

**THE BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551**

FORM 10-KSB

**Annual Report under Section 13 or 15(d)
of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2004

or

**Transition Report under Section 13 or 15(d)
of the Securities Exchange Act of 1934**

For the transition period from _____ to _____

COLONIAL VIRGINIA BANK

(Name of small business issuer in its charter)

Virginia

(State or other jurisdiction of
incorporation or organization)

75-3093106

(I.R.S. Employer
Identification No.)

**6720 Sutton Road
Gloucester, Virginia**

(Address of principal executive offices)

23061

(Zip Code)

(804) 695-9300

(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
None	n/a

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$5.00 per share
(Title of class)

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

Check if disclosure of delinquent filers pursuant in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. []

State issuer's revenues for its most recent fiscal year. \$1,549,889

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. \$11,021,538

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

605,175 shares of common stock, par value \$5.00 per share,
outstanding as of March 30, 2005

COLONIAL VIRGINIA BANK

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PART I

Item 1. Description of Business

General

Colonial Virginia Bank (the “Bank”) was organized under the laws of the Commonwealth of Virginia to engage in commercial and retail banking business. The Bank places special emphasis on serving the financial needs of small and medium sized businesses, professional concerns and individuals in the greater Middle Peninsula, which includes the counties of Gloucester, Mathews and Middlesex, and the Peninsula, which includes the cities of Hampton, Newport News, Williamsburg and Poquoson and the counties of James City and York, regions of Virginia.

The Bank was incorporated on December 17, 2002 and commenced operations on November 6, 2003 (inception), upon receipt of final approval from the Virginia State Corporation Commission’s Bureau of Financial Institutions and the Federal Reserve Bank of Richmond. The Bank received approval for the issuance of deposit insurance from the Federal Deposit Insurance Corporation (“FDIC”) on November 6, 2003.

The Bank’s initial focus is in Gloucester County, where the Bank’s headquarters are located at 6720 Sutton Road in Gloucester and the York River branch office is located at 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point. The Bank is offering a full range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans. The Bank is a community-oriented institution with substantial local ownership, focusing on providing a high level of responsive and personalized services to its customers, delivered in the context of a strong direct relationship between the customer and the Bank.

The Bank is subject to intense competition from existing bank holding companies, commercial banks and savings banks, which have been in business for many years and have established customer bases. Competition also comes from a variety of other non-bank businesses that offer financial services. Many of these competitors operate in the same geographic market where the Bank operates, are well-known with long-standing relationships with businesses and individuals in the communities, and are substantially larger with greater resources than the Bank.

The Bank is also subject to regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. The Bank’s principal regulators are the Federal Reserve Bank of Richmond (“FRB”) and the Virginia State Corporation Commission’s Bureau of Financial Institutions (“BFI”). As a consequence of the extensive regulation of commercial banking activities, the Bank’s business is susceptible to state and federal legislation and regulations.

The Bank has no subsidiaries.

The Bank invests in certain U.S. Government and agency obligations and other investments permitted by applicable laws and regulations. The operating results of the Bank are highly dependent on net interest income, the difference between interest income earned on loans and investments and the cost of interest-bearing deposits and borrowed funds.

Deposit accounts of the Bank, up to \$100,000, are insured by the Bank Insurance Fund (“BIF”), administered by the FDIC. The Bank is a member of the FRB. The Bank is subject to the supervision, regulation and examination of the FRB and the BFI. The Bank is also subject to the regulations of the Board of Governors of the Federal Reserve System governing reserves required to be maintained against deposits.

Business Strategy

The Bank's Officers, Employees and the Board of Directors live and work in the Middle Peninsula and Peninsula regions, predominately in the Counties of Gloucester, Mathews and Middlesex.

The Bank's Management and the Board believe that the existing and future banking market in the Middle Peninsula and Peninsula communities represents an opportunity for locally owned and locally managed community banks. In view of the continuing trend in the financial services industry toward consolidation into larger, sometimes impersonal, statewide, regional and national institutions, the market exists for the personal and customized financial services that an independent, locally owned bank can offer. With the flexibility of its smaller size and through an emphasis on relationship banking, including personal attention and service, the Bank can be more responsive to the individual needs of its customers than its larger competitors. As a community-oriented and locally owned institution, the Bank can invest the majority of its loan resources in the community and will tailor its services to meet the banking and financial needs of its customers who live and do business in the Middle Peninsula and Peninsula communities.

The Bank is engaged in a general commercial and retail banking business, serving the Middle Peninsula and Peninsula area. At the commencement of operations, the Bank is focused on the Gloucester County market. The Bank offers a full range of banking and related financial services focused primarily upon serving individuals, small to medium sized businesses, entrepreneurs, and the professional community. The Bank is striving to develop personal banking relationships with its customers. The Bank's Officers, Employees and Directors believe that the marketing of customized relationship banking services will enable the Bank to establish a niche in the financial services marketplace in the Middle Peninsula market.

The Bank provides its customers with high quality, responsive and technologically advanced banking services. These services include loans that are priced on a deposit-based relationship, easy access to the Bank's decision makers, and quick and innovative action necessary to meet a customer's banking needs. The Bank's initial capitalization enables it to operate with a lending limit that should satisfy the credit needs of a large portion of its targeted market segment, which includes small businesses and individuals. The Bank's membership in the Community Bankers' Bank allows the Bank to offer loan products to customers whose loan requirements exceed the Bank's lending limit. The Bank's initial capitalization should be sufficient to support its initial operations and provide for substantial growth in deposits and loans.

Location and Market Area

The Bank located its initial banking office at 6720 Sutton Road in Gloucester in temporary quarters. Although these are temporary banking facilities, the office has a full-service branch, with the exception of safe deposit box services that will be offered upon completion of the permanent building at the same location, and an automatic teller machine ("ATM"). Gloucester County is primarily a residential area with a work force commuting to other cities and counties. Several large retail establishments have recently located in Gloucester County, including a WalMart SuperCenter, the Home Depot and Lowe's. General traffic volume and centrality of a banking location relative to recent growth trends of the market area indicate that this location will be convenient to the Bank's targeted customer base now and for the future. The Bank located its first branch ("York River") office, also in temporary quarters, at 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point, in the southern part of Gloucester County. This location is convenient to the commuting traffic patterns from the Middle Peninsula area to the Peninsula area.

The Bank expects to establish additional banking locations that will be convenient to the Bank's targeted customer base now and in the future, although presently there are no specific plans. The opening

of any additional banking offices by the Bank will require prior regulatory approval, which takes into account a number of factors, including, among others, a determination that the Bank has capital in an amount deemed sufficient to warrant additional expansion and a finding that the public interest will be served.

The Gloucester market area supports a diverse, well-rounded economy. Gloucester and surrounding counties are served by a modern regional hospital facility, excellent school systems, and a comprehensive communications network. The Board of Directors believes that there are an ample number of newspaper, radio and television outlets that offer diverse and broad opportunities for effective advertising and public relations for the Bank. The area has seen an active housing market with a wide variety of housing types including single-family detached homes, duplexes, townhouses, and garden apartments. Gloucester County is comprised of 225 square miles of land area and 32 square miles of water area. The county's current population is in excess of 35,000, with a projected total population in excess of 46,000, an increase of 30.05%, by 2010.

The Board of Directors believes that growth in the Bank's initial service area will be at least equal to growth in the greater market. The Board of Directors also anticipates that the Bank's services and products will appeal to customers in the greater Middle Peninsula and Peninsula regions, as Peninsula residents have demonstrated increased mobility and activity within Gloucester County, making them a targeted customer base. The Directors of the Bank are residents of, or work in, the greater Middle Peninsula and Peninsula regions. Their belief is based upon their review of the economic outlook for the area and the size, nature and growth potential of the existing market for banking services. While the steady growth that the greater Middle Peninsula and Peninsula regions have experienced is expected to continue in the future, no assurance can be given that such growth will continue.

Banking Services

The Bank receives deposits, makes consumer and commercial loans, issues drafts, and provides other services customarily offered by a commercial banking institution, such as business and personal checking and savings accounts, drive-in windows, and 24-hour automated teller machines. The Bank will not initially apply for permission from the Virginia State Corporation Commission to establish a trust department and offer trust services. The Bank is chartered as a state chartered commercial bank and is a member of the Federal Reserve System. Deposits are insured under the Federal Deposit Insurance Act to the limits provided thereunder. The Bank is independent of any affiliation with a bank holding company.

The Bank offers a full range of short-to-medium term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. The Bank originates and holds or will sell into the secondary market fixed and variable rate mortgage loans and real estate construction and acquisition loans. Fixed rate residential loans will most likely be sold in the secondary market, and adjustable rate residential loans may be held in the Bank's loan portfolio.

The Bank's lending activities are subject to a variety of lending limits imposed by state law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the Bank), in general the Bank is subject to a loans-to-one borrower limit of an amount equal to 15% of the Bank's capital and surplus in the case of loans which are not fully secured by readily marketable or other permissible types of collateral. The Bank may voluntarily choose to impose a policy limit on loans to a single borrower that is less than the legal lending limit. The Bank is a member of the Community Bankers' Bank and will participate in loans when loan amounts exceed the Bank's legal lending limits or internal lending policies.

Other services offered by the Bank include issuance of cashier's checks, certain cash management services, travelers checks, direct deposit of payroll and social security checks and automatic drafts for various accounts. Upon completion of the permanent bank buildings at each location, the Bank will also offer safe deposit box services. The Bank is associated with a shared network of automated teller machines that may be used by Bank customers throughout Virginia and other regions. The Bank also offers MasterCard and VISA credit card services through an agent program with another financial institution.

It is not anticipated the Bank will exercise trust powers during its initial years of operation. The Bank may establish a trust department in the future but cannot do so without prior regulatory approval. In the interim, the Bank may contract for the provision of trust services to its customers through an outside vendor.

Employees

As of December 31, 2004, the Bank had a total of 22 full-time employees. None of the Bank's employees were covered by a collective bargaining agreement. The Bank considers its relationship with its employees to be good. Several employees have been associated with senior management in previous employment positions. The Bank's management believes that these long-term working relationships will continue to contribute to its growth and success.

Effect of Adverse Economic Conditions

The Bank's business may be adversely affected by periods of economic slowdown or recession which may be accompanied by decreased demand for consumer credit and declining real estate values. Any material decline in real estate values reduces the ability of borrowers to use home equity to support borrowings and increases the loan-to-value ratios of loans previously made by the Bank, thereby weakening collateral coverage and increasing the possibility of a loss in the event of default. In addition, delinquencies, foreclosures and losses generally increase during economic slowdowns or recessions.

The Bank anticipates the majority of its depositors will be located in and doing business in the local market and the Bank will lend a substantial portion of its capital and deposits to individuals and business borrowers in this market area. Any factors adversely affecting the economy of this market could, in turn, adversely affect the performance of the Bank.

Asset/Liability Management

Management strives to manage the maturity or repricing match between assets and liabilities. The degree to which the Bank is "mismatched" in its maturities is a primary measure of interest rate risk. In periods of stable interest rates, net interest income can be increased by financing higher yielding long-term mortgage loan assets with lower cost short-term deposits and borrowings. Although such a strategy may increase profits in the short run, it increases the risk of exposure to rising interest rates and can result in funding costs rising faster than asset yields.

Interest Rate Risk

Profitability may be directly affected by the levels of and fluctuations in interest rates, which affect the Bank's ability to earn a spread between interest received on its earning assets (investments and loans) and its funding costs, initially deposits garnered locally. The profitability of the Bank could change dramatically, positively or negatively, if its yield on earning assets responds differently from its funding costs in a rapid and sustained shift in interest rates.

Asset Quality

The Bank made its first loan in November 2003. Loans past due 30 to 89 days totaled \$243,918 at December 31, 2004. There were no loans past due 90 days or more at December 31, 2004.

Interest on most loans is billed monthly. Interest on loans held for investment by the Bank is accrued until the loans become 90 days or more past due. No loans had been placed on non-accrual status at December 31, 2004.

Competition

In the conduct of certain aspects of its banking business, the Bank will encounter strong competition from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions. A number of these competitors are well-established in the Middle Peninsula and Peninsula areas. Competition for loans is keen, and pricing is important. Most of the Bank's competitors have substantially greater resources and higher lending limits than the Bank will initially have and offer certain services, such as extensive and established branch networks and trust services that the Bank either does not expect to provide or will not provide initially. Deposit competition also is strong, and the Bank may have to pay higher interest rates to attract deposits. The adoption of legislation permitting nationwide interstate banking and branching could increase competition in the Bank's markets, and federal legislation recently adopted allows non-banking companies, such as insurance and investment firms, to establish or acquire banks.

The development of the Bank's business is based in large measure upon the belief that a locally owned and managed community bank can successfully compete with larger financial institutions that are not locally owned and managed. There is no assurance that the Bank will be able to attract the necessary resources that are required to make the Bank profitable.

There are numerous other existing banks and financial institutions in the initial market area which are engaged in the type of business in which the Bank is engaged. The Bank competes with a variety of institutions, including other commercial banks, savings and loan associations, savings banks, credit unions, insurance companies, securities brokerage houses, and money market mutual funds for deposit accounts. Additional competition for deposits comes from corporate and governmental securities, which offer a high rate of interest. The Bank also competes with other commercial banks, savings and loan associations, savings banks, insurance companies, mortgage banking firms, and other lending institutions for origination of loans. These competitors of the Bank include larger, more established institutions, which will have available substantially greater resources, broader geographic markets and higher lending limits. The success of the Bank depends largely upon its ability to attract deposits and to make successful loans in competition with such other institutions. There can be no assurance that the competitive environment in which the Bank must operate will be favorable to the Bank's business or its plan of development. In addition, the Bank must compete with other banks and financial institutions for qualified personnel to staff its office or offices.

The Middle Peninsula and Peninsula markets have recently experienced significant mergers or acquisitions involving several banks with branch offices located in these areas. The Bank's Management and Directors believe that the Bank can capitalize on the recent merger activity in the Middle Peninsula and Peninsula market areas and attract customers from those who are dissatisfied with the recently acquired banks. By initially focusing on the Gloucester County area, it is believed that the Bank can compete effectively in this market. Management and the Directors believe that the area will react favorably to the Bank's community bank focus and special emphasis on relationship banking service to small and medium sized businesses, individuals, entrepreneurs, and professional concerns.

Community banks are not nearly as homogeneous as their larger brethren. Substantial differences in markets, asset size, management philosophy, growth opportunities and operating efficiencies tend to make the investment characteristics of each community bank quite unique.

Supervision and Regulation

General. The Bank is a Virginia state bank and a member of the Federal Reserve System, and its depositors are insured by the FDIC. The Federal Reserve and the Virginia State Corporation Commission and its Bureau of Financial Institutions regulate and monitor the Bank's operations. The Bank is required to file with the Federal Reserve quarterly financial reports on the financial condition and performance of the organization. The Federal Reserve and the State conduct periodic onsite and offsite examinations of the Bank. The Bank must comply with a wide variety of reporting requirements and banking regulations. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds and not to protect various shareholders. Additionally, the Bank must bear the cost of compliance with the reporting and regulations; these costs can be significant and have an effect on its financial performance.

The Federal Reserve, State and FDIC have the authority and responsibility to ensure that financial institutions are managed in a safe and sound manner. They have the authority to prevent the continuation of unsound and unsafe activities. Additionally, they must generally approve significant business activities undertaken by financial institutions. Typical examples of transactions requiring approval include branch locations, mergers, capital transactions and major organizational structure changes. Obtaining regulatory approval for these types of activities can be time consuming, expensive and ultimately may not be successful.

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposit accounts are insured by the Bank Insurance Fund of the Federal Deposit Insurance Corporation up to the maximum legal limits of the FDIC and it is subject to regulation, supervision and regular examination by the Virginia Bureau of Financial Institutions and the Federal Reserve. The regulations of these various agencies govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds, and not for the purpose of protecting shareholders.

The Federal Deposit Insurance Act (the FDIA) establishes a risk-based deposit insurance assessment system. Under applicable regulations, deposit premium assessments are determined based upon a matrix formed utilizing capital categories – “well capitalized,” “adequately capitalized” and “undercapitalized” - defined in the same manner as those categories are defined for purposes of Section 38 of the FDIA. Each of these groups is then divided into three subgroups which reflect varying levels of supervisory concern, from those which are considered healthy to those which are considered to be of substantial supervisory concern. The matrix so created results in nine assessment risk classifications, with rates ranging from 0.00% of insured deposits for well capitalized institutions having the lowest level of supervisory concern, to 0.27% of insured deposits for undercapitalized institutions having the highest level of supervisory concern. In general, while the Bank Insurance Fund of the FDIC maintains a reserve ratio of 1.25% or greater, no deposit insurance premiums are required. When the Bank Insurance Fund of the FDIC reserve ratio falls below that level, all insured banks would be required to pay premiums. Payment of deposit premiums, either under current law or as the deposit insurance system may be reformed, will have an adverse impact on earnings.

Bank Capital Adequacy Guidelines. The Federal Reserve Board has issued risk-based and leverage capital guidelines applicable to banking organizations that it supervises. Under the risk-based capital requirements, the Bank is generally required to maintain a minimum ratio of total capital to risk-weighted assets (including specific off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital (4%) must be composed of “Tier 1 Capital”, which is defined as common

equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles. The remainder may consist of “Tier 2 Capital”, which is defined as specific subordinated debt, some hybrid capital instruments and other qualifying preferred stock and a limited amount of the loan loss allowance. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no risk-based capital) for assets such as cash and certain U.S. government and agency securities, to 100% for the bulk of assets which are typically held by a bank holding company, including certain multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Residential first mortgage loans on one to four family residential real estate and certain seasoned multi-family residential real estate loans, which are not 90 days or more past due or nonperforming and which have been made in accordance with prudent underwriting standards, are assigned a 50% level in the risk-weighting system, as are certain privately issued mortgage backed securities representing indirect ownership of such loans.

In addition to the risk-based capital requirements, the Federal Reserve has established a minimum 4.0% Leverage Capital Ratio (Tier 1 Capital to total adjusted assets) requirement for the most highly rated banks, with an additional cushion of at least 100 to 200 basis points for all other banks, which effectively increases the minimum Leverage Capital Ratio for such other banks to a level of 4.0% to 6.0% or more. The highest rated banks are those that are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, those which are considered a strong banking organization. A bank having less than the minimum Leverage Capital Ratio requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit a reasonable plan describing the means and timing by which a bank shall achieve its minimum Leverage Capital Ratio requirement. A bank that fails to file such plan is deemed to be operating in an unsafe and unsound manner, and could subject that bank to a cease and desist order. Any insured depository institution with a Leverage Capital Ratio that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding solely on account of its capital ratios, provided it has entered into and is in compliance with a written agreement to increase its Leverage Capital Ratio and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The capital regulations also provide, among other things, for the issuance of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital or to restore its capital to the minimum capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease and desist order.

Under these regulations, a state-chartered commercial bank will be:

- “well capitalized” if it has a Total Risk-Based Capital ratio of 10% or greater, a Tier 1 Risk-Based Capital ratio of 6% or greater, a Tier 1 leverage ratio of 5% or greater, and is not subject to any written capital order or directive;
- “adequately capitalized” if it has a Total Risk-Based Capital ratio of 8% or greater, a Tier 1 Risk-Based Capital ratio of 4% or greater, and a Tier 1 leverage ratio of 4% or greater (3% in certain circumstances) and does not meet the definition of “well capitalized;”
- “undercapitalized” if it has a Total Risk-Based Capital ratio of less than 8%, a Tier 1 Risk-Based Capital ratio of less than 4% or a Tier 1 leverage ratio of less than 4% (3% in certain circumstances).
- “significantly undercapitalized” if it has a Total Risk-Based Capital ratio of less than 6%, a Tier 1 Risk-Based Capital ratio of less than 3%, or a Tier 1 leverage ratio of less than 3%; or

- “critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

The risk-based capital standards of the Federal Reserve explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution’s ability to manage these risks, as important factors to be taken into account by the agency in assessing an institution’s overall capital adequacy. The capital guidelines also provide that an institution’s exposure to a decline in the economic value of its capital due to changes in interest rates be considered by the agency as a factor in evaluating a banking organization’s capital adequacy.

Prompt Corrective Action. Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA, which: (a) restrict payment of capital distributions and management fees; (b) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (c) require submission of a capital restoration plan; (d) restrict the growth of the institution’s assets; and (e) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: (a) requiring the institution to raise additional capital; (b) restricting transactions with affiliates; (c) requiring divestiture of the institution or the sale of the institution to a willing purchaser; and (d) any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act (the “Act”) implemented major changes to the statutory framework for providing banking and other financial services in the United States. The Act, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms and other financial service providers. A bank holding company that qualifies as a financial holding company will be permitted to engage in activities that are financial in nature or incident or complimentary to financial activities. The activities that the Act expressly lists as financial in nature include insurance activities, providing financial and investment advisory services, underwriting services and limited merchant banking activities.

To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. To qualify as a financial holding company, each insured depository institution controlled by the bank holding company must be well-capitalized, well-managed and have at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding company must file with the Federal Reserve a declaration of its intention to become a financial holding company. The Bank presently has no plans to become a financial holding company.

Although the Act is considered one of the most significant banking laws since Depression-era statutes were enacted, because of its small size and recent organization, the Bank does not expect the Act to materially affect its products, services or other business activities. The Bank does not believe that the Act will have a material adverse impact on its operations. To the extent that it allows banks, securities firms and insurance firms to affiliate, the financial services industry may experience further consolidation. The Act may have the result of increasing competition that the Bank faces from larger institutions and other companies offering financial products and services, many of which may have substantially greater financial resources.

Payment of Cash Dividends. The Bank is subject to laws and regulations that limit the amount of dividends that it can pay. The amount of dividends that may be paid depends upon its earnings and capital position and is limited by federal and state law, regulations and policies. As a bank that is a member of the Federal Reserve System, the Bank must obtain prior written approval for any dividend if

the total of all dividends declared in any calendar year would exceed the total of its net profits for that year combined with its retained net profits for the preceding two years. In addition, the Bank may not pay a dividend in an amount greater than its undivided profits then on hand after deducting its losses and bad debts. For this purpose, bad debts are generally defined to include the principal amount of loans which are in arrears with respect to interest by six months or more unless such loans are fully secured and in the process of collection. Moreover, for purposes of this limitation, the Bank not permitted to add the balance of its allowance for loan losses account to its undivided profits then on hand, however, it may net the sum of its bad debts as so defined against the balance of its allowance for loan losses account and deduct from undivided profits only bad debts so defined in excess of that account. In addition, the Federal Reserve is authorized to determine under certain circumstances relating to the financial condition of a bank that the payment of dividends would be an unsafe and unsound practice and to prohibit payment thereof. The payment of dividends that deplete a bank's capital base could be deemed to constitute such an unsafe and unsound banking practice. The Federal Reserve has indicated that banking organizations generally pay dividends only out of current operating earnings.

In addition, under Virginia law, no dividend may be declared or paid out of the Virginia charter bank's paid-in capital. The Bank may be prohibited under Virginia law from the payment of dividends if the Virginia Bureau of Financial Institutions determines that a limitation of dividends is in the public interest and is necessary to ensure the Bank's financial soundness, and may also permit the payment of dividends not otherwise allowed by Virginia law.

Monetary Policy. Banking is a business which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of the Bank's earnings. Thus, the Bank's earnings and growth will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve, which regulates the supply of money through various means including open market dealings in United States government securities. These dealings include the purchase and sale of securities to expand or contract the general liquidity in the financial system. Additionally, the Board of Governors of the Federal Reserve establishes a target Federal Fund Rate and the Discount Rate. The actions taken by the Federal Reserve System will dictate the general condition of interest rates in the market place.

The Bank's earnings are a function of differentials between interest rates. Depending on the organization's Asset / Liability strategy, actions taken by the Federal Reserve may have a positive or negative effect on the profitability of the organization. The Bank cannot predict the actions of the Federal Reserve nor can it guarantee that its Asset / Liability strategy is consistent with action taken by the Federal Reserve.

Community Reinvestment Act. The Community Reinvestment Act of 1977 requires that federal banking regulators evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. To the best knowledge of the Bank, it is meeting its obligations under this act.

Branching and Interstate Banking. The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle-Neal Act) by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997, which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located

permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act.

The Riegle-Neal Act authorizes the federal banking agencies to approve interstate branching de novo by national and state banks in states which specifically allow for such branching. Virginia has enacted laws which permit interstate acquisitions of banks and bank branches and permit out-of-state banks to establish de novo branches.

Regulatory Enforcement Authority. Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Transactions with Affiliates. Transactions between banks and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any bank or entity that controls, is controlled by or is under common control with such bank. Generally, Section 23A (a) limits the extent to which a bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such institution’s capital stock and surplus, and maintain an aggregate limit on all such transactions with affiliates to an amount equal to 20% of such capital stock and surplus, and (b) requires that all such transactions be on terms substantially the same, or at least as favorable, to the bank as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. Section 23B applies to “covered transaction” as well as sales of assets and payments of money to an affiliate. These transactions must also be conducted on terms substantially the same, or at least as favorable, to the bank as those provided to non-affiliates.

Loans to Insiders. The Federal Reserve Act and related regulations impose specific restrictions on loans to directors, executive officers and principal shareholder of banks. Under Section 22(h) of the Federal Reserve Act, any loan to a director, an executive officer or to a principal shareholder of a bank, or to entities controlled by any of the foregoing, may not exceed, together with all outstanding loans to such persons or entities controlled by such person, the bank’s loan to one borrower limit. Loans in the aggregate to insiders of the related interest as a class may not exceed two times the bank’s unimpaired capital and unimpaired surplus until the bank’s total assets equal or exceed \$100 million, at which time the aggregate is limited to the bank’s unimpaired capital and unimpaired surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and principal shareholders of a bank or bank holding company, and to entities controlled by such persons, unless such loans are approved in advance by a majority of the Board of Directors of the bank with any “interested” director not participating in the voting. The Bank’s loan amount, which includes all other outstanding loans to such person, as to which such prior board of director approval is required, must be the greater of \$25,000 or 5% of capital and surplus (up to \$500,000). Section 22(h) requires that loans to directors, executive officers and principal shareholders be made in terms and underwriting standards substantially the same as offered in comparable transactions to other persons.

Other Regulation. The Bank is subject to a variety of other regulations. State and federal laws restrict interest rates on loans, potentially affecting the Bank’s income. The Truth in Lending Act and the Home Mortgage Disclosure Act impose information requirements on the Bank in making loans. The Equal Credit Opportunity Act prohibits discrimination in lending on the basis of race, creed, or other prohibited factors. The Fair Credit Reporting Act governs the use and release of information to credit reporting agencies. The Truth in Savings Act requires disclosure of yields and costs of deposits and deposit accounts. Other acts govern confidentiality of consumer financial records, automatic deposits and

withdrawals, check settlement, endorsement and presentment, and reporting of cash transactions as required by the Internal Revenue Service.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen the ability of U.S. law enforcement agencies and the intelligence communities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Future Regulatory Uncertainty. Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, the Bank cannot forecast how federal regulation of financial institutions may change in the future and impact its operations. Although Congress in recent years has sought to reduce the regulatory burden on financial institutions with respect to the approval of specific transactions, the Bank fully expects that the financial institution industry will remain heavily regulated in the near future and that additional laws or regulations may be adopted further regulating specific banking practices.

Dependence on Key Personnel

The Bank's growth and development to date have been largely dependent upon the services of William J. Farinholt, President and Chief Executive Officer, and Kenneth E. Smith, Executive Vice President and Chief Financial Officer. The loss of Mr. Farinholt's or Mr. Smith's services for any reason could have a material adverse effect on the Bank. In May 2004, the Bank purchased \$1,000,000 key man life insurance on each of these individuals.

Control by Certain Shareholders

No shareholders own 5.0% or more of the outstanding common stock of the Bank. As a group, the Board of Directors and the Bank's Executive Officers control 17.2% of the outstanding common stock of the Bank. Accordingly, such persons, if they were to act in concert, would not have majority control of the Bank, would not have the ability to approve certain fundamental corporate transactions or the election of the Board of Directors.

Item 2. Description of Property

The Bank's Main Office is located in temporary quarters at 6720 Sutton Road in Gloucester. Construction of the permanent bank building is currently underway, with completion slated for the fourth quarter of 2005.

The Bank's branch office is located in temporary quarters at the intersection of 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point. Construction of the permanent bank building is also underway at this location, with completion slated for the first quarter of 2005.

The Bank is leasing the temporary bank buildings for \$4,305 and \$2,310 per month, respectively. The non-cancelable, renewable leases expire on December 31, 2005.

The Bank's operating headquarters are located in leased quarters at 6558 Main Street, Gloucester. The non-cancelable, renewable lease expires on September 30, 2005. The Bank's operations department will move to the Main Office upon completion of the building. The monthly rental expense at this location is \$690.

Item 3. Legal Proceedings

The Bank is not a party to any pending legal proceeding outside the ordinary course of its business that could have a material impact on financial statements.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Common Equity and Related Shareholder Matters

There is no established public trading market for shares of the Bank's common stock. The initial issue price of the January 27, 2003 stock offering of the Bank's common stock was \$20.00 per share. To the knowledge of management, there were no purchase and sale transactions of the Bank's common stock in 2003. The following table sets forth the high and low prices for transactions in the Bank's common stock known to the Bank in 2004.

<u>2004</u>	High	Low
Fourth Quarter	\$22.00	\$22.00
Third Quarter	\$22.00	\$21.00
Second Quarter	\$21.00	\$21.00
First Quarter	\$21.00	\$20.00

The Bank has not paid any dividends on its Common Stock. The Bank intends to retain all of its earnings to finance its operations and does not anticipate paying cash dividends for the foreseeable future. Any decision made by the Board of Directors to declare dividends in the future will depend on the Bank's future earnings, capital requirements, financial condition and other factors deemed relevant by the Board.

As of March 30, 2005, the Bank had approximately 976 shareholders of record.

Item 6. Management's Discussion and Analysis or Plan of Operation

Overview

The Bank began as a de novo operation on November 6, 2003, although it did not open to the public until November 13, 2003. Therefore, comparative data in this discussion is of sequential interim periods (period ended December 31, 2004 compared to periods ended September 30, 2004, June 30, 2004 and March 31, 2004), rather than year over year annual or interim periods. Certain period end balances are compared between the periods ended December 31, 2004 and December 31, 2003. As a result, comparisons are somewhat skewed and of less significance than will be the case once the Bank has a longer record of operations and can make year over year interim period comparisons.

The Bank's initial business plan included opening two offices at the November 2003 inception of operations. This plan included substantial commitment to experienced, highly qualified personnel and the associated overhead expense. The opening of the second office, in fact, did not occur until December 26, 2003, thus causing the bearing of material overhead expense, without corresponding opportunity for revenue production. This is discussed further below under "Non-interest Expense." Discussions of traditional analytical factors may be distorted during these early stages of operation. Therefore, the following discussion of analytical factors should be viewed in light of the dynamics of a start-up operation experiencing rapid deposit growth and the challenge to develop a high quality, high yielding loan portfolio. Original balance sheet and income and expense projections done early in 2003 were brief in nature and have not been relied upon as a guiding budget. Management is developing a formal budget for 2005, using a combination of original projections and current identification of the market conditions.

The new budget will incorporate market conditions that have been identified since opening that are different from those expected during organization. Originally, management projected a significant concentration in retail consumer lending. However, the Bank has experienced more commercial loan activity. Although this was not due to a definitive directional shift, management previously cultivated many of these new commercial relationships while with their previous bank, Peninsula Trust Bank ("PTB"), in the same community. Thus, the customer directed move of these relationships has been welcomed by management. However, they will influence management's new budget and asset / liability management plans.

Critical Accounting Policies

General

The financial condition and results of operations presented in the Financial Statements, the accompanying Notes to Financial Statements and this section are, to a large degree, dependent upon the accounting policies of the Bank. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change.

Presented below is discussion of those accounting policies that management believes are the most important ("Critical Accounting Policies") to the portrayal and understanding of the Bank's financial condition and results of operations. The Critical Accounting Policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood.

Allowance for Loan and Lease Losses

The Bank monitors and maintains an allowance for loan and lease losses (“ALLL”) to absorb an estimate of probable losses inherent in the loan portfolio. The Bank maintains policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance that the systems are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system. The Bank uses an internal risk rating system and assigns a numeric rating to each loan based on multiple criteria, including but not limited to a borrower’s credit history (evidenced by credit bureau reporting), collateral and its supporting value, type of work or industry in which the borrower is involved, and any noted exceptions to internal policy. Varying percentages of outstanding balances by risk rating are used in determining the adequacy of the ALLL.

The Bank evaluates various loans individually for impairment as required by Statement of Financial Accounting Standards (“SFAS”) No. 114, Accounting by Creditors for Impairment of a Loan, and SFAS No. 118, Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. If a loan evaluated individually is not impaired, then the loan is assessed for impairment under SFAS No. 5, Accounting for Contingencies (“SFAS 5”), with a group of loans that have similar characteristics.

For loans without individual measures of impairment, the Bank makes estimates of losses for groups of loans as required by SFAS 5. Loans are grouped by similar characteristics, including the type of loan, the assigned loan grade and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans are adjusted for relevant environmental factors and other conditions of the portfolio of loans, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loans losses. This estimate of losses is compared to the allowance for loan losses of the Bank as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. If the estimate of losses is below the range of reasonable estimates, the allowance would be reduced by way of a credit to the provision for loan losses. The Bank recognizes the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the Financial Statements.

Financial Summary

In this discussion, comparisons of certain financial factors are made between the current quarter-end and year-end December 2003, while others are made between the sequential quarters ended September 2004 and December 2004. Of particular importance in any de novo institution is the trend toward profitability. The Bank's performance in this area has demonstrated a positive trend throughout fiscal year 2004. The net loss for the three months ended December 31, 2004 totaled \$102,814 compared to a net loss of \$195,673, \$265,298 and \$364,514 for the three month periods ended September 30, 2004, June 30, 2004 and March 31, 2004, respectively. Impressive in this trend is that the loss for the entire fourth quarter was 24.3% less than the \$135,795 loss for the first month of the year. Total average assets increased 120.5% from the December 31, 2003 amount of \$14.6 million to \$32.2 million at December 31, 2004. Average shareholders' equity decreased 2.0% to \$10.9 million in 2004. Return (loss) on average assets and equity at December 31, 2004 were (2.9%) and (8.5%), respectively.

Total assets for the Bank increased to \$43.6 million at December 31, 2004, compared to \$19.2 million at December 31, 2003, representing an increase of \$24.4 million or 127.1%. Total net loans at December 31, 2004 were \$29.4 million, an increase of \$25.8 million from the December 31, 2003 amount of \$3.6 million. The provision for loan losses in 2004 was \$270,590. The allowance for loan and lease losses was \$305,129, or 1.04% of total loans outstanding at December 31, 2004.

The investment portfolio increased 947.6% to \$5.5 million at December 31, 2004 compared to \$520,251 at December 31, 2003 as growth in the deposit base outpaced growth in the loan portfolio. Deposits increased \$25.2 million to \$32.9 million at December 31, 2004 from \$7.7 million at December 31, 2003. Time deposits totaled \$16.8 million at December 31, 2004, an increase of \$13.9 million from the \$2.9 million total at December 31, 2003.

Shareholders' equity was \$10.5 million at December 31, 2004. This amount represents a decrease of 8.7% from the December 31, 2003 amount of \$11.5 million due to losses recognized in 2004. The book value per common share was \$17.36 at December 31, 2004 and \$18.93 at December 31, 2003.

Growth levels continue to be encouraging. The composition of balance sheet growth was initially more commercial than consumer in nature, which has reflected lower than expected yields in the loan portfolio. Management, however, has vigilantly monitored the cost of funds associated with the growth. Due to the strong growth of deposits, along with the substantial initial capital subscription, the Bank has chosen to employ new deposit funds more aggressively through new loans, reducing the expected level of investment securities and overnight investment sales. While this aggressive lending posture is intended to enhance overall asset yield and resultant net interest income, it is imperative that credit quality be at the forefront of asset management. The Bank's initial investment in experienced lending personnel should aid in this effort to closely manage asset quality. As discussed further below, the Bank has been able to continuously increase net interest income throughout all four quarters of its first full year of operation. The positive growth of the loan portfolio has enhanced overall interest income. This enhanced interest income, though, has required a greater than expected provision for loan loss expense of \$270,590. The benefit of the long-term increased yield of the loan growth is expected to more than offset the short-term increase in the loan loss provision.

Net Interest Income

Net interest income is the Bank's primary source of earnings and represents the difference between interest and fees earned on earning assets and the interest expense paid on deposits and other interest bearing liabilities. Net interest income totaled \$449,034 for the fourth quarter 2004, compared to \$332,647, \$229,652 and \$114,790 for the third, second and first quarters of 2004, respectively. Average

earning assets increased \$14.4 million from \$14.0 million for the period ended December 31, 2003 to \$28.4 million for the period ended December 31, 2004. Average deposits increased \$15.0 million from \$6.2 million for the period ended December 31, 2003 to \$21.2 million for the period ended December 31, 2004. Throughout the first full year of operation, locally generated deposits have represented 100% of the Bank's funding sources. However, discussed below under "Liquidity", the Bank has entered into a national deposit program affording it access to a broader base of funding alternatives. While there has been no utilization of this alternative funding vehicle, it may play a significant part in overall management of interest expense and interest rate risk. Total interest expense was \$130,388 for the fourth quarter 2004, compared to \$97,040, \$70,315 and \$47,631 for the third, second and first quarters of 2004, respectively. The net interest margin, on a tax equivalent basis, was 3.96% for the period ended December 31, 2004 compared to 1.52% for the period ended December 31, 2003. The monthly net interest margin, when annualized, has increased steadily throughout 2004.

Quarterly comparisons of actual net interest income performance to original projections also illustrate a positive trend. For the three months ended March 31, 2004, actual net interest income was \$41,161 below projections, \$30,824 above projections for the three months ended June 30, 2004, \$60,493 above projections for the three months ended September 30, 2004 and \$121,000 above projections for the three months ended December 31, 2004. The trend in this area of operations bodes well for absorbing the additional expense discussed below regarding the Bank's strategy of hiring a highly experienced staff.

During the second quarter 2004, the Bank began utilizing asset liability management modeling software. This software provides tools for identifying repricing intervals, maturities, and cash flows of interest earning assets and interest bearing liabilities. In addition, income simulations are performed applying interest rate shocks to interest sensitive assets and liabilities. Modeling techniques may enable the Bank to minimize significant swings or variations in net interest income during periods of substantial fluctuations in market rates. The Bank does not specifically attempt to predict interest rate movements.

As discussed above, the Bank has aggressively attempted to employ excess liquidity through expansion of the loan and investment portfolios in order to enhance yield on earning assets. This strategy has resulted in steady improvement in net interest income, even in a stable interest rate environment. The Bank's current balance sheet structure is well positioned for the rising rate environment that is being forecast for the near term. The Bank's balance sheet structure has evolved into a moderately asset sensitive condition. This condition means that assets may reprice more quickly than liabilities and, in a rising rate environment, interest income would increase more quickly than interest expense. Conversely, when interest rates fall, interest income would decrease more quickly than interest expense. The Federal Reserve, through its Federal Open Market Committee ("FOMC") raised its targeted rate for Federal funds overnight transactions ("Fed funds rate"), the rate for overnight investment transactions involving excess funds between banks, on five occasions during 2004 by a total of 125 basis points. These moves affect other market rates and have favored the Bank's asset sensitive position, as evidenced by the enhanced net interest earnings. Asset yields have increased more rapidly than funding costs. However, management will closely monitor this condition to guard against repricing intervals for assets and liabilities becoming too far out of balance with each other. Management does not take gambling positions within the balance sheet, but does follow economic forecasting information from reputable analysts and financial consulting sources.

Non-interest Income

Non-interest income totaled \$36,175 for the fourth quarter 2004, compared to \$14,147, \$18,876 and \$9,194 for the third, second and first quarters of 2004, respectively. The primary components of non-interest income include service charges on deposit accounts, ATM transaction fees, commissions on credit life insurance, checkbook sales and title insurance. The fluctuation during the second, third, and

fourth quarters is attributable to a timing difference in the application of the title insurance income. This amount is expected to be relatively stable quarter over quarter in the future. The Bank also began developing a merchant card program during the second half of 2004. This program is still in a fledgling state, but is projected to enhance non-interest income through increased fees. Additionally, non-interest bearing deposit accounts associated with prospective merchant relationships, may enhance net interest earnings as well.

Service charges on deposit accounts totaled \$9,043 for the fourth quarter 2004, compared to \$9,033, \$8,546 and \$2,851 for the third, second and first quarters of 2004. The increase during 2004 is attributable to the continuing growth in the number of new accounts, as there were no specific fee rate increases.

Non-interest Expense

Total non-interest expense includes employee-related costs, occupancy and equipment expense and other overhead. Salaries and employee benefits totaled \$280,359 in the fourth quarter 2004, compared to \$259,596, \$256,135 and \$257,791 for the third, second and first quarters of 2004, respectively. The Bank hired highly experienced staff to begin operations. This strategy created substantial non-interest expense in the short-term, but is projected to build customer relationships more quickly and enhance long-term earnings performance for the Bank.

Strategic competitive decisions were made regarding product offerings, such as internet and telephone banking, ATM and debit cards, and optical file storage resulted in substantial initial investment in technology. Along with the decision discussed above regarding personnel, these technology decisions are expected to produce long-term efficiencies and competitive necessities. However, such initial financial investments require more critical mass of customer accounts when such a heavy reliance is placed on net interest income for overall profitability. It is projected that, regarding the relationship to non-interest income, critical mass of operations will reach a level to adequately cover expenses by the second quarter of 2005.

The Bank made the decision to open both banking offices at the outset. This decision was based on identified market demand in both locations. However, the location at Gloucester Point is a smaller lot. As a result, construction activity associated with the permanent building for this location has moderately hampered customer traffic to the temporary trailer on the site and yielded slower than projected growth. Thus, the overhead expense of personnel and rent has slowed the track toward profitable operations of the office. The permanent building is scheduled for completion by the end of March 2005, and occupancy in April 2005. Public response to the permanent building is quite favorable and removal of the temporary trailer is expected to provide an immediate increase in customer traffic.

Construction of the permanent building for the Main Office also experienced unforeseen delays. Since this office will house all information technology, item processing, bookkeeping, and accounting functions (“back office”), the extended period of time for the back office functions to occupy offsite rental space has caused higher than projected rental expense, including additional communication line expense.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses (“ALLL”) at December 31, 2004 was \$305,129, compared to \$37,000 at December 31, 2003. The allowance for loan losses was 1.04% of total loans outstanding at December 31, 2004, compared to 1.03% at December 31, 2003. The provision for loan losses was \$270,590 for the period ended December 31, 2004. Management believes that the allowance for loan losses is adequate to cover credit losses inherent in the loan portfolio at December 31, 2004.

Management revised the Loan Policy during the third quarter 2004 to expand the Bank’s credit risk rating system. The risk-rating system has been revised and was approved by the Board on October 12, 2004. The current system now includes six “pass” grades, as well as four adverse grades. All existing loans have been re-evaluated and assigned new risk ratings. Management will begin in January 2005, to not only incorporate these ratings into its methodology for evaluating the adequacy of the ALLL, but also into pricing strategies. These strategies will bring the Bank into compliance with the accounting standards referenced above. The future methodology will also reflect the provision for loan loss expense to accommodate only the risks associated with this evaluation exercise. During the Bank’s first full year of operation, management established an initial ALLL approximating 1.0% of total loans, until such time as the loan portfolio has seasoned to a degree that embedded risk can be more accurately identified.

Capital Resources

Shareholders’ equity at December 31, 2004 and December 31, 2003 was \$10.5 million and \$11.5 million, respectively. Total common shares outstanding at December 31, 2004 were 605,175.

At December 31, 2004, the Bank’s tier 1 and total risk-based capital ratios were 32.3% and 33.2%, respectively, compared to 141.7% and 142.1% at December 31, 2003. The Bank’s leverage ratio was 26.1% at December 31, 2004, compared to 78.3% at December 31, 2003. The Bank raised in excess of \$12.0 million in initial capital prior to opening, resulting in skewed capital ratios, compared to industry averages, until such time as the Bank’s asset base grows to fully leverage initial capital. The Bank’s capital structure places it above the regulatory guidelines, which affords the Bank the opportunity to take advantage of business opportunities while ensuring that it has the resources to protect against risk inherent in its business. This level of capital also provides sufficient resources during the business development stage.

Liquidity

Liquidity represents an institution’s ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, short-term investments, securities classified as available for sale and loans and securities maturing within one year. As a result of the Bank’s management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Bank maintains overall liquidity sufficient to satisfy its depositors’ requirements and meet its customers’ credit needs.

The Bank also maintains additional sources of liquidity through federal funds guidance lines with correspondent banks, which totaled \$5.2 million at December 31, 2004. During the fourth quarter, the Bank entered into an arrangement with QwickRate, a nationally organized program whereby, financial institutions may publish interest rates for CDs of various maturities and attract deposits from other investors (predominantly credit unions). There are no “brokers” or associated “broker fees.” The

arrangement provides community banks with a vehicle for providing both alternate funding and asset liability, interest rate risk management.

At December 31, 2004, cash, interest-bearing deposits with financial institutions, federal funds sold and securities available for sale were 27.9% of total deposits and liabilities. Management, through a Board approved Liquidity and Funding Policy, routinely monitors the Bank's liquidity position using various schedules and reports. A "Short-term Funds Availability Ratio" computes short-term assets (cash and due from banks, overnight funds and other cash equivalents, market value of available for sale securities, and unused lines of credit). The policy requires that this ratio be equal to or greater than 15% of total assets. At December 31, 2004, this ratio was 24.8%. Liability funding sources are also monitored. Demand and savings deposits, interest bearing and non-interest bearing, and time deposits under \$100,000 are monitored with a targeted level of 60% or greater as a percentage of total assets. At December 31, 2004, this percentage was 65.8%.

The Bank is a 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 loan commitments, standby letters of credit and documentary letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Bank's exposure to credit loss in the event of non-performance by the other party of these loan commitments 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 it does for on-balance sheet instruments.

Since many of the loan commitments and letters of credit may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness 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 counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, owner-occupied real estate and income-producing commercial properties.

The Bank maintains funds on deposit at correspondent banks which at times exceed the federally insured limits. Management of the Bank monitors the balance in these accounts and periodically assesses the financial condition of correspondent banks.

Caution About Forward Looking Statements

Certain information contained in this discussion may include “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by phrases such as “the Bank expects,” “the Bank believes” or words of similar import.

Such forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- risks inherent in making loans such as repayment risks and fluctuating collateral values;
- reliance on the Bank’s management team, including its ability to attract and retain key personnel;
- the successful management of interest rate risk;
- the ability to continue to attract low cost core deposits to fund asset growth;
- competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;
- the ability to successfully manage the Bank’s growth or implement its growth strategies if it is unable to identify attractive markets, locations or opportunities to expand in the future;
- changes in general economic and business conditions in the Bank’s market area;
- changing trends in customer profiles and behavior; and
- problems with technology utilized by the Bank;
- changes in banking and other laws and regulations applicable to the Bank;
- demand, development and acceptance of new products and services;
- maintaining cost controls and asset qualities as the Bank opens or acquires new branches;
- maintaining capital levels adequate to support the Bank’s growth.

Although the Bank believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Bank will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

COLONIAL VIRGINIA BANK

Gloucester, Virginia

FINANCIAL REPORT

DECEMBER 31, 2004

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**REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM**

To the Board of Directors
Colonial Virginia Bank
Gloucester, Virginia

We have audited the accompanying balance sheets of Colonial Virginia Bank as of December 31, 2004 and 2003, and the related statements of operations, changes in shareholders' equity, and cash flows for the year ended December 31, 2004 and the period from November 6, 2003 (commencement of banking operations) through December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the 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 Colonial Virginia Bank as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the year ended December 31, 2004 and for the period from November 6, 2003 (commencement of banking operations) through December 31, 2003, in conformity with U.S. generally accepted accounting principles.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
February 8, 2005

COLONIAL VIRGINIA BANK

Balance Sheets

December 31, 2004 and 2003

Assets	2004	2003
Cash and due from banks	\$ 2,252,740	\$ 1,461,159
Interest-bearing balances in banks	--	310,252
Federal funds sold	3,429,975	11,499,000
Securities available for sale, at fair market value	5,450,360	520,251
Loans, net of allowance for loan losses of \$305,129 in 2004 and \$37,000 in 2003	29,399,114	3,555,114
Bank premises and equipment, net	2,374,454	1,850,258
Bank owned life insurance	512,032	--
Other assets	171,918	36,447
Total assets	<u>\$ 43,590,593</u>	<u>\$ 19,232,481</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	\$ 4,934,971	\$ 696,817
Savings and interest-bearing demand deposits	11,191,954	4,068,859
Time deposits	16,817,293	2,911,530
Total deposits	\$ 32,944,218	\$ 7,677,206
Accrued expenses and other liabilities	142,264	96,385
Commitments and contingencies	--	--
Total liabilities	<u>\$ 33,086,482</u>	<u>\$ 7,773,591</u>
Shareholders' Equity		
Preferred stock, par value \$5 per share, authorized 5,000,000 shares; no shares issued and outstanding	\$ --	\$ --
Common stock, par value \$5 per share, authorized 10,000,000 shares; issued and outstanding 605,175 shares	3,025,875	3,025,875
Capital surplus	9,050,243	9,050,243
Retained (deficit)	(1,544,734)	(616,436)
Accumulated other comprehensive (loss)	(27,273)	(792)
Total shareholders' equity	<u>\$ 10,504,111</u>	<u>\$ 11,458,890</u>
Total liabilities and shareholders' equity	<u>\$ 43,590,593</u>	<u>\$ 19,232,481</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Operations

For the Twelve Months Ended December 31, 2004 and
for the Period from November 6, 2003 (Commencement of Banking Operations)
through December 31, 2003

	2004	2003
Interest and Dividend Income		
Interest and fees on loans	\$ 1,223,792	\$ 23,102
Interest on securities available for sale		
Taxable	152,401	951
Dividends	21,265	3,268
Interest on deposits in other banks	5,932	1,633
Interest on federal funds sold and other	68,107	12,481
Total interest and dividend income	\$ 1,471,497	\$ 41,435
Interest Expense, interest on deposits	\$ 345,374	\$ 8,833
Net interest income	\$ 1,126,123	\$ 32,602
Provision for Loan Losses	270,590	37,000
Net interest income (loss) after provision for loan losses	\$ 855,533	\$ (4,398)
Other Income		
Service charges on deposit accounts	\$ 29,473	\$ 320
Income on bank owned life insurance	12,032	--
Other service charges, commissions and fees	36,887	13
Total other income	\$ 78,392	\$ 333
Other Expenses		
Salaries and employee benefits	\$ 1,053,881	\$ 163,947
Occupancy expense	205,405	29,830
Furniture and equipment expense	8,424	6,778
Data processing	284,627	24,592
Advertising	63,189	3,746
Professional fees	45,107	12,553
Stationary and supplies	31,110	11,241
Postage and freight	21,165	1,712
Regulatory assessments	11,430	--
Insurance	25,450	3,827
Taxes	45,143	578
Other operating expenses	67,292	5,311
Total other expenses	\$ 1,862,223	\$ 264,115

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Operations

(Continued)

For the Twelve Months Ended December 31, 2004 and
for the Period from November 6, 2003 (Commencement of Banking Operations)
through December 31, 2003

	<u>2004</u>	<u>2003</u>
Net (loss) before income taxes	\$ (928,298)	\$ (268,180)
Income Taxes	<u> --</u>	<u> --</u>
Net (loss)	<u>\$ (928,298)</u>	<u>\$ (268,180)</u>
Earnings per Share , basic and diluted	<u>\$ (1.53)</u>	<u>\$ (0.44)</u>
Weighted Average Shares Outstanding , basic and diluted	<u>605,175</u>	<u>605,175</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Changes in Shareholders' Equity

For the Twelve Months Ended December 31, 2004 and
for the Period from November 6, 2003 (Commencement of Banking Operations)
through December 31, 2003

	Common Stock	Capital Surplus	Retained (Deficit)	Accumulated Other Compre- hensive (Loss)	Compre- hensive (Loss)	Total
Balance at November 6, 2003	\$ 3,025,875	\$ 9,050,243	\$ (348,256)	\$ --		\$ 11,727,862
Comprehensive (loss):						
Net (loss)	--	--	(268,180)	--	\$ (268,180)	(268,180)
Other comprehensive (loss), unrealized gain on securities available for sale	--	--	--	(792)	(792)	(792)
Total comprehensive (loss)	--	--	--	--	\$ (268,972)	--
Balance at December 31, 2003	\$ 3,025,875	\$ 9,050,243	\$ (616,436)	\$ (792)		\$ 11,458,890
Comprehensive (loss):						
Net (loss)	--	--	(928,298)	--	\$ (928,298)	(928,298)
Other comprehensive (loss), unrealized gain on securities available for sale	--	--	--	(26,481)	(26,481)	(26,481)
Total comprehensive (loss)	--	--	--	--	\$ (954,779)	--
Balance at December 31, 2004	<u>\$ 3,025,875</u>	<u>\$ 9,050,243</u>	<u>\$ (1,544,734)</u>	<u>\$ (27,273)</u>		<u>\$ 10,504,111</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Cash Flows

For the Twelve Months Ended December 31, 2004 and
for the Period from November 6, 2003 (Commencement of Banking Operations)
through December 31, 2003

Cash Flows From Operating Activities	<u>2004</u>	<u>2003</u>
Reconciliation of net (loss) to net cash (used in) operating activities:		
Net (loss)	\$ (928,298)	\$ (268,180)
Net amortization of premium on investment securities	34,427	4
Depreciation and amortization	194,264	20,431
Provision for loan losses	270,590	37,000
Changes in assets and liabilities:		
(Increase) in accrued interest and other assets	(147,503)	(36,447)
Increase in accrued expenses and other liabilities	<u>45,878</u>	<u>96,385</u>
Net cash (used in) operating activities	<u>\$ (530,642)</u>	<u>\$ (150,807)</u>
Cash Flows From Investing Activities		
Purchases of securities available for sale	\$ (9,784,986)	\$ (521,047)
Principal paydowns of securities available for sale	1,750,270	--
Maturities of securities available for sale	3,000,000	--
Cancellation of Federal Reserve Stock	43,700	--
Purchase of bank owned life insurance	(500,000)	--
Net (increase) in loans	(26,114,590)	(3,592,114)
Purchases of premises and equipment	<u>(718,460)</u>	<u>(1,870,689)</u>
Net cash (used in) investing activities	<u>\$ (32,324,066)</u>	<u>\$ (5,983,850)</u>
Cash Flows From Financing Activities		
Net increase in demand, savings, interest-bearing checking and money market deposits	\$ 11,361,249	\$ 4,765,676
Net increase in time deposits	<u>13,905,763</u>	<u>2,911,530</u>
Net cash provided by financing activities	<u>\$ 25,267,012</u>	<u>\$ 7,677,206</u>
Net increase (decrease) in cash and cash equivalents	\$ (7,587,696)	\$ 1,542,549
Cash and Cash Equivalents		
Beginning	<u>13,270,411</u>	<u>11,727,862</u>
Ending	<u>\$ 5,682,715</u>	<u>\$ 13,270,411</u>
Supplemental Disclosure of Cash Flow Information,		
cash paid for interest	<u>\$ 300,783</u>	<u>\$ 3,841</u>
Supplemental Disclosure of Noncash Activities,		
unrealized (loss) on securities available for sale	<u>\$ (26,481)</u>	<u>\$ (792)</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

Colonial Virginia Bank (the Bank) was organized under the laws of the Commonwealth of Virginia to engage in a general banking business serving the community in and around Gloucester County, Virginia. The Bank was in organization during the period from January 2, 2003 through November 5, 2003. The financial statements reflect the costs associated with the period prior to the opening of the Bank as an accumulated deficit as of that date. These costs include salaries, legal and professional fees and other relevant expenditures. During this period, the Bank had a net loss of \$348,256.

The Bank commenced regular operations on November 6, 2003 and is a member of the Federal Reserve System and the Federal Deposit Insurance Corporation. It is subject to the regulations of the Federal Reserve System and the State Corporation Commission of Virginia. Consequently, it undergoes periodic examinations by these regulatory authorities.

In a common stock offering ending on May 27, 2003, the Bank sold 605,175 shares of its Common Stock par value \$5 per share, at \$20 per share. Of the proceeds, \$3,025,875 was credited to common stock and \$9,050,243 was credited to surplus, net of offering costs.

Significant Accounting Policies

The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The more significant of these policies are summarized below.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing balances with banks and federal funds sold. Generally, federal funds are purchased and sold for one day periods.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity, 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. The Bank classifies all securities as available for sale. Other restricted securities, such as Federal Reserve Bank stock, are carried at cost.

Notes to Financial Statements

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 available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (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

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial loans throughout the Middle Peninsula area of Virginia. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination and commitment fees and certain direct costs are deferred and the net amount is amortized as an adjustment of the related loan's yield. The Bank is amortizing these amounts over the loan's contractual life.

The accrual of interest on mortgage, commercial and consumer loans is discontinued at the time the loan becomes 90 days delinquent unless the credit is well-secured and in process of collection. Non-performing loans are placed either in nonaccrual status pending further collection efforts or charged off if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on loans in nonaccrual status is accounted for on the cash basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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.

Notes to Financial Statements

Because the Bank has no history of loan losses, the current policy is to build an allowance for loan losses of approximately 1.00% of total loans. This percentage was determined based on peer group experience and the composition of the Bank's loan portfolio. In the future, the allowance for loan losses will be evaluated on a regular basis by management, and will be based upon management's periodic review of the collectibility 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 the 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.

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, collateral value, and 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 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. Impairments are charged to the allowance. The Bank had no impaired loans at December 31, 2004 or 2003.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the assets' estimated useful lives. Estimated useful lives range from 10 to 39 years for buildings and 3 to 7 years for furniture, fixtures and equipment.

Foreclosed Properties

Assets acquired through, or in lieu of, loan foreclosure are held for sale. They are initially recorded at the lower of the Bank's cost or the assets' fair market value at the date of foreclosure, less estimated selling costs thus establishing a new cost basis. Subsequent to foreclosure, valuations of the assets are periodically performed by management. Adjustments are made to the lower of the carrying amount or fair market value of the assets less selling costs. Revenue and expenses from operations and valuation changes are included in net expenses from foreclosed assets. The Bank had no foreclosed assets during the periods ended December 31, 2004 and 2003.

Notes to Financial Statements

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, 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, the valuation of foreclosed real estate and the valuation allowance of deferred tax assets.

Income Taxes

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Advertising Costs

The Bank follows the policy of charging the production costs of advertising to expense as incurred. The Bank expensed \$63,189 and \$3,746 for advertising costs for the year ended December 31, 2004 and the period from November 6, 2003 (commencement of banking operations) through December 31, 2003, respectively.

Comprehensive Income

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

Earnings Per Share

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. For the periods ended December 31, 2004 and 2003, the weighted average shares outstanding used to compute basic and diluted earnings (loss) per share were 605,175. For the year ended December 31, 2004, outstanding stock options totaling 32,854 were excluded from the computation as their effect would have been anti-dilutive.

Notes to Financial Statements

Stock-Based Compensation

As of December 31, 2004, the Bank had a stock-based compensation plan. The Bank accounts for the plan under the recognition and measurement principles of APB Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following illustrates the effect on net income and earnings per share for the twelve month period ended December 31, 2004 had the fair value recognition provisions of the SFAS No. 123, *Accounting for Stock-Based Compensation*, been adopted.

	Twelve Months Ended December 31, 2004
Net (loss), as reported	\$ (928,298)
Additional expense had the Bank adopted SFAS No. 123	<u>(72,049)</u>
Pro forma net (loss)	<u>\$ (1,000,347)</u>
Basic earnings (loss) per share as reported	<u>\$ (1.53)</u>
Pro forma	<u>\$ (1.65)</u>
Diluted earnings (loss) per share	<u>\$ (1.53)</u>
Pro forma	<u>\$ (1.65)</u>

The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions for grants in 2004: price volatility of 4.52%, risk-free interest rate of 4.58%, expected dividend yield of 0% and expected lives of 10 years. There were 32,854 grants in 2004.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). This Interpretation provides guidance with respect to the identification of variable interest entities when the assets, liabilities, non-controlling interests, and results of operations of a variable interest entity need to be included in a Bank's financial statements. An entity is deemed a variable interest entity, subject to the interpretation, if the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or in cases in which the equity investors lack one or more of the essential characteristics of a controlling financial interest, which include the

Notes to Financial Statements

ability to make decisions about the entity's activities through voting rights, the obligations to absorb the expected losses of the entity if they occur, or the right to receive the expected residual returns of the entity if they occur. Due to significant implementation issues, the FASB modified the wording of FIN 46 and issued FIN 46R in December of 2003. FIN 46R deferred the effective date for the provisions of FIN 46 to entities other than Special Purpose Entities (SPEs) until financial statements issued for periods ending after March 15, 2004. SPEs were subject to the provisions of either FIN 46 or FIN 46R as of December 15, 2003. The adoption of FIN 46 and FIN 46R did not have a material effect on the Bank's financial position or results of operations.

Emerging Issues Task Force (EITF) Issue No. 03-1, "*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*," was issued and is effective March 31, 2004. The EITF 03-1 provides guidance for determining the meaning of "other than temporarily impaired" and its application to certain debt and equity securities within the scope of SFAS No. 115, "*Accounting for Certain Investments in Debt and Equity Securities*," and investments accounted for under the cost method. The guidance requires that investments which have declined in value due to credit concerns or solely due to changes in interest rates must be recorded as other-than-temporarily impaired unless the Bank can assert and demonstrate its intention to hold the security for a period of time sufficient to allow for a recovery of fair value up to or beyond the cost of the investment which might mean maturity. This issue also requires disclosures assessing the ability and intent to hold investments in instances in which an investor determines that an investment with a fair value less than cost is not other than temporarily impaired. On September 30, 2004, the FASB decided to delay the effective date for the measurement and recognition guidance contained in Issue 03-1. This delay does not suspend the requirement to recognize other than temporary impairments as required by existing authoritative literature. The disclosure guidance in Issue 03-1 was not delayed.

EITF No. 03-16, "*Accounting for Investments in Limited Liability Companies*," was ratified by the FASB and is effective for reporting periods beginning after June 15, 2004." APB Opinion No. 18, "*The Equity Method of Accounting Investments in Common Stock*," prescribes the accounting for investments in common stock of corporations that are not consolidated. AICPA Accounting Interpretation 2, "*Investments in Partnerships Ventures*," of Opinion 18, indicates that "many of the provisions of the Opinion would be appropriate in accounting" for partnerships. In *EITF Abstracts*, Topic No. D-46, "*Accounting for Limited Partnership Investments*," the SEC staff clarified its view that investments of more than 3 to 5 percent are considered to be more than minor and, therefore, should be accounted for using the equity method. Limited liability companies (LLCs) have characteristics of both corporations and partnerships, but are dissimilar from both in certain respects. Due to those similarities and differences, diversity in practice exists with respect to accounting for non-controlling investments in LLCs. The consensus reached was that an LLC should be viewed as similar to a corporation or similar to a partnership for purposes of determining whether a non-controlling investment should be accounted for using the cost method or the equity method of accounting.

Notes to Financial Statements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "*Share-Based Payment.*" This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. The Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. The Statement requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award – the requisite service period (usually the vesting period). The entity will initially measure the cost of employee services received in exchange for an award of liability instruments based on its current fair value; the fair value of that award will be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of those instruments (unless observable market prices for the same or similar instruments are available). If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification. This Statement is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. Under the transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosures. For periods before the required effective date, entities may elect to apply a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods by SFAS No. 123.

Notes to Financial Statements

Note 2. Securities

Amortized cost and fair values of securities available for sale at December 31, 2004, were as follows:

	2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities of U.S. government and federal agencies	\$ 1,250,000	\$ --	\$ (12,900)	\$ 1,237,100
Mortgage-backed securities	3,908,183	13,716	(28,089)	3,893,810
Restricted stock	<u>319,450</u>	<u>--</u>	<u>--</u>	<u>319,450</u>
Total	<u>\$ 5,477,633</u>	<u>\$ 13,716</u>	<u>\$ (40,989)</u>	<u>\$ 5,450,360</u>

Amortized cost and fair values of securities available for sale at December 31, 2003, were as follows:

	2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities of U.S. government and federal agencies	\$ 157,893	\$ --	\$ (792)	\$ 157,101
Restricted stock	<u>363,150</u>	<u>--</u>	<u>--</u>	<u>363,150</u>
Total	<u>\$ 521,043</u>	<u>\$ --</u>	<u>\$ (792)</u>	<u>\$ 520,251</u>

At December 31, 2004 and 2003, no securities were pledged.

Notes to Financial Statements

The amortized cost and fair value of securities available for sale at December 31, 2004, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without penalties.

	Amortized Cost	Fair Value
One to five years	\$ 1,815,177	\$ 1,797,010
Five to ten years	1,822,486	1,808,591
After ten years	1,520,520	1,525,309
Other	319,450	319,450
Total	\$ 5,477,633	\$ 5,450,360

There were no proceeds from sales and calls of securities available for sale for the twelve months ended December 31, 2004 or in the period from inception through December 31, 2003.

There were no held to maturity securities at December 31, 2004 or December 31, 2003.

At December 31, 2004, 15 investment securities had an unrealized loss totaling \$40,989 (all in an unrealized loss position for less than twelve months). The investment securities are obligations of entities that are excellent credit risks. The temporary impairment noted is the result of market conditions and does not reflect on the ability of the issuers to repay the obligations. As management has the ability and intent to hold these securities, or the foreseeable future, no declines are deemed to be other than temporary. There were no investment securities held at December 31, 2004 or 2003 that had been in an unrealized loss position for greater than 12 months.

Notes to Financial Statements

Note 3. Loans

The loan portfolio was composed of the following at the dates indicated:

	December 31,	
	2004	2003
Mortgage:		
Construction and land development	\$ 6,277,640	\$ 269,488
Residential real estate	7,348,238	504,399
Nonresidential	5,110,932	256,937
Commercial	7,776,096	1,696,085
Agricultural and other farm loans	415,000	--
Consumer and all other loans	2,879,906	881,315
	\$ 29,807,812	\$ 3,608,224
Allowance for loan losses	305,129	37,000
Unearned income	103,569	16,110
Loans, net	\$ 29,399,114	\$ 3,555,114

Overdrafts totaling \$2,422 and \$733 at December 31, 2004 and 2003, respectively, were reclassified from deposits to loans.

The Bank had no non-performing assets at December 31, 2004 or 2003.

An analysis of the allowance for loan losses was as follows for the periods indicated:

	December 31,	
	2004	2003
Balance at the beginning of the period	\$ 37,000	\$ --
Provision for loan losses	270,590	37,000
Loans charged off	(2,590)	--
Recoveries on loans		
previously charged off	129	--
Balance at the end of the period	\$ 305,129	\$ 37,000

Notes to Financial Statements

Note 4. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	December 31,	
	2004	2003
Land and land improvements	\$ 1,445,992	\$ 1,265,522
Furniture, fixtures and equipment	565,016	433,967
Leasehold improvements	35,261	24,901
Construction in progress	542,881	146,299
	<u>\$ 2,589,150</u>	<u>\$ 1,870,689</u>
Less accumulated depreciation	214,696	20,431
	<u>\$ 2,374,454</u>	<u>\$ 1,850,258</u>

Depreciation expense for the year ended December 31, 2004 totaled \$194,264. For the period from November 6, 2003 (commencement of banking operations) through December 31, 2003, depreciation expense was \$20,431.

As of December 31, 2004, the Bank had three noncancellable lease agreements for the operating headquarters and two temporary branch banking facilities. Pursuant to the terms of lease agreements regarding bank premises, future minimum rent commitments under operating leases are as follows: 2005, \$51,885.

The leases state that if the Bank holds possession of the premises after the expiration date, the Bank shall become a tenant on a month-to-month basis. The monthly rental payment shall continue as provided unless notice is given. Total rent expense for the year ended December 31, 2004 and the period from November 6, 2003 (commencement of banking operations) through December 31, 2003 amounted to \$88,279 and \$14,012, respectively.

Note 5. Borrowings

The Bank has unsecured lines of credit with correspondent banks totaling \$5,200,000 available for overnight borrowing.

Note 6. Related Party Transactions

In the normal course of business, the Bank extends credit to directors and executive officers. The aggregate amount of outstanding loans at December 31, 2004 and 2003 totaled \$1,794,656 and \$546,420, respectively. During the year ended December 31, 2004, total principal additions were \$1,843,558 and total principal repayments were \$595,322.

Deposits from related parties totaled \$1,855,710 and \$1,151,767 at December 31, 2004 and 2003, respectively.

Notes to Financial Statements

Note 7. Time Deposits

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2004 and 2003 was \$2,868,819 and \$730,012, respectively.

At December 31, 2004, the scheduled maturities on certificates of deposit are as follows:

2005	\$ 16,441,968
2006	320,885
2007	<u>54,440</u>
	<u>\$ 16,817,293</u>

Note 8. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2004 and 2003 are presented below:

	December 31,	
	2004	2003
Deferred Tax Assets:		
Allowance for loan losses	\$ 103,744	\$ 12,580
Organizational and start-up expenses	114,497	144,366
Deferred compensation	5,042	--
Other	697	--
Unrealized losses on securities available for sale	<u>9,273</u>	<u>269</u>
	\$ 233,253	\$ 157,215
Deferred Tax Liabilities:		
Bank premises and equipment	<u>44,819</u>	<u>56,000</u>
	\$ 188,434	\$ 101,215
Less: Valuation Allowance	<u>(188,434)</u>	<u>(101,215)</u>
Net Deferred Tax Assets	<u>\$ --</u>	<u>\$ --</u>

The provision for income taxes charged to operations for the year ended December 31, 2004 and the period from November 6, 2003 (commencement of banking operations) through December 31, 2003, consists of the following:

	2004	2003
Current tax expense	\$ --	\$ --
Deferred tax (benefit)	(87,219)	(80,309)
Change in valuation allowance	<u>87,219</u>	<u>80,309</u>
	<u>\$ --</u>	<u>\$ --</u>

Notes to Financial Statements

Under the provisions of the Internal Revenue Code, the Bank has approximately \$582,531 of net operating loss carryforwards which can be offset against future taxable income. The carryforwards expire December 31, 2024. The full realization of the tax benefits associated with the carryforwards depends predominately upon the recognition of ordinary income during the carryforward period.

Note 9. Financial Instruments with Off-Balance-Sheet Risk

The Bank is party to credit related 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. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

	December 31,	
	2004	2003
	(in thousands)	
Commitments to grant loans	\$ 1,556	\$ 1,274
Unfunded commitments under lines of credit	5,112	208
Commercial and standby letters of credit	512	56

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. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Notes to Financial Statements

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary.

The Bank maintains its cash accounts in several correspondent banks. The amount by which cash on deposit in those banks exceeds the federally insured limits totaled \$1,173,691 and \$1,148,891 at December 31, 2004 and 2003, respectively.

Note 10. Stock Option Plans

During 2004, the Bank adopted an incentive stock plan under which options may be granted to certain key employees and directors for purchase of the Bank's common stock. The effective date of the plan was June 16, 2004, with an expiration date of June 16, 2014. The plan reserves for issuance 75,000 shares of the Bank's voting common stock. The stock option plan requires that options be granted at an exercise price equal to at least 100% of the fair market value of the common stock on the date of the grant. Such options are generally not exercisable until one year from the date of issuance. The options will expire in no more than ten years after the date of grant.

A summary of the activity in the plan during 2004 follows:

	2004	
Shares	Weighted Average Exercise Price	
Outstanding at beginning of year	--	\$ --
Granted	32,854	21.08
Outstanding at end of year	32,854	\$ 21.08
Options exercisable, end of year	--	--
Weighted average fair value of options granted during the year	\$	7.65

Notes to Financial Statements

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend rate of 0.00%, price volatility of 4.52%, risk-free interest rate of 4.58% and an expected life of 10 years. The options have exercise prices ranging from \$21 to \$22 and have a weighted average remaining term of 9.6 years.

Note 11. Deferred Compensation and Life Insurance

In connection with employment contracts between the Bank and its two executive officers, provision has been made for the future compensation which is payable upon their termination of employment through retirement. At December 31, 2004, \$14,829 has been accrued under these contracts and this liability is recognized in the financial statements.

The Bank is the owner and beneficiary of life insurance policies aggregating \$6.5 million on the lives of those employees. The policies had an aggregate cash surrender value of \$512,032 at December 31, 2004.

The deferred compensation is to be paid to the individuals or their beneficiaries over a period of 15 years commencing with the first year following the termination of employment after completion of required service. The Bank records periodic accruals for the cost of providing such benefits by charges to income. The accruals increase each year for the discount rate (6.00%) used in determining the estimated liability that will be accrued when the employees are eligible for benefits.

The employment agreements with the officers mentioned above also provide that death benefits totaling \$1.15 million at December 31, 2004, will be paid to their beneficiaries in the event the officers should die while they are employees of the Bank. The amount of death benefits payable under the terms of the agreements remain level while the executives are employed and begin decreasing upon the activation of their respective retirements.

Note 12. Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, 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, financial institutions must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. A financial institution's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Notes to Financial Statements

Quantitative measures established by regulation to ensure capital adequacy require financial institutions to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2004, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2004, the most recent notification from the Federal Reserve Bank categorized the Bank as 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 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios as of December 31, 2004 and 2003 are also presented in the 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>
(Amounts in Thousands)						
As of December 31, 2004:						
Total Capital (to Risk Weighted Assets)	\$ 10,836	33.20%	\$ 2,611	8.00%	\$ 3,264	10.00%
Tier 1 Capital (to Risk Weighted Assets)	\$ 10,531	32.27%	\$ 1,306	4.00%	\$ 1,958	6.00%
Tier 1 Capital (to Average Assets)	\$ 10,531	26.05%	\$ 1,617	4.00%	\$ 2,022	5.00%
As of December 31, 2003:						
Total Capital (to Risk Weighted Assets)	\$ 11,497	142.11%	\$ 647	8.00%	\$ 809	10.00%
Tier 1 Capital (to Risk Weighted Assets)	\$ 11,460	141.66%	\$ 324	4.00%	\$ 485	6.00%
Tier 1 Capital (to Average Assets)	\$ 11,460	78.32%	\$ 585	4.00%	\$ 732	5.00%

Notes to Financial Statements

Note 13. Fair Value of Financial Instruments and Interest Rate Risk

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. 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. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

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

Cash, short-term investments and federal funds sold: The carrying amounts of cash and short-term instruments approximate fair values. The carrying amounts of interest-bearing deposits maturing within 90 days approximate their fair values.

Securities: Fair values for securities, excluding restricted stock, are based on quoted market prices. The carrying value of restricted stock approximates fair value based on the redemption provisions of the respective entity.

Loans: For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits: The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Off-balance-sheet instruments: Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At December 31, 2004 and 2003, the fair value of loan commitments and standby letters of credit were immaterial.

The estimated fair values and related carrying amounts of the Bank's financial instruments are as follows:

	2004	
	<u>Carrying</u>	<u>Fair</u>
	<u>Amount</u>	<u>Value</u>
	(In Thousands)	
Financial assets:		
Cash and short-term investments	\$ 5,683	\$ 5,683
Securities	5,450	5,450
Loans, net	29,399	28,962
Accrued interest receivable	109	109
Financial liabilities:		
Deposits	\$ 32,944	\$ 31,928
Accrued interest payable	50	50

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Bank's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 8A. Controls and Procedures

As of the end of the period covered by this report, the Bank carried out an evaluation, under the supervision and with the participation of the Bank's management, including the Bank's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Bank's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Bank's Chief Executive Officer and Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective in timely alerting them to material information relating to the Bank required to be included in the Bank's periodic filings with the Board of Governors of the Federal Reserve System.

The Bank's management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in the Bank's internal control over financial reporting identified in connection with the evaluation of it that occurred during the quarter that ended December 31, 2004 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Item 8B. Other Information

None.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act

Directors and Executive Officers

The directors and executive officers of the Bank are as follows:

<u>Name</u>	<u>Age</u>	<u>Position(s) and Offices Presently Held with the Bank</u>
Hal D. Bourque	54	Director and member of Executive Committee and Audit Committee
Charles F. Dawson	63	Director and member of Audit Committee
William J. Farinholt	58	President and Chief Executive Officer, Director and member of Executive Committee and Loan Committee
Joseph F. Fary	51	Director and member of Loan Committee
William D. Fary	75	Director and member of Loan Committee
Robert D. Foster	62	Director and member of Executive Committee and Loan Committee
Walter B. Hurley	79	Director and member of Audit Committee
Joseph A. Lombard, Jr.	58	Chairman of the Board and member of the Executive Committee and Audit Committee
James L. Miller, Jr.	51	Director and member of Loan Committee
Kenneth E. Smith	53	Executive Vice President and Chief Financial Officer, Director and member of Asset Liability Management Committee
Elsa C. Verbyla	52	Director and member of Audit Committee
David G. Walker	60	Director and member of Executive Committee and Asset Liability Management Committee
Valerie Wilcox	56	Director and member of Asset Liability Management Committee and Audit Committee

The following paragraphs sets forth the principal occupations and business experience for the directors and executive officers. The date shown for first election as a director in the information below represents the year in which the director was first elected to the Board of Directors of the Bank. Unless otherwise indicated, the business experience and principal occupations shown for each director or executive officer has extended for five or more years.

Hal D. Bourque, 54, has been a director since 2002.

Mr. Bourque is Executive Vice President and Director of Virginia Health Services, Inc., a health care management company located in Newport News, Virginia.

Charles F. Dawson, 63, has been a director since 2002.

Mr. Dawson is a Partner with Bay Design Group, P.C., an engineering and land surveying company with locations in Gloucester, Richmond, and Saluda, Virginia. For the past six years, he has also served on the Board of Directors of Bay Design Group, P. C. and BDG Properties, LLC.

William J. Farinholt, 58, has served as President and Chief Executive Officer and has been a director since 2002.

Mr. Farinholt is the President and Chief Executive Officer of the Bank. Mr. Farinholt has 33 years of banking experience. He was a founder, organizing Director, President, and Chief Executive Officer of PTB., a community bank based in Gloucester from 1988 to 2001. He was President and Chief Executive Officer of AFC (formerly MACB), a bank holding company owning two community banks, PTB and United Community Bank, from 1998 to 2001. He served as Area President of F&M Bank-Atlantic from 2001 to 2002 and most recently as City Executive for BB&T located in Gloucester.

Joseph F. Fary, 51, has been a director since 2002.

Mr. Fary is the manager of W. T. Fary Brothers Company, LLC, a retail lumber sales company located in Gloucester, Va.

William D. Fary, 75, has been a director since 2002.

Mr. Fary is the owner and President of Bill Fary Ford, Inc. a retail automobile sales establishment located in Gloucester, Virginia. He is also President of Mobjack Development, Ltd.

Robert D. Foster, 62, has been a director since 2002.

Mr. Foster is the President of Tre-Suz-Ann Development and Foster Management.

Walter B. Hurley, 79, has been a director since 2002.

Mr. Hurley is the owner of Bethpage Camp-Resort in Urbanna and Grey's Point Camp in Topping, Virginia.

Joseph A. Lombard, Jr., 58, has served as the Chairman of the Board of Directors since 2002.

Dr. Lombard is a self-employed Dentist with Drs. Lombard, Luckam, Gordon & Smith, a dental practice located in Gloucester, Virginia.

James L. Miller, Jr., 51, has been a director since 2002.

Mr. Miller is the President of Jim Miller Construction, Inc., a general contractor located in Gloucester, Virginia. Mr. Miller is also President of Miller's Septic Service.

Kenneth E. Smith, 53, has served as the Executive Vice President and Chief Financial Officer and has been a director since 2002.

Mr. Smith is the Executive Vice President & Chief Financial Officer of the Bank. Mr. Smith has 31 years of banking experience. He was a founder, organizing Director, Executive Vice President and Chief Financial Officer of PTB, a community bank located in Gloucester from 1988 to 2001. He was Executive Vice President and Chief Financial Officer of AFC (formerly MACB), a bank holding company owning two banks, PTB and United Community Bank, from 1998 to 2001. He served as Executive Vice President of F&M Bank-Atlantic and then returned to the Federal Reserve Bank as a commercial bank examiner where he served as Special Operations Coordinator in the Banking Supervision and Regulation Department from October, 2001 through December, 2002.

Elsa C. Verbyla, 52, has been a director since 2002.

Ms. Verbyla is the Managing Editor of the Gloucester-Mathews Gazette Journal, a weekly newspaper, and Vice-President of its publishing company, Tidewater Newspapers, Inc., located in Gloucester, Virginia.

David G. Walker, 60, has been a director since 2002.

Dr. Walker is a self-employed dentist located in Williamsburg, Virginia.

Valerie Wilcox, 56, has been a director since 2002.

Ms. Wilcox is the owner of Twice Told Tales, Ltd., a retail bookstore with two locations in Gloucester, one in Essex County and one in Kilmarnock.

Code of Ethics

The Board of Directors has approved a Code of Business Conduct and Ethics for directors, officers and employees of the Bank. This Code of Ethics includes the Bank's Chief Executive Officer and Principal Financial Officer. The Code addresses such topics as protection and proper use of Bank assets, compliance with applicable laws and regulations, accuracy and preservation of records, accounting and financial reporting, and conflicts of interest. The Bank's reputation for honesty and integrity is determined by the personal reputations of all individuals associated with the Bank. To protect this reputation and to warrant the public trust, each individual must strive to avoid situations that might cause a conflict of interest among the Bank, its customers, its suppliers, and the respective individual employees. This code presents some guidelines and practices that should be helpful individuals to understand their responsibilities. The Bank is prohibited from knowingly employing anyone who has been convicted of any criminal offense involving dishonesty or a breach of trust. A copy of the code is available upon request from the Corporate Secretary of the Bank at P. O. Box 2120 Gloucester, VA 23061.

Audit Committee Financial Expert

The members of the Audit Committee are Mr. Dawson, Mr. Bourque, Mr. Hurley, Ms. Verbyla and Ms. Wilcox, as well as Chairman of the Board Lombard (ex-officio member of the Audit Committee), all of whom the Board, in its business judgment, has determined are independent, as that term is defined in the listing standards of the Nasdaq Stock Market, Inc. The Bank has not currently designated an "audit committee financial expert." The Board, however, believes that the current members of the Audit Committee have the ability to understand financial statements and generally accepted accounting principles, the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves, an understanding of internal controls and procedures for financial reporting and an understanding of audit committee functions. Mr. Dawson, chairman of the committee, was a founder and organizing Director of Peninsula Trust Bank ("PTB") in 1988 and subsequently served on the Board of Directors of its successors. He also served on the Executive committee and the Audit committee of PTB and the Audit committee of Mid-Atlantic Community BankGroup ("MACB") and Atlantic Financial Corp. ("AFC"). He participated in review of regulatory examinations and applications associated with the formation of one bank holding company and the merger of two bank holding companies. He also reviewed the operating procedures manual and related internal controls of PTB.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Bank's directors and executive officers, and any persons who own more than 10% of the outstanding shares of Common Stock, to file with the Federal Reserve reports of ownership and changes in ownership of Common Stock. Directors and executive officers are required by regulations to furnish the Bank with copies of all Section 16(a) reports that they file. Based solely on review of the copies of such reports furnished to the Bank or written representation that no other reports were required, the Bank believes that, during the 2004 year, all

filing requirements applicable to its officers and directors were complied with, except that Form 4 filings for stock options granted on July 13, 2004, to two executive officers and to each director were made on or about November 26, 2004.

Item 10. Executive Compensation

Executive Compensation

The following table shows, for the fiscal years ended December 31, 2004 and 2003, the cash compensation paid by the Bank, as well as certain other compensation paid or accrued for those years, to each of the named executive officers in all capacities in which he or she served:

Summary Compensation Table

<u>Name and Principal Position</u>	<u>Year</u>	<u>Annual Compensation</u>			<u>Long Term Compensation Securities Underlying Options (#)</u>
		<u>Salary (\$)</u>	<u>Bonus (\$)</u>	<u>Other Annual Compensation (\$)</u>	
William J. Farinholt President and Chief Executive Officer	2004	125,000	--	*	
	2003	125,000	--	*	
Kenneth E. Smith Executive Vice President and Chief Financial Officer	2004	100,000	--	*	
	2003	100,000	--	*	

* All benefits that might be considered of a personal nature did not exceed the lesser of \$50,000 or 10% of total annual salary and bonus.

Stock Options

The following table sets forth for the year ended December 31, 2004, the grants of stock options to the named executive officers:

Option Grants In Last Fiscal Year

<u>Name</u>	<u>Number of Securities Underlying Options Granted (#)⁽¹⁾</u>	<u>Percent of Total Options Granted to Employees in Fiscal Year (%)⁽²⁾</u>	<u>Exercise or Base Price (\$/Share)</u>	<u>Expiration Date</u>
William J. Farinholt	2,000	29.63%	\$21.00	7/13/2014
Kenneth E. Smith	2,000	29.63%	\$21.00	7/13/2014

⁽¹⁾ Stock options were granted at or above the fair market value of the shares of Common Stock at the date of award. Each grant becomes exercisable on July 13, 2005, or one year from the date of the grant.

⁽²⁾ Options to purchase 2,750 shares of Common Stock were granted to employees during the year ended December 31, 2004.

The following table sets forth information with respect to the exercise of stock options by the named executive officers in 2004 and the amount and value of stock options held by the named executive officers as of December 31, 2004:

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year End Option Values

<u>Name</u>	<u>Shares Acquired on Exercise (#)</u>	<u>Value Realized (\$) ⁽¹⁾</u>	<u>Number of Securities Underlying Unexercised Options at Fiscal Year End (#)</u>		<u>Value of Unexercised In-the-Money Options at Fiscal Year End (\$) ⁽²⁾</u>	
			<u>Exercisable</u>	<u>Unexercisable</u>	<u>Exercisable</u>	<u>Unexercisable</u>
William J. Farinholt	None	\$0	None	2,000	\$0	\$2,000
Kenneth E. Smith	None	\$0	None	2,000	\$0	\$2,000

⁽¹⁾ The value realized was calculated by determining the difference between (i) the fair market value of common stock underlying the options at the date of exercise and (ii) the exercise price of the options.

⁽²⁾ The value of in-the-money options at fiscal year end was calculated by determining the difference between the fair market value of a share of Common Stock on December 31, 2004 and the exercise price of the options.

Employment Agreements

Effective as of August 5, 2003, the Bank and William J. Farinholt entered into an employment contract that provides for Mr. Farinholt's service as President and Chief Executive Officer of the Bank. Mr. Farinholt's employment contract is for five years at an initial base annual salary of \$125,000, and he is eligible for base salary increases and bonuses as determined by the Board of Directors. Mr. Farinholt's employment may be terminated by the Bank with or without cause. If he resigns for "good reason" or is terminated without "cause" (as those terms are defined in the employment agreement), however, he is entitled to salary and certain benefits for the greater of the remainder of his contract or one year. Mr. Farinholt's contract also contains a covenant not to compete.

Effective as of August 5, 2003, the Bank and Kenneth E. Smith entered into an employment contract that provides for Mr. Smith's service as Executive Vice President and Chief Financial Officer of the Bank. Mr. Smith's employment contract is for five years at an initial base annual salary of \$100,000, and he is eligible for base salary increases and bonuses as determined by the Board of Directors. Mr. Smith's employment may be terminated by the Bank with or without cause. If he resigns for "good reason" or is terminated without "cause" (as those terms are defined in the employment agreement), however, he is entitled to salary and certain benefits for the greater of the remainder of his contract or one year. Mr. Smith's contract also contains a covenant not to compete.

Director Compensation

There were no fees paid to Directors in 2004. Director compensation is reviewed periodically relative to their service, their legal liability and the financial condition of the Bank. During the initial period of the Bank experiencing net operating losses, it was deemed appropriate to withhold director fees. Payment of fees will be reconsidered as the Bank reaches profitability.

Pursuant to the 2004 Equity Compensation Plan, approved by the stockholders on June 16, 2004, a total of 26,104 stock options were granted to the organizing directors on July 13, 2004. These options were granted at \$21.00 per share with an expiration date of July 13, 2014.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security Ownership of Directors and Executive Officers

The following table sets forth, as of March 30, 2005, certain information with respect to beneficial ownership of shares of Common Stock owned by each of the members of the Board of Directors, by each of the executive officers named in the “Summary Compensation Table” below and by all directors and executive officers as a group. Beneficial ownership includes shares, if any, held in the name of the spouse, minor children or other relatives of a director living in such person’s home, as well as shares, if any, held in the name of another person under an arrangement whereby the director or executive officer can vest title in himself at once or at some future time.

<u>Name</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Class (%)</u>
Directors:		
Hal D. Bourque ⁽¹⁾	3,060	*
Charles F. Dawson ⁽²⁾	5,818	*
William J. Farinholt ⁽³⁾	18,713	3.09
Joseph F. Fary ⁽⁴⁾	1,450	*
William D. Fary	3,750	*
Robert D. Foster ⁽⁵⁾	5,400	*
Walter B. Hurley	17,188	2.84
Joseph A. Lombard, Jr. ⁽⁶⁾	21,923	3.62
James L. Miller, Jr. ⁽⁷⁾	4,244	*
Kenneth E. Smith ⁽⁸⁾	9,850	1.63
Elsa C. Verbyla ⁽⁹⁾	3,250	*
David G. Walter ⁽¹⁰⁾	5,500	*
Valerie Wilcox ⁽¹¹⁾	4,050	*
Directors and executive officers as a group (13 persons)	104,196	17.22%

* Percentage of ownership is less than one percent of the outstanding shares of Common Stock.

- (1) Amount disclosed includes 3,060 shares of Common Stock owned in Mr. Bourque’s IRA account.
- (2) Amount disclosed includes 5,613 shares of Common Stock owned in Mr. Dawson’s IRA accounts and 205 shares held in Education IRA accounts for his grandchildren.
- (3) Amount disclosed includes 17,500 shares of Common Stock owned in Mr. Farinholt’s IRA account and 1,213 shares held jointly with his spouse.
- (4) Amount disclosed includes 950 shares of Common Stock held jointly with Mr. Fary’s spouse.
- (5) Amount disclosed includes 1,650 shares held as custodian for Mr. Foster’s grandchildren.
- (6) Amount disclosed includes 17,100 shares of Common Stock owned in Dr. Lombard’s IRA account, 2,323 shares held in Dr. Lombard’s spouse’s IRA account and 2,500 shares held jointly with his spouse.
- (7) Amount disclosed includes 294 shares of Common Stock owned in Mr. Miller’s IRA account, 294 shares held in Mr. Miller’s spouse’s IRA account, 2,206 shares held jointly with his spouse, 250

shares held jointly with his spouse and his daughter, 500 shares held jointly with his mother and his sister and 200 shares held jointly by his spouse and Mr. Miller's mother-in-law.

- (8) Amount disclosed includes 8,750 shares of Common Stock owned in Mr. Smith's IRA accounts, 500 shares owned by Mr. Smith's spouse and 600 shares owned by Mr. Smith's resident children.
- (9) Amount disclosed includes 2,750 shares of Common Stock held jointly with Ms. Verbyla's spouse.
- (10) Amount disclosed includes 5,000 shares of Common Stock held in Dr. Walker's spouse's trust account.
- (11) Amount disclosed includes 3,250 shares of Common Stock held jointly with Ms. Wilcox's spouse, 150 shares held in trust for Ms. Wilcox's granddaughter and 150 shares held by Ms. Wilcox's spouse as custodian for his child.

Security Ownership of Certain Beneficial Owners

To the Bank's knowledge, no person owns five percent or more of the outstanding shares of Common Stock.

Equity Compensation Plans

The following table sets forth information as of December 31, 2004, with respect to compensation plans under which shares of Common Stock are authorized for issuance.

Equity Compensation Plan Information

<u>Plan Category</u>	<u>Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</u>	<u>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans ⁽¹⁾</u>
Equity Compensation Plans Approved by Shareholders:	32,854	\$21.08	42,146
Equity Compensation Plans Not Approved by Shareholders ⁽²⁾	--	--	--
Total	32,854	\$21.08	42,146

⁽¹⁾ Amounts exclude any securities to be issued upon exercise of outstanding options, warrants and rights.

⁽²⁾ The Bank does not have any equity compensation plans that have not been approved by shareholders.

Item 12. Certain Relationships and Related Transactions

Some of the directors and officers of the Bank are customers of the Bank, and the Bank has had banking transactions in the ordinary course of its business with directors, officers, and their associates, on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with others. Officers, directors and their affiliates had borrowings with the Bank of \$1,794,656 outstanding on lines of credit totaling \$3,161,292 at December 31, 2004.

Item 13. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Articles of Incorporation of Bank, incorporated herein by reference to Exhibit 2(a) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
3.2	Bylaws of the Bank, incorporated herein by reference to Exhibit 2(b) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.1	Executive Employment Agreement, effective as of August 5, 2003, between William J. Farinholt and the Bank, incorporated herein by reference to Exhibit 6(a) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.2	Executive Employment Agreement, effective as of August 5, 2003 between Kenneth E. Smith and the Bank, incorporated herein by reference to Exhibit 6(b) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.3	Equity Compensation Plan, incorporated herein by reference to Exhibit 6(c) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.4	Lease, effective as of July 15, 2003, between Spectrum Financial Systems, Inc. and the Bank, incorporated herein by reference to Exhibit 6(d) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.5	Lease, effective as of November 25, 2003, between David Young Holdings, LLC and the Bank, incorporated herein by reference to Exhibit 6(e) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. § 1350

Item 14. Principal Accountant Fees and Services

The following fees were paid to Yount, Hyde & Barbour, P.C. for services provided to the Bank for the periods ended December 31, 2004 and 2003. The Audit Committee determined that the provision of non-audit services by Yount, Hyde & Barbour P.C. did not compromise the firm's ability to maintain its independence.

	2004		2003	
	Fees	Percentage	Fees	Percentage
Audit fees	\$ 27,500	92%	\$ 10,000	83%
Tax fees	2,500	8%	2,000	17%
	<u>\$ 30,000</u>	<u>100%</u>	<u>\$ 12,000</u>	<u>100%</u>

Audit fees: Audit and review services and review of documents filed with the Federal Reserve System.

Tax fees: Preparation of federal and state tax returns.

The Audit Committee meets in advance and specifically approves of the provision of all services of Yount, Hyde & Barbour, P.C.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COLONIAL VIRGINIA BANK

Date: March 30, 2005

By: /s/ Kenneth E. Smith
Kenneth E. Smith
Executive Vice President and
Chief Financial Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ William J. Farinholt</u> William J. Farinholt	President & CEO (Principal Executive Officer)	March 30, 2005
<u>/s/ Kenneth E. Smith</u> Kenneth E. Smith	EVP & Chief Financial Officer (Principal Financial Officer)	March 30, 2005
<u>/s/ Kathleen C. Healy</u> Kathleen C. Healy	VP & Accounting Officer (Principal Accounting Officer)	March 30, 2005
<u>/s/ Hal D. Bourque</u> Hal D. Bourque	Director	March 30, 2005
<u>/s/ William J. Farinholt</u> William J. Farinholt	Director	March 30, 2005
<u>/s/ William D. Fary, Sr.</u> William D. Fary, Sr.	Director	March 30, 2005
<u>/s/ Robert D. Foster</u> Robert D. Foster	Director	March 30, 2005

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Joseph A. Lombard, Jr.</u> Joseph A. Lombard, Jr.	Director	March 30, 2005
<u>/s/ Kenneth E. Smith</u> Kenneth E. Smith	Director	March 30, 2005
<u>/s/ Elsa C. Verbyla</u> Elsa C. Verbyla	Director	March 30, 2005

Rule 13a-14(a) Certification of Chief Executive Officer

I, William J. Farinholt, certify that:

1. I have reviewed this annual report on Form 10-KSB of Colonial Virginia Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: March 30, 2005

/s/ William J. Farinholt

William J. Farinholt

Chief Executive Officer

Rule 13a-14(a) Certification of Chief Financial Officer

I, Kenneth E. Smith, certify that:

1. I have reviewed this annual report on Form 10-KSB of Colonial Virginia Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: March 30, 2005

/s/ Kenneth E. Smith
Kenneth E. Smith
Chief Financial Officer

Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. § 1350

In connection with the Annual Report on Form 10-KSB for the period ended December 31, 2004 (the "Form 10-KSB") of Colonial Virginia Bank (the "Bank"), we, William J. Farinholt, Chief Executive Officer of the Bank, and Kenneth E. Smith, Chief Financial Officer of the Bank, hereby certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

- (a) the Form 10-KSB fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (b) the information contained in the Form 10-KSB fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods presented in the Form 10-KSB.

By: /s/ William J. Farinholt
William J. Farinholt
Chief Executive Officer

Date: March 30, 2005

By: /s/ Kenneth E. Smith
Kenneth E. Smith
Chief Financial Officer

Date: March 30, 2005