SOUTHERN FIRST BANCSHARES INC
Form 10-Q
November 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 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

Southern First Bancshares, Inc.
(Exact name of registrant as specified in its charter)

South Carolina	58-2459561
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
100 Verdae Boulevard, Suite 100 Greenville, S.C.	29606
(Address of principal executive offices)	(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 [X] 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 [X]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 2,946,456 shares of common stock, $.01 par value per share, were issued and outstanding as of October 17, 2007.

SOUTHERN FIRST BANCSHARES, INC.
PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Assets		
Cash and due from banks	$ 9,153,673	$ 9,112,675
Federal funds sold	18,313,901	7,466,458
Investment securities available for sale	65,223,677	50,199,513
Investment securities held to maturity- (fair value $14,685,693 and $16,576,673)	15,199,166	17,044,531
Other investments, at cost	8,292,500	7,060,100
Loans, net of allowance for loan losses	478,250,361	397,233,829
Property and equipment, net	5,109,183	6,450,854
Accrued interest receivable	3,036,557	2,381,336
Other real estate owned	363,733	1,012,030
Bank owned life insurance	8,811,402	8,142,947
Deferred income taxes	1,960,719	1,907,966
Other assets	555,746	1,331,712
Total assets	$ 614,270,618	$ 509,343,951
Liabilities		
Deposits	$ 415,063,727	$ 345,504,076
Official checks outstanding	1,257,952	4,131,107
Repurchase agreements	10,000,000	-
Federal Home Loan Bank advances	133,500,000	108,500,000
Junior subordinated debentures	13,403,000	13,403,000
Accrued interest payable	2,597,877	2,278,154
Accounts payable and accrued expenses	1,356,552	944,168
Total liabilities	577,179,108	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, 2,946,456 and 2,933,868 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively	29,465	29,339
Non-vested restricted stock	(43,936)	-
Additional paid-in capital	30,971,882	30,846,538
Accumulated other comprehensive income (loss)	(255,687)	(16,465)
Retained earnings	6,389,786	3,724,034
Total shareholders' equity	37,091,510	34,583,446
Total liabilities and shareholders' equity	$ 614,270,618	$ 509,343,951

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

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

	For the three months ended September 30, 2007	2006
	(Unaudited)	
Interest income		
Loans	$ 9,095,562	$ 7,266,867
Investment securities	1,107,560	766,990
Federal funds sold	77,278	100,211
Total interest income	10,280,400	8,134,068
Interest expense		
Deposits	4,015,307	3,068,681
Borrowings	1,842,256	1,371,967
Total interest expense	5,857,563	4,440,648
Net interest income	4,422,837	3,693,420
Provision for loan losses	450,000	400,000
Net interest income after provision for loan losses	3,972,837	3,293,420
Noninterest income		
Loan fee income	45,364	29,683
Service fees on deposit accounts	111,345	66,772
Income from bank owned life insurance	96,000	55,000
Real estate owned activity	(70,129)	(88,903)
Other income	64,865	50,375
Total noninterest income	247,445	112,927
Noninterest expenses		
Compensation and benefits	1,547,014	1,085,922
Professional fees	130,621	126,386
Marketing	139,018	108,067
Insurance	116,349	48,068
Occupancy	336,572	161,981
Data processing and related costs	310,319	225,558
Telephone	28,977	20,540
Other	176,466	77,654
Total noninterest expenses	2,785,336	1,854,176
Income before income tax expense	1,434,946	1,552,171
Income tax expense	478,384	532,494
Net income	$ 956,562	$ 1,019,677
Earnings per common share		
Basic	$ .32	$ .35
Diluted	$ .30	$ .32
Weighted average common shares outstanding		
Basic	2,946,456	2,933,721
Diluted	3,235,959	3,231,605

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

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

For the nine months ended September 30,

	2007	2006
	(Unaudited)	
Interest income		
Loans	$ 25,315,003	$ 20,210,226
Investment securities	3,227,767	1,855,836
Federal funds sold	441,126	192,007
Total interest income	28,983,896	22,258,069
Interest expense		
Deposits	11,532,891	7,696,917
Borrowings	5,094,018	3,945,043
Total interest expense	16,626,909	11,641,960
Net interest income	12,356,987	10,616,109
Provision for loan losses	1,290,000	1,200,000
Net interest income after provision for loan losses	11,066,987	9,416,109
Noninterest income		
Loan fee income	120,589	89,145
Service fees on deposit accounts	293,334	195,031
Income from bank owned life insurance	278,383	55,000
Real estate owned activity	109,126	(103,392)
Other income	187,556	166,716
Total noninterest income	988,988	402,500
Noninterest expenses		
Compensation and benefits	4,479,330	3,176,784
Professional fees	415,659	308,250
Marketing	387,392	350,192
Insurance	328,119	135,776
Occupancy	1,080,548	495,587
Data processing and related costs	865,015	622,147
Telephone	96,833	59,818
Other	459,217	264,564
Total noninterest expenses	8,112,113	5,413,118
Income before income tax expense	3,943,862	4,405,491
Income tax expense	1,278,110	1,573,955
Net income	$ 2,665,752	$ 2,831,536
Earnings per common share		
Basic	$ .91	$ .97
Diluted	$ .82	$ .87
Weighted average common shares outstanding		
Basic	2,941,007	2,930,898
Diluted	3,241,437	3,237,901

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

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(Unaudited)

	Common stock Shares	Common stock Amount	Nonvested restricted stock	Additional paid-in capital	Accumulated other comprehensive income(loss)	Retained Earnings	Total share-holders' equity
December 31, 2005	2,659,719	$ 26,597	$ -	$ 25,626,740	$ (150,602)	$ 4,970,012	$ 30,472,747
Net income	-	-	-	-	-	2,831,536	2,831,536
Comprehensive income, net of tax -							
Unrealized holding loss on securities available for sale	-	-	-	-	(19,936)	-	(19,936)
Comprehensive income	-	-	-	-	-	-	2,811,600
Proceeds from exercise of stock options and warrants	7,500	75	-	49,645	-	-	49,720
Stock dividend (10%), net of cash in lieu of fractional shares	266,649	2,667	-	5,143,659	-	(5,146,772)	(446)
September 30, 2006	**2,933,868**	**$ 29,339**	**$ -**	**$ 30,820,044**	**$ (170,538)**	**$ 2,654,776**	**$ 33,333,621**
December 31, 2006	2,933,868	$ 29,339	$ -	$ 30,846,538	$ (16,465)	$ 3,724,034	$ 34,583,446
Net income	-	-	-	-	-	2,665,752	2,665,752
Comprehensive income, net of tax -							
Unrealized holding loss on securities available for sale	-	-	-	-	(239,222)	-	(239,222)
Comprehensive income	-	-	-	-	-	-	2,426,530
Proceeds from exercise of stock options and warrants	10,088	101	-	62,786	-	-	62,887
Issuance of restricted stock	2,500	25	(54,075)	54,050	-	-	-
Amortization of deferred compensation on restricted stock	-	-	10,139	-	-	-	10,139
Compensation expense related to stock options	-	-	-	8,508	-	-	8,508
September 30, 2007	**2,946,456**	**$ 29,465**	**$ (43,936)**	**$ 30,971,882**	**$ (255,687)**	**$ 6,389,786**	**$ 37,091,510**

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

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

	For the nine months ended September 30, 2007	2006
	(Unaudited)	
Operating activities		
Net income	$ 2,665,752	$ 2,831,536
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	1,290,000	1,200,000

Depreciation and other amortization		361,334		259,626
Accretion and amortization of securities discounts and premium, net		62,944		80,005
(Gain) loss on sale of real estate		181,118		(1,065)
Gain on sale of property held for sale		(319,291)		-
Compensation expense related to stock options		18,647		-
Increase in cash surrender value of bank owned life insurance		(278,383)		-
(Increase) decrease in deferred tax asset		26,149		(402,413)
(Increase) decrease in other assets, net		120,746		(630,448)
Decrease in other liabilities, net		(2,141,048)		(9,165,535)
Net cash provided by (used for) operating activities		1,987,968		(5,828,294)
Investing activities				
Increase (decrease) in cash realized from:				
Origination of loans, net		(82,306,533)		(55,017,192)
Purchase of property and equipment		(1,055,036)		(1,023,655)
Purchase of investment securities:				
Available for sale		(21,082,579)		(41,828,730)
Other investments		(2,042,400)		(5,567,200)
Payments and maturity of investment securities:				
Available for sale		5,706,491		3,624,315
Held to maturity		1,816,220		1,791,564
Other investments		810,000		4,162,500
Purchase of bank owned life insurance		(390,072)		(8,055,000)
Proceeds from sale of property held for sale		2,354,664		-
Proceeds from sale of real estate acquired in settlement of loans		467,180		1,340,269
Net cash used for investing activities		(95,722,066)		(100,573,129)
Financing activities				
Increase in deposits, net		69,559,651		85,811,563
Increase (decrease) in short-term borrowings		10,000,000		(14,680,000)
Proceeds from the exercise of stock options		62,887		49,720
Increase in Federal Home Loan Bank advances		25,000,000		25,000,000
Cash in lieu of fractional shares		-		(446)
Net cash provided by financing activities		104,622,538		96,180,837
Net increase (decrease) in cash and cash equivalents		10,888,441		(10,220,586)
Cash and cash equivalents at beginning of the period		16,579,133		25,604,152
Cash and cash equivalents at end of the period	$	27,467,574	$	15,383,566
Supplemental information				
Cash paid for				
Interest	$	16,307,186	$	10,978,656
Income taxes	$	1,252,011	$	1,976,369
Schedule of non-cash transactions				
Transfer of property and equipment to property held for sale	$	2,035,373	$	-
Foreclosure of real estate	$	-	$	2,118,421
Unrealized gain (loss) on securities, net of income taxes	$	(239,222)	$	(19,936)

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

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

Note 1 - Nature of Business and Basis of Presentation

Business activity

Southern First Bancshares, Inc. is a South Carolina corporation that owns all of the capital stock of Southern First Bank, N.A. and all of the stock of Greenville First Statutory Trust I and Trust II (collectively the "Trusts"). On July 2, 2007, the holding company changed its name from Greenville First Bancshares, Inc. to Southern First Bancshares, Inc. and the bank changed its name from Greenville First Bank, N.A. to Southern First Bank, N.A. The bank will however, continue to operate under the trade name, Greenville First Bank, in Greenville County. The bank is a national bank organized under the laws of the United States located in Greenville and Richland Counties, 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 used 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 and nine month periods ended September 30, 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 Southern First Bancshares, Inc., and its wholly owned subsidiary Southern 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. Accordingly, we 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. On April 13, 2007, we completed the sale of the former main office building. Based on the sales contract, adjusted for commissions and other selling costs, we recorded a $319,291 gain on the sale of the building during the nine months ended September 30, 2007. The $319,291 gain was partially offset by other unrelated real estate operating expenses of $140,036. The net gain on real estate operations recorded in the nine months ended September 30, 2007 was $210,165.

Note 3 - Note Payable

The company has an unused $4.5 million revolving line of credit with another bank that matures on March 20, 2008. The line of credit bears interest at a rate of three-month libor plus 2.00%, which at September 30, 2007 was 7.23%. The company has pledged the stock of the bank as collateral for this line of credit. The line of credit agreement contains various covenants related to net income and asset quality. As of

September 30, 2007, the company believes it is in compliance with all covenants.

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 and nine months ended September 30, 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.

At September 30, 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 September 30,			
	2007		2006	
Basic Earnings Per Share				
Average common shares		2,946,456		2,933,721
Net income	$	956,562	$	1,019,677
Earnings per share	$	0.32	$	0.35
Diluted Earnings Per Share				
Average common shares		2,946,456		2,933,721
Average dilutive common shares		289,503		297,884
Adjusted average common shares		3,235,959		3,231,605
Net income	$	956,562	$	1,019,677
Earnings per share	$	0.30	$	0.32

	Nine months ended September 30,			
	2007		2006	
Basic Earnings Per Share				
Average common shares		2,941,007		2,930,898
Net income	$	2,665,752	$	2,831,536
Earnings per share	$	0.91	$	0.97
Diluted Earnings Per Share				
Average common shares		2,941,007		2,930,898
Average dilutive common shares		300,430		307,003
Adjusted average common shares		3,241,437		3,237,901
Net income	$	2,665,752	$	2,831,536
Earnings per share	$	0.82	$	0.87

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 resulted in a reduction of compensation expense by approximately $68,000 for the year ended December 31, 2006 and will result in a reduction of compensation expense by approximately $52,000, $4,000, and $4,000 for the years ended December 31, 2007, 2008, and 2009, respectively.

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 is 10 years, and the assumed dividend rate was zero.

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;

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. On July 2, 2007, we changed our name to Southern First Bancshares, Inc. and the bank's name to Southern First Bank, N.A., although we will continue to operate as Greenville First Bank in Greenville County. Our primary reason for the name change was related to our expansion into the Columbia, SC market. 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 nine 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

Following an economic decline and historically low interest rates that ended in the first six months of 2004, the Federal Reserve began increasing short-term rates as the economy showed signs of strengthening. Between July 2004 and July 2006, the Federal Reserve increased rates at 17 of their meetings for a total of 425 basis points. Between July 2006 and September 18, 2007, the Federal Reserve allowed short-term rates to remain unchanged, leading many economists to believe that the Federal Reserve was nearing the end of this cycle of rate increases. Consequently, beginning in July 2004 and continuing until September 18, 2007, our rates on both short-term or variable rate interest-earning assets and interest-bearing liabilities have increased. The momentum of the 17 rate increases resulted in higher rates on interest-earning assets and higher interest-bearing liabilities during the first nine months of 2007; subsequently, as fixed rate loans, deposits, and borrowings have matured they have repriced at higher interest rates. On September 18, 2007, the Federal Reserve reversed their position and lowered the short-term rates by 50 basis points, leading many economists to believe that the Federal Reserve may begin a cycle of rate decreases. The results of the Federal Reserve's actions on September 18, 2007 resulted in a decline of rates on our variable rate loans, investments, deposits and borrowings. The following discussion includes our analysis of the effect that we anticipate changes in interest rates will have on our financial condition. However, we can give no assurances as to the future actions of the Federal Reserve or to the anticipated results that will actually occur.

Results of Operations

Income Statement Review

Summary

Three months ended September30, 2007 and 2006

Our net income was $956,562 and $1.0 million for the three months ended September 30, 2007 and 2006, respectively, a decrease of $63,115, or 6.2%. The $63,115 decrease in net income resulted primarily from an increase of $931,160 in noninterest expenses and an additional $50,000 in the provision for loan losses, partially offset by increases of $729,417 in net interest income and $134,518 in noninterest income. 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 59.6% and 48.7% for the three months ended September 30, 2007 and 2006, respectively. We believe that our efficiency ratio will improve in future periods as earning assets are anticipated to increase at a higher rate than noninterest expenses due to our recent investment in infrastructure. However, we can give no assurances that we will be able to achieve this goal.

Nine months ended September 30, 2007 and 2006

Our net income was $2.7 million and $2.8 million for the nine months ended September 30, 2007 and 2006, respectively, a decrease of $165,784, or 5.9%. The decrease in net income resulted primarily from increases of $2.7 million in noninterest expenses and $90,000 in the provision for loan losses, partially offset by increases of $1.7 million in net interest income and $586,488 in noninterest income. Our efficiency ratio was 60.8% and 49.1% for the nine months ended September 30, 2007 and 2006, respectively. We believe that our efficiency ratio will improve in future periods as earning assets are anticipated to increase at a higher rate than noninterest expenses due to our recent investment in infrastructure. However, we can give no assurances that we will be able to achieve this goal.

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 nine months ended September 30, 2007, our average loan portfolio increased $76.4 million compared to the average for the nine months ended September 30, 2006. The actual growth in the first nine months of 2007 was $81.0 million. We anticipate the growth in loans will continue to drive the growth in assets and the growth in net interest income. However, we can give no assurances that we will be able to continue to increase loans at the same levels we have experienced in the past.

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 September 30, 2007, net loans represented 77.9% 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. Consequently, net loans as a percentage of total assets remained at 77.9%. Our investment portfolio increased by $14.9 million from September 30, 2006 to September 30, 2007. At September 30, 2007, investments and federal funds sold represented 17.4% of total assets.

The historically low interest rate environment that was experienced between January of 2000 and July of 2004, 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.

We opened two retail deposit offices in 2005. During the third quarter of 2007, we converted our Columbia loan production office into a full service branch facility. Our focus for these three locations is to obtain low cost transaction accounts. 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. We anticipate opening two additional retail deposit offices during the first six months of 2008, one in the Columbia market and one in the Greenville market. These offices will assist us in meeting the previously stated objectives. We believe that this growth strategy will provide us with additional clients in our two market areas and will eventually provide a lower alternative cost of funding. At September 30, 2007, retail deposits represented $269.6 million, or 43.9% of total assets, borrowings represented $156.9 million, or 25.5% of total assets, and wholesale out-of-market deposits represented $145.4 million, or 23.7% of total assets.

Our net interest income margin for the nine months ended September 30, 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 $48.7 million and $45.4 million for the nine months ended September 30, 2007 and 2006, respectively.

In addition to the growth in both assets and liabilities, and the ratio of interest-earning assets to interest-bearing liabilities, net interest income is also affected by the timing of the repricing of our assets and liabilities, and the changes in interest rates earned on our assets and interest rates paid on our liabilities. Until September 18, 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 July 30, 2006 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 September 30, 2007. Given the fact that the Federal Reserve increased short-term rates by 425 basis points between July 2004 and July 2006 and allowed rates to remain unchanged until September 18, 2007, we believed during most of 2006 and the first nine months of 2007 that short-term interest rates were at or near their peak. Therefore, we chose 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. On September 18, 2007, the Federal Reserve decided to decrease the short-term rates by 50 basis points. While the bank had more assets that repriced down on September 18, 2007, the amount of liabilities that will reprice over the next three months will "neutralize" the immediate downward negative impact and then we believe we will begin to have a positive impact on our net interest income for the nine months thereafter.

As more fully discussed in the - "Market Risk" and - "Liquidity and Interest Rate Sensitivity" sections below, at September 30, 2007, 60% of our loans had fixed rates. During 2006 and the first nine months of 2007, we have placed more emphasis on fixed rate loans. During this period, our fixed rates loans as a percentage of total loans increased from 39% to 60%. While our percentage of fixed rate loans has increased, our focus during the past three years has been to obtain short-term liabilities to fund our asset growth. This strategy has resulted in our ability to move from being asset sensitive to being liability sensitive. We are currently positioned to benefit from lower market rates and to be negatively impacted by higher market rates.

At September 30, 2007, 89.0% of our interest-bearing liabilities were either variable rate or 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 September 30, 2007, we had $200.1 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 have included a number of tables to assist in our description of various measures of our financial performance. For example, the "Average Balances" tables 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 month periods ended September 30, 2007 and 2006. A review of these tables 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 continued 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 tables set 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 and nine month periods ended September 30, 2007 and 2006, we had no interest-bearing deposits in other banks or any securities purchased with agreements to resell. All investments owned have an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

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

	2007	**2006**

	Average Balance	Income/ Expense	Yield/ Rate(1)	Average Balance	Income/ Expense	Yield/ Rate(1)
			(Dollars in thousands)			
Earnings						
Federal funds sold	$ 5,876	$ 77	5.20%	$ 7,482	$ 100	5.30%
Investment securities, taxable	76,749	1,072	5.54%	59,694	767	5.10%
Investment securities, nontaxable (2)	3,629	54	5.90%	-	-	-
Loans	473,027	9,096	7.63%	383,853	7,267	7.51%
Total interest-earning assets	559,281	10,299	7.31%	451,029	8,134	7.15%
Non-interest-earning assets	22,530			19,176		
Total assets	$ 581,811			$ 470,205		
Interest-bearing liabilities						
NOW accounts	$ 34,108	145	1.69%	$ 30,821	145	1.87%
Savings & money market	89,159	807	3.59%	93,989	828	3.50%
Time deposits	235,017	3,063	5.17%	169,864	2,096	4.90%
Total interest-bearing deposits	358,284	4,015	4.45%	294,674	3,069	4.13%
FHLB advances	134,043	1,556	4.61%	92,853	1,036	4.43%
Other borrowings	15,869	287	7.18%	19,107	336	6.98%
Total interest-bearing liabilities	508,196	5,858	4.57%	406,634	4,441	4.33%
Non-interest-bearing deposits	31,632			26,958		
Non-interest-bearing liabilities	5,436			3,584		
Shareholders' equity	36,547			33,029		
Total liabilities and shareholders' equity	$ 581,811			$ 470,205		
Net interest spread			2.74%			2.82%
Net interest income (tax equivalent) / margin		$ 4,441	3.15%		$ 3,693	3.25%
Less: tax-equivalent adjustment (2)		18			-	
Net interest income		$ 4,423			$ 3,693	

(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 2.74% for the three months ended September 30, 2007 compared to 2.82% for the three months ended September 30, 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 8 basis point reduction in our net interest spread resulted primarily from the lower spread on the $108.3 million growth in average earning assets in the third quarter of 2007 compared to the same period in 2006. The additional earning assets and liabilities yielded a lower than historical net spread of 2.15%, accounting for a 14 basis point reduction in the net interest spread. The 14 basis point decline was partially offset by a 6 basis point increase related to the remaining assets repricing at a higher rate then the related liabilities.

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During 2006 and the first nine months of 2007, management determined that the bank had excess capital. Consequently, 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, $19.1 million or 17.6% of the total growth in earning assets occurred in investments and federal funds, yielding a combined weighted rate of 5.40% for the third quarter of 2007. The remaining growth in earning assets of $89.2 million, or 82.4% of the total growth, occurred in loans which yielded a weighted rate of 7.63% in the third quarter of 2007. This combination of investments, federal funds, and loans yielded a weighted rate of 7.24%.

The growth of $108.3 million in earning assets was funded primarily with $38.0 million in borrowings with a weighted rate of 4.88% and $65.1 million in certificates of deposit with a weighted rate of 5.17%. Since the total growth in earning assets was funded with higher borrowing and certificate of deposit rates, the combined funding cost was 5.09%.

Although, substantially all of the variable rate assets and the short-term and variable rate liabilities have repriced to market rates, our net interest spread may continue to decline in future periods, should a substantial portion of growth in earning assets continue to be funded with higher rate borrowings and 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 September 30, 2007 was 3.15% compared to 3.25% for the three months ended September 30, 2006. During the three months ended September 30, 2007, interest-earning assets exceeded interest-bearing liabilities by $51.1 million compared to $44.4 million for the three month period ended September 30, 2006. The primary reasons for the $6.7 million increase in interest-earnings assets exceeding interest- bearing liabilities relates to the $2.4 million proceeds from the sale of real estate and the earnings accumulated between the second and third quarters of 2007.

Our loan yield increased 12 basis points for the three months ended September 30, 2007 compared to the three months ended September 30, 2006 as a result of loans maturing or being renewed at market rates higher than their original rates and the impact of higher market rates on our variable rate loans which represent approximately 40% of the loan portfolio at September 30, 2007. Offsetting the increase in our loan yield was a 32 basis point increase in the cost of our interest-bearing deposits for the third 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 also being much higher than those in the past combined with our lower costing transaction accounts which now represent a smaller percentage of our total interest-bearing deposits. The cost of our FHLB advances increased 18 basis points while other borrowings increased 20 basis points. As of September 30, 2007, approximately 49% 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 $4.4 million and $3.7 million for the three months ended September 30, 2007 and 2006, respectively. The increase in the third quarter of 2007 related primarily to the net effect of higher levels of both average interest-earning assets and interest-bearing liabilities. Average interest-earning assets were $108.3 million higher during the three months ended September 30, 2007 compared to the same period in 2006. During the same period, average interest-bearing liabilities increased $101.6 million. The higher average balances resulted in $1.2 million additional net interest income for the three months ended September 30, 2007, while lower spreads on the average balances reduced net interest income by $406,000.

Interest income for the three months ended September 30, 2007 was $10.3 million, consisting of $9.1 million on loans, $1.1 million on investments, and $77,278 on federal funds sold. Interest income for the three months ended September 30, 2006 was $8.1 million, consisting of $7.3 million on loans, $766,990 on investments, and $100,211 on federal funds sold. Interest on loans for the three months ended September 30, 2007 and 2006 represented 88.5% and 89.3%, respectively, of total interest income, while income from investments and federal funds sold represented only 11.5% and 10.7%, 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 84.6% and 85.1% of average interest-earning assets for the three months ended September 30, 2007 and 2006, respectively. Included in interest income on loans for the three months ended September 30, 2007 and 2006 was $178,810 and $124,731, respectively, which related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense for the three months ended September 30, 2007 was $5.9 million, consisting of $4.0 million related to deposits and $1.8 million related to FHLB advances and other borrowings. Interest expense for the three months ended September 30, 2006 was $4.4 million, consisting of $3.1 million related to deposits and $1.4 million related to FHLB advances and other borrowings. Interest expense on deposits for the three months ended September 30, 2007 and 2006 represented 68.5% and 69.1%, respectively, of total interest expense, while interest expense on FHLB advances and other borrowings represented 31.5% and 30.9%, respectively, of total interest expense for the same three month periods. For the three months ended September 30, 2007, average interest-bearing deposits increased by $63.6 million over the same period in 2006, while FHLB advances increased $41.2 million and other borrowings decreased $3.2 million during the three months ended September 30, 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.

Average Balances, Income and Expenses, and Rates
For the Nine Months Ended September 30,

	2007			2006		
	Average Balance	**Income/ Expense**	**Yield/ Rate(1)**	**Average Balance**	**Income/ Expense**	**Yield/ Rate(1)**
	(Dollars in thousands)					
Earnings						