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**ANNUAL REPORT**

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# 2009 Annual Report

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*This Annual Report to Shareholders contains forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, changes in the interest rate environment, management's business strategy, national, regional and local market conditions and legislative and regulatory conditions.*

*Readers should not place undue reliance on forward-looking statements, which reflect management's view only as of the date hereof. The Bank undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.*



March 30, 2010

Dear Shareholders:

As we all predicted and experienced, 2009 was another year of challenging times for the financial industry. And while we are by no means out of the woods, there have been some recent signs of stabilization in the national, state and local economies.

Despite these steep challenges, your Bank has posted some solid numbers and gains in 2009. As of December 31, 2009, we reported total assets of \$114.2 million, an increase of \$70.5 million or 161.4% over December 31, 2008. Over the same period, our loan portfolio increased \$57.4 million or 155.6% to \$94.2 million and our securities portfolio increased \$9.8 million or 321.6% to \$12.8 million. In addition, our deposits increased \$71.4 million or 320.4% to \$93.7 million.

Net income in this environment has been tough for the industry in general and layering on all the necessary costs associated with a new bank, it has been a challenge for us as well. Our net loss before taxes remained flat at \$1,862,121 and \$1,865,079 for the years December 31, 2008 and 2009, respectively. However during the fourth quarter of 2009, we recorded the benefit of our deferred tax asset, which resulted in an income tax benefit of \$1,795,475. The end result was a net loss of \$69,604 for the year ending December 31, 2009.

Since our loan portfolio grew, we need to add reserves for possible loan losses. We added \$1,034,909 to those reserves in 2009 which was an increase of \$448,174 or 76.4% over 2008. While our total reserves now stand at \$1,561,840 or 1.66% of total loans, we charged off only \$59,804 in all of 2009.

We think 2010 could be another difficult year for our industry. Commercial real estate has yet to hit bottom in our opinion. Good solid loan growth that meets our standards appears to be slowing which may slow our growth for 2010.

We continue to be well capitalized and well positioned to take advantage of opportunities the markets present. Our credit quality remains solid but is not totally immune from the difficulties our clients continue to face in these incredible economic times. As I have said before, adversity brings opportunity, we see the glass as half full and we believe we are well positioned for another solid year. Let me hear from you and how we can better serve your needs, because we value your relationship. And as always, tell a friend about blueharbor bank.

Sincerely,

A handwritten signature in black ink that reads "Joe I. Marshall, Jr." with a stylized flourish at the end.

Joe I. Marshall, Jr.  
President and Chief Executive Officer  
(704) 658-3701



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
blueharbor bank  
 Mooresville, North Carolina

We have audited the accompanying balance sheets of blueharbor bank (the Bank) as of December 31, 2009 and 2008, and the related statements of operations, changes in shareholders' equity, and cash flows for the year ended December 31, 2009 and for the period from January 8, 2008 (opening date) through December 31, 2008. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2009 and 2008 and the related statements of operations, changes in shareholders' equity, and cash flows for the year ended December 31, 2009 and for the period from January 8, 2008 (opening date) through December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We were not engaged to examine management's assessment about the effectiveness of the Bank's internal control over financial reporting as of December 31, 2009 included in the accompanying Form 10-K, item 9 and, accordingly, we do not express an opinion thereon.

*Elliott Davis, PLLC*

Elliott Davis, PLLC  
Galax, VA  
March 30, 2010

## Balance Sheets

December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>Assets</b>		
Cash and due from banks	\$ 3,228,974	\$ 496,882
Federal funds sold	-	897,180
Cash and cash equivalents	<u>3,228,974</u>	<u>1,394,062</u>
Investment securities available-for-sale	12,622,686	3,032,584
Federal Home Loan Bank stock	161,400	-
Loans, net of allowance for loan losses of \$1,561,840 for 2009 and \$586,735 for 2008	92,655,048	36,273,974
Property and equipment, net	2,474,296	2,740,499
Accrued interest receivable	337,223	136,930
Deferred tax asset	2,014,780	-
Other assets	731,728	118,845
Total assets	<u>\$ 114,226,135</u>	<u>\$ 43,696,894</u>
<b>Liabilities and Shareholders' Equity</b>		
<i>Liabilities</i>		
Deposits:		
Noninterest-bearing	\$ 4,082,600	\$ 1,093,048
Interest-bearing	<u>89,651,081</u>	<u>21,203,035</u>
Total deposits	93,733,681	22,296,083
Repurchase agreements	583,877	2,897,954
Federal funds purchased	1,040,000	252,000
Accrued interest payable	125,772	46,786
Other liabilities	<u>656,342</u>	<u>116,153</u>
Total liabilities	<u>96,139,672</u>	<u>25,608,976</u>
Commitments and contingencies	-	-
<i>Shareholders' equity</i>		
Preferred stock, 5,000,000 shares authorized: no shares issued and outstanding at December 31, 2009 and 2008	-	-
Common stock, \$5 par value; 20,000,000 shares authorized: 1,900,000 shares issued and outstanding at December 31, 2009 and 2008	9,500,000	9,500,000
Surplus	10,504,521	10,395,207
Retained deficit	(1,931,725)	(1,862,121)
Accumulated other comprehensive income	<u>13,667</u>	<u>54,832</u>
Total shareholders' equity	<u>18,086,463</u>	<u>18,087,918</u>
Total liabilities and shareholders' equity	<u>\$ 114,226,135</u>	<u>\$ 43,696,894</u>

See Notes to Financial Statements

# Statements of Operations

For the periods from January 8, 2008 (opening date) through December 31, 2008 and the year ended December 31, 2009

	<u>2009</u>	<u>2008</u>
<b>Interest income</b>		
Loans and fees on loans	\$ 3,511,823	\$ 760,342
Investment securities	280,363	48,606
Interest bearing deposits	796	-
Federal funds sold	9,265	323,213
Total interest income	<u>3,802,247</u>	<u>1,132,161</u>
<b>Interest expense</b>		
Deposits	1,402,296	386,379
Borrowings	15,818	6,075
Total interest expense	<u>1,418,114</u>	<u>392,454</u>
Net interest income	2,384,133	739,707
<b>Provision for loan losses</b>		
Net interest income after provision for loan losses	<u>1,034,909</u> <u>1,349,224</u>	<u>586,735</u> <u>152,972</u>
<b>Noninterest income</b>		
Service charges on deposit accounts	26,601	7,743
Other service charges and fees	64,149	15,402
Mortgage fees	1,715	-
Gain on sale/paydown of securities	5,977	30
Other income	510	170
Total noninterest income	<u>98,952</u>	<u>23,345</u>
<b>Noninterest expense</b>		
Salaries and employee benefits	1,763,586	1,139,451
Occupancy expense	414,207	237,758
Equipment expense	208,421	115,499
Data processing expense	272,307	158,161
Professional services	158,131	146,909
Advertising expense	93,742	64,791
Regulatory expense	169,628	10,595
Other expense	233,233	165,274
Total noninterest expense	<u>3,313,255</u>	<u>2,038,438</u>
Net loss before income taxes	(1,865,079)	(1,862,121)
Income tax benefit	(1,795,475)	-
Net loss	<u>\$ (69,604)</u>	<u>\$ (1,862,121)</u>
<b>Basic loss per common share</b>	<u>\$ (0.04)</u>	<u>\$ (0.98)</u>
<b>Diluted loss per common share</b>	<u>\$ (0.04)</u>	<u>\$ (0.98)</u>
<b>Weighted average common shares outstanding</b>	<u>1,900,000</u>	<u>1,900,000</u>
<b>Weighted average dilutive common shares outstanding</b>	<u>1,900,000</u>	<u>1,900,000</u>

See Notes to Financial Statements

## Statements of Changes in Shareholders' Equity

For the periods from January 8, 2008 (opening date) through December 31, 2008 and the year ended December 31, 2009

	Common		Surplus	Retained (Deficit)	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
<b>Comprehensive loss</b>						
Net loss	-	\$ -	\$ -	\$ (1,862,121)	\$ -	\$ (1,862,121)
Net change in unrealized appreciation on investment securities available-for-sale	-	-	-	-	54,832	54,832
<b>Total comprehensive loss</b>						<b>(1,807,289)</b>
Pre-opening expenses, net	-	-	(1,032,812)	-	-	(1,032,812)
Shares issued pursuant to pre-opening stock subscriptions	1,900,000	9,500,000	11,400,000	-	-	20,900,000
Stock based compensation	-	-	28,019	-	-	28,019
<b>Balance, December 31, 2008</b>	<u>1,900,000</u>	<u>9,500,000</u>	<u>10,395,207</u>	<u>(1,862,121)</u>	<u>54,832</u>	<u>18,087,918</u>
<b>Comprehensive loss</b>						
Net loss	-	-	-	(69,604)	-	(69,604)
Net change in unrealized appreciation on investment securities available-for-sale (net of tax of \$8,575)	-	-	-	-	(41,165)	(41,165)
<b>Total comprehensive loss</b>						<b>(110,769)</b>
Stock based compensation	-	-	109,314	-	-	109,314
<b>Balance, December 31, 2009</b>	<u>1,900,000</u>	<u>\$ 9,500,000</u>	<u>\$ 10,504,521</u>	<u>\$ (1,931,725)</u>	<u>\$ 13,667</u>	<u>\$ 18,086,463</u>

See Notes to Financial Statements

# Statements of Cash Flows

For the periods from January 8, 2008 (opening date) through December 31, 2008 and the year ended December 31, 2009

	<u>2009</u>	<u>2008</u>
<b><i>Cash flows from operating activities</i></b>		
Net loss	\$ (69,604)	\$ (1,862,121)
Adjustments to reconcile net loss to net cash used by operations:		
Depreciation and amortization	319,966	203,967
Provision for loan losses	1,034,909	586,735
Accretion of discount on securities, net of amortization	28,814	2,362
Gain on sale/paydown of investment securities	(5,977)	(30)
Stock based compensation	109,314	28,019
Changes in assets and liabilities:		
Accrued income	(200,293)	(136,930)
Deferred tax asset	(2,014,780)	-
Other assets	(612,883)	(118,845)
Accrued interest payable	78,986	46,786
Other liabilities	<u>531,614</u>	<u>116,153</u>
Net cash used by operating activities	<u>(799,934)</u>	<u>(1,133,904)</u>
<b><i>Cash flows from investing activities</i></b>		
Purchases of investment securities	(15,040,532)	(3,004,760)
Principal payments on investment securities	5,233,603	24,676
Net increase in loans	(57,415,983)	(36,860,709)
Purchases of property and equipment	<u>(53,763)</u>	<u>(2,944,466)</u>
Net cash used in investing activities	<u>(67,276,675)</u>	<u>(42,785,259)</u>
<b><i>Cash flows from financing activities</i></b>		
Net increase in deposits	71,437,598	22,296,083
Net proceeds from issuance of common stock	-	19,867,188
Net change in repurchase agreements	(2,314,077)	2,897,954
Net change in federal funds purchased	<u>788,000</u>	<u>252,000</u>
Net cash provided by financing activities	<u>69,911,521</u>	<u>45,313,225</u>
Net increase in cash and cash equivalents	1,834,912	1,394,062
<b><i>Cash and cash equivalents, beginning</i></b>	<u>1,394,062</u>	-
<b><i>Cash and cash equivalents, ending</i></b>	<u>\$ 3,228,974</u>	<u>\$ 1,394,062</u>
<b><i>Supplemental disclosure of cash flow information</i></b>		
Interest paid	<u>\$ 1,339,128</u>	<u>\$ 345,668</u>
Income taxes paid	<u>\$ -</u>	<u>\$ -</u>
Transfer of loans to other real estate	<u>\$ 187,352</u>	<u>\$ -</u>

See Notes to Financial Statements



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# Notes to Financial Statements

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## **Note 1. Organization and Summary of Significant Accounting Policies**

### *Organization*

blueharbor bank (the “Bank”) was incorporated on January 3, 2008 under the laws of the State of North Carolina and commenced operations on January 8, 2008. The Bank currently serves Iredell County, North Carolina and surrounding areas through its banking offices in Mooresville and Huntersville, North Carolina. The Bank opened the Huntersville branch in late November 2008. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the North Carolina Commissioner of Banks and the Federal Deposit Insurance Corporation.

The accounting and reporting policies of the Bank follow generally accepted accounting principles (“GAAP”) and general practices within the financial services industry. Following is a summary of the more significant policies:

### *Critical Accounting Policies*

Management believes the policies with respect to the methodology for the determination of the allowance for loan losses and asset impairment judgments involve a high degree of complexity. Management must make difficult and subjective judgments which require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

### *Pre-opening Expenses*

In accordance with applicable North Carolina banking regulations, the Bank charged its results of operations prior to the opening date, January 8, 2008, to surplus. GAAP require such operating results be charged to retained earnings. Interest income on bank deposits and expenses prior to opening amounted to \$240,980 and \$1,273,792, respectively. The classification of net pre-opening expenses of \$1,032,812 in surplus rather than retained earnings is required by North Carolina banking regulations and does not affect the Bank’s total shareholders’ equity.

### *Business Segments*

The Bank reports its activities as a single business segment. In determining the appropriateness of segment definition, the Bank considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

### *Use of Estimates*

In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

### *Cash and Cash Equivalents*

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption “cash and due from banks” and “federal funds sold.”

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# Notes to Financial Statements

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## Note 1. Organization and Summary of Significant Accounting Policies, continued

### *Securities*

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized costs. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held-to-maturity or trading, including equity securities with readily determinable fair values, are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

### *Loans Receivable*

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal amount adjusted for any charge-offs and the allowance for loan losses. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Discounts and premiums on any purchased loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management’s opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest for the current year is reversed. Interest income is subsequently recognized on the cash basis or cost recovery method, as appropriate. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

### *Allowance for Loan Losses*

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating losses in the portfolio.

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# Notes to Financial Statements

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## Note 1. Organization and Summary of Significant Accounting Policies, continued

### *Allowance for Loan Losses, continued*

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and other circumstances impacting the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

### *Property and Equipment*

Bank premises, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization computed by the straight-line method over the following estimated useful lives:

	<u>Years</u>
Leasehold improvements	2-10
Furniture and equipment	2-7

### *Foreclosed Properties*

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less anticipated cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management, and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in loss on foreclosed real estate. The Bank held \$187,352 and \$0 in foreclosed properties at December 31, 2009 and 2008, respectively.

### *Transfers of Financial Assets*

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### *Advertising Expense*

The Bank expenses advertising costs as they are incurred.

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## Notes to Financial Statements

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### Note 1. Organization and Summary of Significant Accounting Policies, continued

#### *Income Taxes*

Provision for income taxes is based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Deferred income tax liability relating to unrealized appreciation (or the deferred tax asset in the case of unrealized depreciation) on investment securities available-for-sale is recorded in other liabilities (assets) when applicable. Such unrealized appreciation or depreciation is recorded as an adjustment to equity in the financial statements and not included in income determination until realized. Accordingly, the resulting deferred income tax liability or asset is also recorded as an adjustment to equity.

#### *Basic Earnings (Loss) per Share*

Basic earnings (loss) per share is computed by dividing income (loss) available to shareholders by the weighted average number of shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

#### *Diluted Earnings (Loss) per Share*

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

#### *Comprehensive Income*

Annual comprehensive income reflects the change in the Bank's equity during the year arising from transactions and events other than investment by and distributions to shareholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of shareholders' equity rather than as income or expense.

#### *Fair Value of Financial Instruments*

Fair value information about financial instruments is required to be disclosed, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all nonfinancial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

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# Notes to Financial Statements

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## **Note 1. Organization and Summary of Significant Accounting Policies, continued**

### ***Fair Value of Financial Instruments, continued***

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments:

*Cash and due from banks:* The carrying amounts reported in the balance sheet for cash and due from banks approximate their fair values.

*Federal funds sold:* The carrying amounts reported in the balance sheet for federal funds sold approximate their fair values.

*Securities:* Fair values for securities, excluding restricted equity securities, are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying values of restricted equity securities approximate fair values.

*Loans receivable:* For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable. The carrying amount of accrued interest receivable approximates its fair value.

*Deposit liabilities:* The fair values disclosed for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date. The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.

*Repurchase agreements and federal funds purchased:* The carrying amounts reported in the balance sheet for repurchase agreements and federal funds purchased approximate their fair values.

### ***Recent Accounting Pronouncements***

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

In June 2009, the Financial Accounting Standards Board (“FASB”) issued guidance which restructured GAAP and simplified access to all authoritative literature by providing a single source of authoritative nongovernmental GAAP. The guidance is presented in a topically organized structure referred to as the FASB Accounting Standards Codification (“ASC”). The new structure is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included is considered nonauthoritative.

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

## **Note 2. Restrictions on Cash**

To comply with banking regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirement was \$2,818,072 at December 31, 2009 and \$672,671 at December 31, 2008.

## Notes to Financial Statements

### Note 3. Securities

Debt and equity securities have been classified in the balance sheet according to management's intent. The carrying amount of securities (all available-for-sale) and their approximate fair values at December 31, 2009 and 2008 are:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<b>2009</b>				
Government sponsored enterprises	\$ 6,205,132	\$ 21,529	\$ 55,938	\$ 6,170,723
Mortgage-backed securities	<u>6,395,312</u>	<u>68,719</u>	<u>12,068</u>	<u>6,451,963</u>
	<u>\$ 12,600,444</u>	<u>\$ 90,248</u>	<u>\$ 68,006</u>	<u>\$ 12,622,686</u>
<b>2008</b>				
Government sponsored enterprises	\$ 2,003,614	\$ 24,826	\$ -	\$ 2,028,440
Mortgage-backed securities	<u>974,138</u>	<u>30,006</u>	<u>-</u>	<u>1,004,144</u>
	<u>\$ 2,977,752</u>	<u>\$ 54,832</u>	<u>\$ -</u>	<u>\$ 3,032,584</u>

The fair value of securities pledged for agreements to repurchase were \$2,760,024 and \$3,032,584 at December 31, 2009 and 2008, respectively.

The Bank had \$5,977 and \$30 of realized gains on investment securities for the periods ended December 31, 2009 and 2008, respectively. Proceeds from the sale of investment securities were \$534,219 and \$0 for the periods ended December 31, 2009 and 2008, respectively.

As of December 31, 2009, no securities have been in a continuous unrealized loss position for more than 12 months. There were no unrealized losses in the Bank's available-for-sale investment portfolio as of December 31, 2008.

The scheduled maturities of available-for-sale debt securities were as follows:

	<u>December 31, 2009</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in less than one year	\$ -	\$ -
Due in one to three years	2,000,000	2,009,622
Due in three to five years	1,000,000	1,011,908
Due in five to ten years	5,688,123	5,706,018
Due after fifteen years	<u>3,912,321</u>	<u>3,895,138</u>
Total	<u>\$ 12,600,444</u>	<u>\$ 12,622,686</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The unrealized losses in the Bank's investment portfolio relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities for the foreseeable future, no declines are deemed to be other-than-temporary.

## Notes to Financial Statements

### Note 4. Loans Receivable

The major components of loans on the balance sheet at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Commercial	\$ 10,890,400	\$ 3,651,002
Real estate:		
Construction and development	8,275,762	3,109,745
Residential, 1-4 families	26,026,855	13,116,918
Nonfarm nonresidential	44,389,817	14,600,212
Farmland	248,640	-
Consumer and overdrafts	2,556,887	2,040,245
Multi-family	<u>1,869,579</u>	<u>349,995</u>
	94,257,940	36,868,117
Unearned Income	(41,052)	(7,408)
Allowance for loan losses	<u>(1,561,840)</u>	<u>(586,735)</u>
Loans, net of allowance	<u>\$ 92,655,048</u>	<u>\$ 36,273,974</u>

There were \$38,065,975 of loans pledged to the Federal Home Loan Bank (“FHLB”) of Atlanta at December 31, 2009 to secure an unused \$9,930,000 line of credit and no loans were pledged at December 31, 2008.

### Note 5. Allowance for Loan Losses

An analysis of the allowance for loan losses at December 31, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of period	\$ 586,735	\$ -
Provision for loan losses charged to operations	1,034,909	586,735
Recoveries of amounts charged off	-	-
Amounts charged off	<u>59,804</u>	<u>-</u>
Balance at end of period	<u>\$ 1,561,840</u>	<u>\$ 586,735</u>

An analysis of impaired loans and other real estate owned at December 31, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>
Impaired loans	\$ 1,627,809	\$ -
Related allowance for credit losses	\$ 14,942	\$ -
Interest income recognized on impaired loans	\$ 39,677	\$ -
Average balance of impaired loans (based on month-end balances)	\$ 864,264	\$ -
Impaired loans with no allowance for credit losses	\$ 1,457,226	\$ -
Nonaccrual loans	\$ 170,582	\$ -
Loans past due 90 days or more and still accruing interest	\$ -	\$ -
Other real estate owned	\$ 187,352	\$ -

## Notes to Financial Statements

### Note 6. Property and Equipment

#### *Components of Property and Equipment*

Components of property and equipment and total accumulated depreciation at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Land	\$ 1,677,575	\$ 1,677,575
Buildings and improvements	553,583	530,425
Furniture and equipment	<u>754,949</u>	<u>736,466</u>
Property and equipment, total	2,986,107	2,944,466
Less accumulated depreciation	<u>511,811</u>	<u>203,967</u>
Property and equipment, net of depreciation	<u>\$ 2,474,296</u>	<u>\$ 2,740,499</u>

Depreciation expense was \$319,966 and \$203,967 for the years ended December 31, 2009 and 2008, respectively.

#### *Leases*

In June 2008, the Bank entered into an operating lease for its branch facility in Huntersville. Total rent expense was \$112,627 and \$38,705 for the fiscal years ended December 31, 2009 and 2008, respectively. In September 2007, the Bank (in its pre-organizational phase) entered into an operating lease on the temporary bank building in Mooresville. Total rent expense was \$69,248 and \$69,174 for the fiscal years ended December 31, 2009 and 2008, respectively. In September 2008, the Bank entered into an operating lease to rent storage space. Total rent expense was \$1,500 and \$500 for the fiscal years ended December 31, 2009 and 2008, respectively.

Future minimum lease payments are as follows:

2010	\$ 184,129
2011	116,361
2012	118,450
2013	<u>121,310</u>
	<u>\$ 540,250</u>

### Note 7. Deposits

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2009 was \$28,568,361. At December 31, 2009, the scheduled maturities of time deposits are as follows:

	<u>Less Than \$100,000</u>	<u>\$100,000 or More</u>	<u>Total</u>
2010	\$ 9,176,404	\$ 21,790,232	\$ 30,966,636
2011	2,438,881	6,377,001	8,815,882
2012	320,122	153,995	474,117
2013	195,248	247,133	442,381
2014	26,503	-	26,503
Thereafter	-	-	-
	<u>\$ 12,157,158</u>	<u>\$ 28,568,361</u>	<u>\$ 40,725,519</u>



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## Notes to Financial Statements

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### Note 8. Borrowings

#### *Lines of Credit*

The Bank has established credit facilities to provide additional liquidity if and as needed. These credit facilities consist of unsecured lines of credit with correspondent banks for federal funds purchased totaling \$8,200,000 and a secured line of credit with FHLB of Atlanta of \$9,930,000 for a total of \$18,130,000 available. There were \$1,040,000 and \$252,000 outstanding under these credit facilities at December 31, 2009 and 2008, respectively.

#### *Repurchase Agreements*

The Bank had securities sold under agreements to repurchase that mature on a daily basis of \$583,877 and \$2,897,954 at December 31, 2009 and 2008, respectively. The weighted average interest rate on these agreements were 0.99% and 0.96% at December 31, 2009 and 2008, respectively.

### Note 9. Fair Value of Financial Instruments

Disclosures about the fair value of assets and liabilities recognized in the balance sheet are required whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has been established, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

#### *Fair Value Hierarchy*

The three levels of inputs that may be used to measure fair value are as follows:

- Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.
- Level 2: Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

#### *Investment Securities Available-for-Sale*

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value is measured based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 2 securities include Treasury notes and bills, mortgage-backed securities issued by government sponsored entities, municipal bonds and other securities issued by government sponsored agencies.

## Notes to Financial Statements

### Note 9. Fair Value of Financial Instruments, continued

#### *Impaired Loans*

The Bank does not record loans at fair value on a recurring basis. From time to time, a loan is considered impaired. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value, and discounted cash flows. When the fair value of collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as Level 2. If the fair value of the loan is based on criteria other than observable market prices or current appraised value, the loan is recorded as Level 3.

#### *Foreclosed Assets*

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based upon independent observable market prices or appraised values of the collateral, which the Bank considers to be Level 2 inputs.

#### *General*

The Bank has no liabilities carried at fair value or measured at fair value on a recurring or nonrecurring basis. The Bank has no assets or liabilities whose fair values are measured using Level 3 inputs. Below is a summary of assets carried at fair value or measured at fair value on a recurring or nonrecurring basis as of December 31, 2009:

<b>Recurring Basis</b>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Investment in securities available-for-sale	\$ 12,622,686	\$ -	\$ 12,622,686	\$ -
Total assets at fair value	\$ 12,622,686	\$ -	\$ 12,622,686	\$ -
<b>Nonrecurring Basis</b>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Impaired loans, net of related allowance for credit losses	\$ 1,612,867	\$ -	\$ 1,612,867	\$ -
Other real estate owned	187,352	-	187,352	-
Total assets at fair value	\$ 1,800,219	\$ -	\$ 1,800,219	\$ -

For assets and liabilities that are not presented on the balance sheet at fair value, the Bank uses the following methods to determine fair value:

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets or liabilities not considered financial instruments include deferred tax assets, premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered.

## Notes to Financial Statements

### Note 9. Fair Value of Financial Instruments, continued

The Bank's fair value methods and assumptions for assets and liabilities that are not presented on the balance sheet at fair value are as follows:

- *Cash and due from banks, FHLB stock, accrued interest receivable, repurchase agreements, and accrued interest payable.* The carrying value is a reasonable estimate of fair value.
- *Loans, net.* The carrying value for variable rate loans is a reasonable estimate of fair value due to contractual interest rates based on prime. Fair value for fixed rate loans is estimated based upon discounted future cash flows using discount rates comparable to rates currently offered for such loans.
- *Deposit accounts.* The fair value of certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities. The fair value of all other deposit account types is the amount payable on demand at year end.
- *FHLB borrowings and federal funds purchased.* The carrying value of variable rate borrowings is considered to approximate fair value.
- *Commitments to extend credit and standby letters of credit.* The large majority of the Bank's loan commitments are at variable rates, and therefore, are subject to minimal interest rate risk exposure. Therefore, the fair value of these financial instruments is considered to approximate the commitment amount.

Based on the limitations, methods, and assumptions noted, the estimated fair values of the Bank's financial instruments at December 31, 2009 and 2008 are as follows:

	<b>December 31, 2009</b>		<b>December 31, 2008</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
Financial assets:				
Cash and due from banks	\$ 3,228,974	\$ 3,228,974	\$ 496,882	\$ 496,882
Federal funds sold	-	-	897,180	897,180
Investment securities, available-for-sale	12,622,686	12,622,686	3,032,584	3,032,584
FHLB Stock	161,400	161,400	-	-
Loans, net	92,655,048	94,767,068	36,273,974	36,273,974
Financial liabilities:				
Deposit accounts	93,733,681	94,118,676	22,296,083	22,296,083
Federal funds purchased	583,877	583,877	2,897,954	2,897,954
Repurchase agreements	1,040,000	1,040,000	252,000	252,000

The carrying value of loans, net and deposit accounts at December 31, 2008 is considered to fairly estimate the fair value of those financial instruments due to the majority of the loans, net and deposit accounts being added to the balance sheet later in 2008.

### Note 10. Stock and Earnings per Share

Upon opening, the Bank issued 1,900,000 shares of common stock. The Bank is authorized to issue 20,000,000 shares of common stock with a par value of \$5 per share and 5,000,000 shares of preferred stock with no par value.

## Notes to Financial Statements

### Note 10. Stock and Earnings per Share, continued

#### *Earnings (Loss) per Share*

The following table details the computation of basic earnings (loss) per share for the periods ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Net income (loss) available to common shareholders	\$ (69,604)	\$ (1,862,121)
Weighted average shares outstanding,	1,900,000	1,900,000
<i>Effect of dilutive securities</i>	<u>-</u>	<u>-</u>
Weighted average shares outstanding, diluted	<u>1,900,000</u>	<u>1,900,000</u>
Basic earnings (loss) per common share	\$ (0.04)	\$ (0.98)
Dilutive earnings (loss) per common share	<u>\$ (0.04)</u>	<u>\$ (0.98)</u>

No dilutive effect was considered for the 182,190 stock options outstanding at December 31, 2009 and 2008 due to the anti-dilutive effect they would produce.

### Note 11. Income Taxes

#### *Operating Loss Carryforwards*

The Bank recorded the full benefit of the net deferred tax asset of \$1,786,900 in the fourth quarter of 2009 as management determined it was more likely than not that the Bank would be able to utilize the value of the deferred tax asset in future years. The Bank has a loss carryforward of \$2,904,865 for federal and state income tax purposes that may be used to offset future taxable income. If not previously utilized, the federal and state loss carryforward will begin to expire in 2028 and 2023, respectively.

#### *Current and Deferred Income Tax Components*

The components of income tax expense (substantially all federal) for the periods ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Current	\$ -	\$ -
Deferred benefit	(707,880)	(1,087,595)
Deferred tax asset valuation allowance change	<u>(1,087,595)</u>	<u>1,087,595</u>
	<u>\$ (1,795,475)</u>	<u>\$ -</u>

## Notes to Financial Statements

### Note 11. Income Taxes, continued

#### *Deferred Income Tax Analysis*

The significant components of net deferred tax assets at December 31, 2009 and 2008 are summarized as follows:

	<u>2009</u>	<u>2008</u>
<i>Deferred tax assets</i>		
Allowance for loan losses	\$ 532,404	\$ 185,191
Net operating losses	1,113,366	731,601
Pre-opening expenses	345,097	371,644
Non-qualified stock option compensation expense	21,641	3,091
Other	<u>2,272</u>	<u>1,218</u>
Deferred tax asset	<u>2,014,780</u>	<u>1,292,745</u>
<i>Deferred tax liabilities</i>		
Unrealized gains on securities	8,575	21,140
Deferred loan costs	107,513	43,555
Prepaid assets	24,021	10,074
Depreciation	87,909	130,589
Other	<u>(138)</u>	<u>(208)</u>
Deferred tax liability	<u>227,880</u>	<u>205,150</u>
Deferred tax asset valuation allowance	<u>-</u>	<u>(1,087,595)</u>
Net deferred tax asset	<u>\$ 1,786,900</u>	<u>\$ -</u>

### Note 12. Commitments and Contingencies

#### *Litigation*

In the normal course of business, the Bank may be involved in various legal proceedings. The Bank was not involved in any litigation during the fiscal years ended December 31, 2009 and 2008.

#### *Financial Instruments with Off-balance-sheet Risk*

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

## Notes to Financial Statements

### Note 12. Commitments and Contingencies, continued

Standby letters of credit are conditional financial commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

At December 31, 2009 and 2008, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>2009</u>	<u>2008</u>
Commitments to grant loans	\$ 4,884,130	\$ 4,118,596
Unfunded commitments under lines of credit	\$ 5,392,339	\$ 3,572,083
Standby letters of credit	\$ 574,146	\$ -

### *Concentrations of Credit Risk*

Substantially all of the Bank's loans and commitments to extend credit have been granted to customers in the Bank's market area and such customers are generally depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4. The Bank's primary focus is toward consumer and small business transactions, and accordingly, it does not have a significant number of loans or commitments to any single borrower or group of related borrowers in excess of \$2,000,000.

The Bank from time to time may have cash and cash equivalents on deposit with financial institutions that exceed federally-insured limits.

### Note 13. Regulatory Restrictions

#### *Dividends*

The Bank, as a North Carolina banking corporation, may pay dividends only out of undivided profits (retained earnings) as determined pursuant to North Carolina General Statutes Section 53-87. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the bank. Additionally, dividends for the first three years of operations of new banks are explicitly prohibited by the North Carolina Commissioner of Banks and the Federal Deposit Insurance Corporation unless special exceptions are made.

#### *Capital Requirements*

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as all those terms are defined in the applicable regulations. As of December 31, 2009 and 2008, the Bank met all capital adequacy requirements to which it was subject.

## Notes to Financial Statements

### Note 13. Regulatory Restrictions, continued

As of December 31, 2009 and 2008, the Bank met the criteria to be considered well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. These minimum requirements as well as the Bank's actual capital amounts and ratios are presented in the following table:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<i>(thousands)</i>						
<b>December 31, 2009</b>						
Total Capital						
(to Risk-Weighted Assets)	\$ 17,624	18.2%	\$ 7,755	8.0%	\$ 9,694	10.0%
Tier I Capital						
(to Risk-Weighted Assets)	\$ 16,408	16.9%	\$ 3,877	4.0%	\$ 5,816	6.0%
Tier I Capital						
(to Average Assets) <sup>(1)</sup>	\$ 16,408	15.5%	\$ 4,244	4.0%	\$ 5,305	5.0%
<b>December 31, 2008</b>						
Total Capital						
(to Risk-Weighted Assets)	\$ 18,484	51.3%	\$ 2,881	8.0%	\$ 3,601	10.0%
Tier I Capital						
(to Risk-Weighted Assets)	\$ 18,033	50.1%	\$ 1,440	4.0%	\$ 2,161	6.0%
Tier I Capital						
(to Average Assets) <sup>(1)</sup>	\$ 18,033	43.2%	\$ 1,672	4.0%	\$ 2,090	5.0%

<sup>(1)</sup> The amounts listed for Minimum Capital Requirement (4.0%) and Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions (5.0%) are the general regulatory limits. The Bank, as part of its charter, agreed to maintain 8.0% of Tier I Capital to Average Assets for the first three years of operations which required Tier I Capital of \$8,488,000 and \$3,344,000 at December 31, 2009 and 2008, respectively.

### Note 14. Transactions with Related Parties

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. Annual activity consisted of the following:

	<u>2009</u>	<u>2008</u>
Beginning balance	\$ 632,857	\$ -
New loans	1,307,879	846,162
Repayments	(558,460)	(213,305)
Ending balance	<u>\$ 1,382,276</u>	<u>\$ 632,857</u>

Deposits and repurchase agreements from related parties held by the Bank at December 31, 2009 and 2008 amounted to \$10,727,577 and \$7,117,490, respectively.

# Notes to Financial Statements

## Note 15. Employee Benefit Plans

### *Defined Contribution Plan*

The Bank maintains a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). The plan covers substantially all full-time employees who are 21 years of age and have completed 90 days of service. Participants may contribute a percentage of compensation, subject to a maximum allowed under the Code. In addition, the Bank must match certain contributions and may make additional contributions at the discretion of the Board of Directors. The Bank's contribution was \$41,044 and \$9,919 for the periods ended December 31, 2009 and 2008, respectively.

### *Supplemental Executive Retirement Plan*

The Bank maintains a Supplemental Executive Retirement Plan ("SERP") for its President and Chief Executive Officer, Joe I. Marshall, Jr., to which benefits will be contributed to the extent permitted by Section 409A of the Code upon the Bank obtaining profitability and an annual retirement benefit of 70% of his average annual compensation from the Bank during the three calendar years preceding his retirement, continuing on a monthly basis thereafter for a period of 20 years and vesting 10% annually from the date the agreement was signed and 100% upon a Change in Control. In 2009, a total of \$216,644 was expensed related to Mr. Marshall's SERP which represents the cumulative expense from May 2008 to December 2009 for the monthly vesting of the present value of the future retirement payments.

### *Stock Option Plans*

The Bank has adopted both an Incentive Stock Option Plan and a Nonstatutory Stock Option Plan (each a "Plan" and collectively, the "Plans"). Under each Plan up to 190,000 shares may be issued for a total of 380,000 shares. Options granted under both Plans expire no more than 10 years from the date of grant. Option exercise price under both Plans shall be set by the Board of Directors at the date of grant, but shall not be less than 100% of fair market value of the related stock at the date of the grant. Under both Plans, option vesting terms shall be set by the Board of Directors at the date of grant. All options granted so far under the Plans vest over a five-year period from the date of the grant.

Compensation expense related to options granted was \$109,314 and \$28,019 for the periods ended December 31, 2009 and 2008, respectively.

The weighted average fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average estimated fair values of stock option grants and the assumptions that were used in calculating such fair values were based on estimates at the date of grant as follows:

	<u>2008</u>
Weighted average fair value of each option granted during the year	\$ 2.89
Assumptions:	
Average risk free interest rate	1.87%
Average expected volatility	20.00%
Expected dividend rate	0.00%
Expected life in years	7.0



## Notes to Financial Statements

### Note 15. Employee Benefit Plans, continued

There were no stock options granted during the 12 months ended December 31, 2009. There were no options exercised during the years ended December 31, 2009 and 2008. Activity under each Plan during the periods ended December 31, 2009 and 2008 are summarized below:

	Incentive Plan		Nonstatutory Plan	
	Available for Grant	Granted	Available for Grant	Granted
<i>Beginning balance</i>	190,000	-	190,000	-
Forfeited	15,000	(15,000)	-	-
Granted	(117,000)	117,000	(80,190)	80,190
Exercised	-	-	-	-
<b><i>Balance December 31, 2008 and 2009</i></b>	<u>88,000</u>	<u>102,000</u>	<u>109,810</u>	<u>80,190</u>

A summary of option activity under the Plans during the periods ended December 31, 2008 and 2009 are presented below:

	Options Outstanding	Weighted Average Exercise Price	Average Remaining Contractual Term	Aggregate Intrinsic Value <sup>(1)</sup>
Outstanding at January 8, 2008	-	\$ -		\$ -
Granted	197,190	11.00		
Forfeited	(15,000)	11.00		
Exercised	-	-		
Outstanding at December 31, 2008	<u>182,190</u>	<u>\$ 11.00</u>	<u>9.74 years</u>	<u>\$ -</u>
Exercisable at December 31, 2008	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>
Granted	-	-		
Forfeited	-	-		
Exercised	-	-		
Outstanding at December 31, 2009	<u>182,190</u>	<u>\$ 11.00</u>	<u>8.74 years</u>	<u>\$ -</u>
Exercisable at December 31, 2009	<u>36,437</u>	<u>\$ 11.00</u>	<u>8.74 years</u>	<u>\$ -</u>

<sup>(1)</sup> The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. This amount changes based on changes in the market value of the Bank's stock. The fair value (present value of the estimated future benefit to the option holder) of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

Options vested during 2009 totaled 36,437 shares while no options vested in 2008. Total unrecognized compensation expense related to outstanding non-vested stock options will be recognized over the following periods:

2010	109,314
2011	109,314
2012	109,314
2013	81,295
Total	<u>\$ 409,237</u>

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# Board of Directors and Employees

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## Board of Directors

Kelley K. Earnhardt (Vice-Chairperson) .....	JR Motorsports
Phil M. Gandy, Jr. (Chairman) .....	Gandy Communities
Abigail M. Jennings.....	Lake Norman Realty
Joe I. (“Jim”) Marshall, Jr.....	blueharbor bank
Wm. Bynum Marshall .....	Lowe’s Companies
Clarence E. (“Rock”) Pickard, Jr. ....	Central Carolina Insurance Agency
William P. (“Bill”) Pope.....	Pope, McMillan, Kutteh, Privette, Edwards & Schieck, P.A.
Riley B. (“R. B.”) Sloan, Jr. ....	City of Danville, Virginia
Louis G. Stanfield, Jr. ....	Stanfield & Blackman, LLC and Stanfield & Company, LLC
James R. (“Rick”) Teague .....	Potts, Combs, Rhyne & Teague, P.A.

## Employees

Joe I. (“Jim”) Marshall, Jr.....	President and Chief Executive Officer
James W. Clement .....	Senior Vice President and Chief Credit Officer
Richard E. (“Rick”) Eveson.....	Senior Vice President and Senior Consumer Lender
Carl T. Larson.....	Senior Vice President and Chief Financial Officer
William H. (“Bill”) Lynch.....	Senior Vice President and Senior Lending Officer
Brent W. Dugan.....	Vice President and Branch Manager
Danielle H. Johnson.....	Vice President and Deposit Operations Manager
John G. Reeves .....	Vice President and Commercial Lender
Nancy M. Sweet .....	Vice President and Branch Manager
Elizabeth L. (“Beth”) Mills.....	Assistant Vice President
Kelly S. Yost .....	Corporate Secretary and Executive Assistant
David C. Bowles.....	Universal Associate
Susan C. Cloninger.....	Universal Associate
Jennifer L. Dugan .....	Mortgage Lending Specialist
Maria C. (“Christina”) Graves .....	Universal Associate
Shelia L. Lockhart .....	Universal Associate
Martha D. (“Mardi”) Moore .....	Universal Associate
Eileen A. Ruvolo .....	Universal Associate
Zerlina J. (“ZZ”) Zamora.....	Universal Associate

## **Shareholders Information**

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### **Annual Meeting**

The 2010 Annual Meeting of Shareholders of the Bank will be held on May 17, 2010, at 2:00 p.m., Eastern Daylight Saving Time, at The Charles Mack Citizen Center, Merchant Room, 215 N. Main Street, Mooresville, North Carolina 28115.

### **Requests for Information**

Requests for information should be directed to Mr. Carl T. Larson, Senior Vice President and Chief Financial Officer, at blueharbor bank, Post Office Box 3546, Mooresville, North Carolina 28117.

#### **Independent Auditors**

Elliott Davis, PLLC  
Post Office Box 760  
Galax, Virginia 24333

#### **Stock Transfer Agent**

First Shareholder Services  
Post Office Box 29522 – FCC61  
Raleigh, North Carolina 27626-0522

### **Federal Deposit Insurance Corporation**

The Bank is a member of the Federal Deposit Insurance Corporation. This Annual Report has not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

### **Banking Offices**

#### **Main Office (Located at Morrison Plantation)**

106 Corporate Park Drive  
Mooresville, North Carolina  
(704) 662-7700

#### **Huntersville Branch**

104 North Statesville Road  
Huntersville, North Carolina  
(704) 990-7200

### **Mailing Address**

blueharbor bank  
Post Office Box 3546  
Mooresville, North Carolina 28117

### **Internet Address**

<http://www.blueharborbank.com/>

### **Stock Information**

*Market Information.* The Bank's common stock began trading on July 7, 2008. As of March 30, 2010, there were approximately 773 holders of record, not including the number of persons or entities whose stock is held in nominee or street name through various brokerage firms or banks. The Bank's stock is traded on the Over-The-Counter Bulletin Board under the symbol BLHK.OB.

*Dividend Information.* The Bank has not paid any dividends to shareholders since its formation on January 3, 2008. In determining whether to declare future dividends, the Board of Directors will take into account the Bank's operating results, capital requirements, financial condition, tax considerations and other relevant factors including federal and state regulatory restrictions on dividends. Also, the Bank's ability to declare and pay future cash dividends will be dependent upon, among other things, restrictions imposed by the reserve and capital requirements of federal and state law.



## *What makes us different from other banks?*

### Difference #1 - The “blueharbor” client experience

- It starts with our People who day in and day out provide the *customer service you expect and deserve*
- *Our Warm and Inviting Atmosphere* – A Place where you want to just sit back and relax, enjoy a newspaper, Wireless Web, Gourmet Coffee, and listen to real music not muzac
- *Where Customers Feel Like Family*, where you’re not an account number, you’re a person
- *Community Banking at its core*, but still providing “big bank” technology and products

### Difference #2 – Our local lenders and our entire approach to your credit needs

- *Local / Hands on Decision Making* by Responsive Experienced Bankers
- *All the Decisions are made “in house”*, not sent to another zip code, area code or state
- blueharbor bank is dedicated to helping the local economy. We serve only the Lake Norman area, therefore we reinvest your deposits back via loans to local businesses and residents
- We explore Every Angle when looking at an opportunity, because *we don’t forget it’s a privilege to have an opportunity to earn your business*, therefore we try harder to find a way to say yes

### Difference #3 – blueharbor’s innovative products

- Neon Blue Checking Accounts that pay interest better than most CDs
- Free Unlimited Nationwide Access to any ATM with your blueharbor debit card
- Online Banking
- Wide array of innovative Commercial and Consumer Loan Products to fit virtually any need

## *Now, This is Banking*

### TWO GREAT LOCATIONS SERVING THE LAKE NORMAN AREA

#### Mooresville Branch

Located in Morrison Plantation  
106 Corporate Park Drive  
Mooresville, NC 28117  
(704) 662-7700

#### Huntersville Branch

Located in Huntersville Square  
104 North Statesville Road  
Huntersville, NC 28078  
(704) 990-7200

**Check us out at [www.blueharborbank.com](http://www.blueharborbank.com)**

