$628</u>
Accruing Troubled Debt Restructured loans	\$3,985	\$1,263	-	-	-
Allowance for loan losses to total non-performing loans	43.6%	87.1%	32.0%	148.0%	257.0%
Non-performing loans to total loans	3.94%	1.47%	3.80%	0.89%	0.65%
Non-performing assets to total assets	5.22%	2.59%	3.49%	0.76%	0.44%

The Company had no loans past due over ninety days and still accruing interest at December 31, 2010 or December 31, 2009. No interest was included in net income in respect of impaired loans after they were placed on non-accrual status. The accrual of interest on loans is discontinued when, in management's opinion, the full collection of principal or interest is in doubt, or a scheduled loan payment has become over ninety days past due.

Management has not identified any other loans which it has serious doubts as to the ability of the borrower to comply with the present repayment terms.

Real estate acquired through or in the process of foreclosure is recorded at fair value less estimated disposal costs. The Company periodically evaluates the recoverability of the carrying value of the real estate acquired through foreclosure using current estimates of fair value when it has reason to believe that real estate values have declined for the particular type and location of the real estate owned. In the event of a subsequent decline, an allowance would be provided to reduce real estate acquired through foreclosure to fair value less estimated disposal cost. The Company acquired through foreclosure a commercial building with a fair value of approximately \$653 thousand in March 2009. Because of the decline in real estate values in this building's area, the Company has reduced the carrying value of this owned building by \$153 thousand during 2010 with an offsetting increase in non-interest expenses. The Company acquired another commercial building by foreclosure in November 2009 with a fair value of approximately \$1.8 million. The Company is leasing these properties to others under short term leases as it offers them for sale. The Company also acquired through foreclosure five residential properties, comprised of four condominium units and one single family residence, during the fourth quarter of 2010.

Further information regarding the Company's loan portfolio, including nonaccrual loans and Troubled Debt Restructured loans, is contained in Note 4 - Loans and Allowance for Loan Losses in the accompanying Consolidated Financial Statements.

### Investments

The Company does not maintain an investment securities portfolio as the portfolio was reduced to zero in December 2009 as the sole security in the portfolio was redeemed. The Company is maintaining its liquid assets in its account at the Federal Reserve and fully FDIC insured certificates of deposits in other financial institutions for safety and liquidity purposes. The Company will make additional securities investments when interest rates have increased and the Company has sufficient excess liquidity

All investments securities, if any are held, are classified as "available for sale" and are reflected in the statement of financial condition at their fair value.

The table below presents the composition and carrying amounts of securities in the investment securities portfolio, all of which are classified as available-for-sale and thus recorded at fair value, and investments in restricted stock, recorded at cost, as of December 31, 2010, 2009 and 2008.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<i>(In thousands)</i>			
Investment securities:			
U.S Treasuries	\$ -	\$ -	\$3,086
Restricted stock:			
Federal Reserve Bank stock	465	465	405
Corporate equities	62	62	62
Total securities	<u>\$527</u>	<u>\$527</u>	<u>\$3,553</u>

The restricted stocks do not have maturity dates and are carried at cost on the Company's books. The Company received a semi-annual cash dividend on the Federal Reserve Bank stock that it owns at a 6% annual rate. Earnings on the other restricted stock are immaterial.

At December 31, 2010, there were no issuers whose securities owned by the Company have a book or market value exceeding ten percent of the Company's stockholders' equity.

### Deposits and Liquidity Management

The Company currently has no business other than that of the Bank and does not currently have any material funding commitments unrelated to that business. The Bank's principal sources of funds for loans, investments and general operations are deposits from its primary market area, principal and interest payments on loans, and proceeds from maturing investment securities. Its principal funding commitments are for the origination or purchase of loans and the payment of maturing deposits, and the payment for checks drawn upon it. The Bank's most liquid assets are cash and cash equivalents, which are cash on hand, amounts due from other financial institutions including the Federal Reserve and Federal funds sold, if any. The levels of such

assets are dependent on the Bank's lending, investment and operating activities at any given time. The variations in levels of liquid assets are influenced by deposit flows and loan demand, both current and anticipated.

The Company's deposits consist of demand deposits, NOW accounts, money market accounts, savings accounts and certificates of deposit. These accounts provide the Company with a relatively stable source of funds. The Company generally targets larger deposit relationships by offering competitive interest rates on certificates of deposit of \$75 thousand or more in our local markets. Deposits from the local market areas are supplemented with out-of-area deposits comprised of funds obtained through the use of deposit listing services (national market certificates of deposit), deposits obtained through the use of brokers and through the Certificates of Deposit Account Registry Service (CDARS) program. As a result, a substantial portion of our deposits, 24.5% at December 31, 2010 and 37.8% at December 31, 2009, are comprised of certificate of deposit accounts of \$100 thousand or more. Total certificates of deposit represent 68.5% of deposits at December 31, 2010 and 77.9% of deposits at December 31, 2009.

The Company's reliance on certificates of deposit, including the use of larger denomination certificates of deposit and brokered deposits, facilitates funding the growth in the loan portfolio. The Company has relied on certificates of deposit as a primary funding source and has used larger certificates of deposits as a funding source since its inception. While sometimes requiring higher interest rates, such funds carry lower acquisition costs (marketing, overhead costs) and can be obtained when required at the maturity dates desired. Substantially all of the deposit accounts over \$100 thousand are fully insured by the FDIC through differing ownership and trustee arrangements and the insured deposit limit of \$250 thousand. All of the brokered deposits and national market deposits are fully insured by the FDIC. This insurance and the strong capital position of the Company reduce the likelihood of large deposit withdrawals for reasons other than interest rate competition. Interest rates on these deposits can be, but are not always, higher than other deposits products. There is, however, a risk that some deposits would be lost if rates were to increase and the Company elected not to remain competitive with its own deposit rates. Under those conditions, the Company believes that it is positioned to use other sources of funds, such as borrowing on its unsecured credit facilities with other banks or the sale of loans.

At December 31, 2010, deposits totaled \$180.1 million as compared to \$178.6 million at December 31, 2009. The \$1.5 million increase in deposits resulted from the \$2.7 million increase in noninterest bearing deposits, the \$12.6 million increase in savings accounts balance, the decline of \$15.8 million in the amount of certificates of deposit and the increase of \$2 million in other deposit accounts. There were \$33.1 million and \$44.8 million of brokered certificates of deposit at December 31, 2010 and December 31, 2009, respectively. Included in these brokered deposits at December 31, 2010 are \$8.3 million of certificates of deposits received in exchange for the placement of the Company's customers' deposit funds with other financial institutions under the CDARS program. Included in deposits are deposits of officers and directors (and their affiliated entities) of \$13.0 million at December 31, 2010.

As a result of the enactment of the Dodd-Frank Act, banks are no longer prohibited from paying interest on demand deposit accounts, including those from businesses, effective in July 2011. If the Company starts to pay interest on these accounts, its net interest margin would decline. It is not clear what effect the elimination of this prohibition will have on the Bank's interest expense, allocation of deposits, deposit pricing, loan pricing, net interest margin, ability to compete, ability to establish and maintain customer relationships, or profitability.

Deposits are summarized below as of dates indicated:

	December 31,	%	December 31:		
	2010	Change	2009	2008	2007
<i>In thousands</i>					
Non-interest bearing deposits	\$23,760	13.0%	\$21,024	\$23,599	\$19,246
Interest bearing deposits:					
NOW accounts	1,279	313.9%	\$309	\$1,247	\$2,440
Money Market accounts	8,824	12.5%	7,841	13,049	16,268
Savings accounts	22,962	121.2%	10,379	148	36
Certificates of deposit accounts:					
Less than \$100,000	79,209	10.6%	71,593	37,539	11,383
\$100,000 or more	44,076	(34.7%)	67,499	69,659	74,035
Total interest bearing deposits	156,350	(0.8%)	157,621	121,642	104,162
Total deposits	\$180,110	0.8%	\$178,645	\$145,241	\$123,408

The table below shows the maturities of certificates of deposit:

	<b>December 31, 2010</b>	
	<b>CDs of \$100,000 or more</b>	<b>All CDs</b>
<i>In thousands</i>		
Three months or less	\$9,228	\$21,682
Over three months to six months	15,492	28,124
Over six months to twelve months	7,486	29,325
Over twelve months through three years	9,058	36,497
Over three years	2,812	7,657
Total	<u>\$44,076</u>	<u>\$123,285</u>

The table below shows the source of the Company's certificate of deposits (CDs) as well as the amount equal to or greater than \$100,000 at December 31, 2010:

<b>Source</b>	<b>CDs with balances of less than \$100,000</b>	<b>CDs with balances of \$100,000 or greater</b>	<b>Total</b>
<i>(thousands)</i>			
Local markets	\$7,997	\$30,783	\$38,780
National market	50,990	448	51,438
CDARS program:			
Customers' funds	450	7,812	8,262
Proprietary funding	5,172	3,830	9,002
Other brokered funds	14,600	1,203	15,803
Total	<u>\$79,209</u>	<u>\$44,076</u>	<u>\$123,285</u>

CDARS program funding is reflected in the above schedule as "Customers' funds" and "Proprietary funding". The Company, acting as agent for its customers, places customer funds in other financial institutions under the program up to the FDIC insurance limit. Under the CDARS program, other financial institutions place deposits in the Company for the same amount of the customers' funds. "Customers' funds" are comprised of deposits from these customer transactions. The Company can obtain funding under the CDARS program by bidding for deposit funds without customers' involvement. This "Proprietary funding" results in traditional brokered deposits.

The Company's short term liquid assets of cash and cash equivalents were \$13.7 million, or 6.8% of assets at December 31, 2010 and \$10.5 million, or 5.2%, at December 31, 2009. Continued growth in deposits will be required to fund any loan growth. Accordingly, the Company intends to maintain a competitive posture in its deposit interest rate offerings. While adequate liquidity is imperative, excess liquidity has the effect of a lower interest margin, as funds not invested in loans are placed in short-term investments that earn significantly lower yields.

The Bank has available unsecured credit facilities for short-term liquidity needs from financial institutions of \$8,500,000 at December 31, 2010 and 2009. There were no borrowings outstanding under these credit arrangements at December 31, 2010 and 2009.

The Company believes its levels of liquidity are adequate to conduct the business of the Company and Bank.

### **Stockholders' Equity**

Total stockholders' equity was \$22.4 million at December 31, 2010 representing an increase of \$1.4 million from December 31, 2009. The increase from December 31, 2009 was attributable to the net income of the Company of \$1.4 million.

At December 31, 2010, the Company and the Bank continued to exceed all regulatory capital requirements to be considered “well capitalized” under federal regulations. The Company believes its level of capital is adequate to conduct the business of the Company and Bank.

## RESULTS OF OPERATIONS

Net income for the year ended December 31, 2010 was \$1.4 million (\$0.78 basic and diluted earnings per share), an increase of \$745 thousand, or 109.9%, from the net income of \$678 thousand (\$0.37 basic earnings and diluted earnings per share) during 2009. Net income increased in 2010 as compared to 2009 primarily because of the increase in net interest income of \$2.1 million and the increase in non-interest income of \$374 thousand. These increases were offset by increased provisions for loan losses of \$1.1 million and increased non-interest expenses of \$119 thousand (all amounts are before tax effects).

Return on equity, return on assets and ratio of equity to assets are as follows:

	<b>Year Ended December 31,</b>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Return on Average Equity	8.61%	4.54%	1.92%
Return on Average Earning Assets	0.94%	0.51%	0.25%
Ratio of Average Equity to Average Assets	10.62%	11.03%	12.86%

### Net Interest Income and Net Interest Margin

Net interest income is the difference between income on assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investments; the expense associated with interest bearing deposits and customer repurchase agreements and other borrowings is the cost of funds. Non-interest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

Total interest income increased by \$632 thousand or 5.3% to \$12.6 million for the year ended December 31, 2010 as compared to \$11.9 million in 2009. This increase was primarily attributable to the growth in average earning assets. The increase attributable to this growth was somewhat offset by the reduction in yield on earning assets. Average interest earning assets increased by \$17.9 million or 6.2% during 2010 as compared to 2009; however, the yield on earning assets decreased to 6.24% in 2010 from 6.51% in 2009.

Interest expense decreased by \$1.5 million, or 31.8% to \$3.1 million for the year ended December 31, 2010 as compared \$4.6 million in 2009. This decrease was attributable to the decrease in the cost of deposits during 2010 to 1.94% from 3.19% in 2009. This decrease resulted primarily from the re-pricing or replacement of higher rate certificates of deposit as they matured during 2010. The effect of the reduction in the cost of deposits was partially offset by the increase in average interest bearing liabilities of \$17.4 million, or 12.1%.

Net interest income was \$9.4 million in 2010, a \$2.1 million increase from the \$7.4 million net interest income in 2009, a 28.5% increase. The increase in net interest income results primarily from the growth in earning assets and the reduction in interest costs resulting from the re-pricing of the interest bearing liabilities during 2010.

The following table provides information for the designated periods with respect to average balances, income and expense and annualized yields and costs associated with various categories of interest earning assets and interest bearing liabilities for the past three years. Non-accrual loans have been included in loans receivable in the tables. The table includes a measurement of spread and margin. Interest spread is the mathematical difference between the average interest yield on interest earning assets and average interest paid on interest bearing liabilities. Interest margin is the net interest yield on interest earning assets and is derived by dividing net interest income by average interest earning assets.

**AVERAGE BALANCES, RATES AND INTEREST INCOME AND EXPENSE**

Years Ended

(In thousands)	2010			2009		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Assets:</b>						
Interest Earning Assets:						
Loans receivable	\$184,036	\$12,474	6.78%	\$169,888	\$11,791	6.94%
Investment securities	527	28	5.31%	2,391	108	4.52%
Interest bearing deposits	16,619	58	0.35%	10,127	26	0.26%
Federal funds sold	32	-	0.00%	949	3	0.32%
Total Interest Earning Assets	<u>201,214</u>	<u>12,560</u>	<u>6.24%</u>	<u>183,355</u>	<u>11,928</u>	<u>6.51%</u>
Less allowance for loan losses	(2,461)			(2,146)		
Non-Interest Earning Assets	<u>8,455</u>			<u>5,830</u>		
Total Assets	<u>\$207,208</u>			<u>\$187,039</u>		
<b>Liabilities and Stockholders' Equity:</b>						
Interest Bearing Liabilities:						
Interest bearing demand deposits	\$746	\$1	0.07%	\$1,600	\$1	0.06%
Money market deposit accounts	7,946	36	0.45%	11,942	63	0.53%
Savings accounts	17,465	223	1.28%	3,942	71	1.80%
Certificates of deposit	135,237	2,871	2.12%	126,451	4,452	3.52%
Total Interest Bearing Liabilities	<u>161,394</u>	<u>3,131</u>	<u>1.94%</u>	<u>143,935</u>	<u>4,587</u>	<u>3.19%</u>
Non-Interest Bearing Liabilities:						
Demand deposits	22,996			21,413		
Other	807			1,058		
Total Liabilities	<u>185,197</u>			<u>166,406</u>		
Stockholders' Equity	<u>22,011</u>			<u>20,633</u>		
Total Liabilities and Equity	<u>\$207,208</u>			<u>\$187,039</u>		
Net Interest Income		<u>\$9,430</u>			<u>\$7,341</u>	
Net Interest Spread			<u>4.30%</u>			<u>3.32%</u>
Net Interest Margin			<u>4.69%</u>			<u>4.00%</u>

*Yields on securities are calculated based on amortized cost. Loans receivable include nonaccrual loans.*

**AVERAGE BALANCES, RATES AND INTEREST INCOME AND EXPENSE**

Year Ended

(In thousands)	2008		
	Average Balance	Interest	Yield/Rate
<b>Assets:</b>			
Interest Earning Assets:			
Loans receivable	\$138,166	\$10,130	7.31%
Investment securities	7,718	341	4.41%
Interest bearing deposits	306	8	2.61%
Federal funds sold	8,654	171	1.97%
Total Interest Earning Assets	<u>154,844</u>	<u>10,650</u>	<u>6.86%</u>
Less allowance for loan losses	(1,738)		
Non-Interest Earning Assets	<u>5,971</u>		
Total Assets	<u>\$159,077</u>		
<b>Liabilities and Stockholders' Equity:</b>			
Interest Bearing Liabilities:			
Interest bearing demand deposits	\$1,373	\$3	0.22%
Money market deposit accounts	17,852	321	1.79%
Savings accounts	91	-	-
Certificates of deposit	97,124	4,729	4.86%
Securities sold under agreements to repurchase	2,651	302	1.13%
Total Interest Bearing Liabilities	<u>119,091</u>	<u>5,083</u>	<u>4.26%</u>

	<b>2008</b>		
	<b>Average Balance</b>	<b>Interest</b>	<b>Yield/ Rate</b>
<i>Continued (In thousands)</i>			
Non-Interest Bearing Liabilities:			
Demand deposits	18,608		
Other	917		
Total Liabilities	<u>138,616</u>		
Stockholders' Equity	<u>20,461</u>		
Total Liabilities and Equity	<u>\$159,077</u>		
Net Interest Income		<u>\$5,567</u>	
Net Interest Spread			<u>2.60%</u>
Net Interest Margin			<u>3.59%</u>

*Yields on securities are calculated based on amortized cost. Loans receivable include nonaccrual loans.*

The increase in net interest margin and net interest spread in 2010 as compared to 2009 primarily results from the Bank's reduction of cost of deposits as the result of re-pricing or replacing higher rate certificates of deposit as they matured during 2010.

### Rate/Volume Analysis of Net Interest Income

The following table sets forth certain information regarding changes in interest income and interest expense of the Company for the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (i) changes in volume (change in volume of the asset multiplied by the prior year's rate) and (ii) changes in rates (change in rate multiplied by the current year's volume).

	<b>RATE/VOLUME ANALYSIS</b>					
	<b>2010 vs. 2009</b>			<b>2009 vs. 2008</b>		
	<b>Increase (Decrease)</b>			<b>Increase (Decrease)</b>		
	<b>Due to</b>			<b>Due to</b>		
<i>In thousands</i>	<b>Volume</b>	<b>Rate</b>	<b>Total</b>	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
<b>Interest-Earning Assets:</b>						
Federal funds sold	\$(3)	\$-	\$(3)	\$(152)	\$(16)	\$(168)
Interest bearing deposits	18	14	32	18	-	18
Investment portfolio	(78)	(2)	(80)	(258)	24	(234)
Loans receivable	982	(299)	683	2,325	(664)	1,661
<b>Net Change in Interest Income</b>	<u>919</u>	<u>(287)</u>	<u>632</u>	<u>1,933</u>	<u>(656)</u>	<u>1,277</u>
<b>Interest Bearing Liabilities:</b>						
Interest bearing deposits	602	(2,059)	(1,457)	1,193	(1,660)	(467)
Other borrowed funds	-	-	-	-	-	-
Securities sold under agreements to repurchase	-	-	-	(30)	-	(30)
<b>Net Change in Interest Expense</b>	<u>602</u>	<u>(2,059)</u>	<u>(1,457)</u>	<u>1,163</u>	<u>(1,660)</u>	<u>(497)</u>
<b>Change in Net Interest Income</b>	<u>\$317</u>	<u>\$1,772</u>	<u>\$2,089</u>	<u>\$770</u>	<u>\$1,004</u>	<u>\$1,774</u>

### Provision for Loan Losses

The provision for loan losses represents the expense recognized to fund the allowance for loan losses. The loan loss expense of \$2.7 million for the year ended December 31, 2010 reflected an increase of \$1.1 million from the provision of \$1.6 million for the year ended December 31, 2009. This increase is the result of specific valuation reserves of \$2.0 million on loans experiencing repayment problems as well as increases in general reserves in recognition of adverse economic conditions that are effecting the Company's borrowing customers.

Additionally, the Bank has established a reserve for unfunded commitments that is recorded by a provision charged to other expenses. The balance of this reserve was \$60 thousand and \$54 thousand at December 31, 2010 and 2009, respectively. The reserve is an amount that management believes will be adequate over time to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

### **Non-interest Income**

Non-interest income principally consists of gains from the sale of the guaranteed portion of Small Business Administration (SBA) loans and from deposit account services charges. For the year ended December 31, 2010, gains on sales of the guaranteed portion of SBA loans was \$615 thousand as compared to \$257 thousand during 2009. Generally, the Company desires to sell the guaranteed portion of most additional SBA loans resulting in a continuing stream of income that may vary significantly from quarter to quarter, depending in part upon the volume of loans actually sold. Deposit account service charges and other income amounted to \$479 thousand during the year ended December 31, 2010 as compared to \$463 thousand in 2009, reflecting an increase in the number of accounts subject to service charges on such deposit accounts. This increase was somewhat offset by declines in net rental income from rental of other real estate owned properties caused by additional expenses to maintain the properties. When possible, the Company leases OREO to others while awaiting final resolution of the properties. During 2010 and 2009, rental income less expenses totaled \$3 thousand and \$19 thousand, respectively.

### **Non-interest Expense**

Total non-interest expenses increased by \$119 thousand during the 2010 as compared to those in 2009, a 2.24% increase. The 2009 expenses included \$86 thousand of a FDIC special insurance assessment whereas no special assessment was charged during 2010. The 2010 expenses reflect \$153 thousand of provision for declining value of other real estate owned; no such provision was expensed in 2009. In each year, salary and benefit expense was the largest component of non-interest expenses: \$3.0 million in 2010 and \$2.9 million in 2009. The Company continues to control its expenses even during periods of asset growth.

### **Income Taxes**

The Company uses the liability method of accounting for income taxes as required by ASC 740, *Accounting for Income Taxes*. Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the enacted rates that will be in effect when these differences reverse. Income tax expense for 2010 was \$951 thousand, 40.0% of pretax income and \$452 thousand, 40.0% of pretax income in 2009.

### **Off-Balance Sheet Arrangements**

With the exception of the Bank's obligations in connection with its irrevocable letters of credit and loan commitments, the Bank has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Bank's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources, that is material to investors. For additional information on off-balance sheet arrangements, please see Note 9 to the Consolidated Financial Statements.

### **Interest Rate Risk Management**

Banks and other financial institutions are dependent upon net interest income, the difference between interest earned on interest earning assets and interest paid on interest bearing liabilities. Changes in interest rates inevitably have an impact on interest income. GAP, a measure of the difference in volume between interest bearing assets and interest bearing liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indicator of the rate sensitivity of the Company. A positive GAP indicates the degree to which the volume of repriceable assets exceeds repriceable liabilities in particular time periods. The Company has a negative GAP, a liability sensitive position, for a one year period which would generally indicate decreased net interest income in a rising rate environment and increased net interest income in a declining rate environment. However, this measurement of interest rate risk sensitivity represents a static position as of a single day and is not necessarily indicative of the interest rate risk position at any other point in time, does not take into account the sensitivity of yields and costs of specific assets and liabilities to changes in market rates, and does not take into account the specific timing of, or the extent to which, changes to a specific asset or liability will occur. Further this measurement does not take into account the effect of competitive factors on interest rates, and the effect of changes in interest rates on the capacity of customers to meet their obligations. The Company will be

addressing the current negative GAP level for the purpose of reducing its exposure to interest rate changes, although there can be no assurance that the Company's efforts will be successful in reducing its exposure to interest rate changes, or that it will correctly predict the timing and magnitude of changes in interest rates.

#### RATE SENSITIVITY ANALYSIS (Static GAP)

December 31, 2010

<i>(In thousands)</i>	<u>0-3</u> <u>Months</u>	<u>4-12</u> <u>Months</u>	<u>&gt;1-3</u> <u>Years</u>	<u>&gt;3&lt;5</u> <u>Years</u>	<u>5 YRS +</u>	<u>Total</u>
<b><u>Interest earning assets</u></b>						
Interest bearing deposits	\$12,289	\$ -	\$ -	\$ -	\$ -	\$12,289
Loans*	61,060	13,115	56,384	45,972	1,069	177,600
Total	<u>73,349</u>	<u>13,115</u>	<u>56,384</u>	<u>45,972</u>	<u>1,069</u>	<u>189,889</u>
<b><u>Interest bearing liabilities</u></b>						
Savings/Money						
Market/NOW	33,065	-	-	-	-	33,065
Certificates of deposit	21,681	57,450	36,497	7,657	-	123,285
Total	<u>54,746</u>	<u>57,450</u>	<u>36,497</u>	<u>7,657</u>	<u>-</u>	<u>156,350</u>
<b>GAP:</b>						
Period	<u>\$18,603</u>	<u>(44,335)</u>	<u>19,887</u>	<u>38,315</u>	<u>1,069</u>	<u>\$33,539</u>
Cumulative		<u>\$(25,732)</u>	<u>\$(5,845)</u>	<u>\$32,470</u>	<u>\$33,539</u>	

\*Loan amounts above exclude \$7.3 million of loans on non-interest accrual.

#### Capital Resources and Adequacy

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. The adequacy of the Company's capital is reviewed by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses. The ability of the Company to grow is dependent on the availability of capital with which to meet regulatory capital requirements. To the extent the Company is successful it may need to acquire additional capital through the sale of additional common stock, other qualifying equity instruments, such as trust preferred securities, or subordinated debt. There can be no assurance that additional capital will be available to the Company on a timely basis or on attractive terms.

Under recent guidance by the federal banking regulators, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital. It is possible that we may be required to maintain higher levels of capital than we would otherwise be expected to maintain as a result of our levels of construction, development and commercial real estate loans, which may require us to obtain additional capital.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company will be subject to the capital guidelines when its assets exceed \$500 million, it engages in certain highly leveraged activities or it has publicly issued debt. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. At December 31, 2010, the Company and the Bank were in full compliance with these guidelines, as follows:

	<u>December 31,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>	<u>Minimum Ratios</u>	
			<u>To be “Adequately Capitalized”</u>	<u>To be “Well Capitalized”</u>
Total capital:				
Company	13.1%	12.3%	8.0%	N/A
Bank	12.3%	11.5%	8.0%	10.0%
Tier I:				
Company	11.8%	11.0%	4.0%	N/A
Bank	11.1%	10.2%	4.0%	6.0%
Leverage Total:				
Company	11.0%	10.4%	4.0%	N/A
Bank	10.3%	9.7%	4.0%	5.0%

Significant further growth of the Company may be limited because the current level of capital will not support rapid short term growth while maintaining regulatory capital expectations. Loan portfolio growth will need to be funded by increases in deposits as the Company has limited amounts of on-balance sheet assets deployable into loans. Growth will depend upon Company earnings and/or the raising of additional capital.

### Market for Common Stock and Dividends

The Company’s Common Stock is listed for trading on the NASDAQ Capital Market under the symbol “CFMB.” The following table sets forth the high and low sales prices for the Common Stock during each calendar quarter of 2010 and 2009. These quotations do not necessarily reflect the intrinsic or market values of the Common Stock. As of December 31, 2010, there were 1,820,548 shares of Common Stock outstanding, held by approximately 300 shareholders of record.

	<u>2010</u>		<u>2009</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First Quarter	\$7.75	5.75	\$5.60	4.05
Second Quarter	9.40	7.60	6.25	4.50
Third Quarter	9.76	8.29	6.75	5.26
Fourth Quarter	10.68	8.50	6.25	5.08

From its organization through December 31, 2010 the Company has not paid any dividends. The payment of dividends by the Company may depend largely upon the ability of the Bank, its sole operating business, to declare and pay dividends to the Company. Regulations of the Federal Reserve Board and Maryland law place limits on the amount of dividends the Bank may pay to the Company without prior approval. Prior regulatory approval is required to pay dividends which exceed the Bank’s net profits for the current year plus its retained net profits for the preceding two calendar years, less required transfers to surplus. Additionally, without prior approval, the Bank may pay dividends only out of its undivided profits. Even if the Bank and the Company have earnings in an amount sufficient to pay dividends, the Board of Directors may determine to retain earnings for the purpose of funding the growth of the Company and the Bank.

### Financial Statements

The audited financial statements for the Company as of December 31, 2010 and 2009 and for each of the years then ended are included herewith.