

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

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2009

or

Transition Report pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COLONIAL VIRGINIA BANK

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of  
incorporation or organization)

75-3093106

(IRS Employer  
Identification No.)

6720 Sutton Road  
Gloucester, Virginia

(Address of principal executive offices)

23061

(Zip Code)

(804) 695-9300

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

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

610,175 shares of common stock, par value \$5.00 per share,  
outstanding as of May 14, 2009

# COLONIAL VIRGINIA BANK

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## PART I. FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS

#### COLONIAL VIRGINIA BANK Balance Sheets

	(Unaudited) March 31, 2009	December 31, 2008
	<u>                    </u>	<u>                    </u>
<b>Assets:</b>		
Cash and due from banks	\$ 3,325,344	\$ 10,116,510
Federal funds sold	3,028,000	3,825,000
Securities available for sale, at fair market value	31,338,757	26,347,158
Securities held to maturity (fair market value of \$482,655 in 2009 and \$807,289 in 2008)	462,989	790,373
Loans, net of allowance for loan losses of \$625,577 in 2009 and \$622,068 in 2008	64,994,700	62,120,125
Bank premises and equipment, net	4,236,013	3,987,464
Bank owned life insurance	2,663,537	2,618,333
Other assets	<u>1,007,473</u>	<u>966,939</u>
 Total assets	 <u>\$ 111,056,813</u>	 <u>\$ 110,771,902</u>
 <b>Liabilities and Shareholders' Equity:</b>		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	\$ 6,604,624	\$ 7,187,310
Savings and interest bearing demand deposits	18,186,018	17,026,196
Time deposits	<u>64,581,973</u>	<u>62,575,457</u>
Total deposits	\$ 89,372,615	\$ 86,788,963
 Accrued expenses and other liabilities	 1,188,526	 1,081,168
FHLB Advances	<u>8,500,000</u>	<u>11,000,000</u>
Total liabilities	<u>\$ 99,061,141</u>	<u>\$ 98,870,131</u>
 Shareholders' Equity:		
Preferred stock, par value \$5.00 per share, authorized 5,000,000 shares; no shares issued and outstanding	\$ -	\$ -
Common stock, par value \$5.00 per share, authorized 10,000,000 shares; issued and outstanding 610,175 shares	3,050,875	3,050,875
Capital surplus	9,134,834	9,132,538
Retained (deficit)	(535,502)	(589,350)
Accumulated other comprehensive income, net	<u>345,465</u>	<u>307,708</u>
Total shareholders' equity	<u>\$ 11,995,672</u>	<u>\$ 11,901,771</u>
 Total liabilities and shareholders' equity	 <u>\$ 111,056,813</u>	 <u>\$ 110,771,902</u>

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Income**

(Unaudited)

	<b>Three Months Ended March 31, 2009</b>	<b>Three Months Ended March 31, 2008</b>
<b>Interest and Dividend Income</b>		
Interest and fees on loans	\$1,142,614	\$1,189,493
Interest on securities available for sale		
Taxable	351,199	365,115
Tax exempt interest income	1,994	0
Dividends	4,718	8,310
Interest on federal funds sold and other	4,254	52,137
Total interest income	<u>\$1,504,779</u>	<u>\$1,615,055</u>
<b>Interest Expense</b>		
Interest on deposits	\$599,427	\$874,883
Interest on short-term borrowings	45,621	3,636
Total interest expense	<u>\$645,048</u>	<u>\$878,519</u>
Net interest income	\$859,731	\$736,536
<b>Provision for Loan Losses</b>		
	<u>41,050</u>	<u>21,050</u>
Net interest income after provision for loan losses	<u>\$818,681</u>	<u>\$715,486</u>
<b>Other Income</b>		
Service charges on deposit accounts	\$25,768	\$23,143
Income on bank owned life insurance	46,581	7,200
Net gain on sale of repossessions	0	2,500
Net gain on securities	5,244	63,726
Other service charges, commissions and fees	22,100	60,515
Total other income	<u>\$99,693</u>	<u>\$157,084</u>
<b>Other Expense</b>		
Salaries and employee benefits	\$460,858	\$449,346
Occupancy expense	47,180	45,656
Furniture and equipment expense	22,016	20,109
Data processing	120,539	115,702
Advertising	25,035	34,094
Professional fees	49,571	35,567
Stationery and supplies	13,951	10,493
Postage and freight	8,568	7,831
Regulatory assessments	23,374	20,389
Insurance	10,145	9,151
Franchise tax	18,296	16,653
Directors fees	16,800	16,200
Other operating expenses	44,493	25,151
Total other expense	<u>\$860,826</u>	<u>\$806,342</u>
Net Income before income taxes	\$57,548	\$66,228
Income taxes	3,700	0
Net Income	<u>\$53,848</u>	<u>\$66,228</u>
Earnings per share, basic and diluted	\$0.09	\$0.11
Weighted Average Shares Outstanding, basic	610,175	610,175
Weighted Average Shares Outstanding, diluted	610,351	610,568

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Changes in Shareholders' Equity**  
**For the Three Months Ended March 31, 2009**  
**and March 31, 2008 (Unaudited)**

	<u>Common Stock</u>	<u>Capital Surplus</u>	<u>Retained (Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Comprehensive Income</u>	<u>Total</u>
<b>Balance at December 31, 2007</b>	\$ 3,050,875	\$ 9,130,243	\$ (724,288)	\$ 49,123		\$ 11,505,953
Comprehensive income:						
Net income	--	--	66,228	--	\$ 66,228	66,228
Other comprehensive income,						
Change in unrealized loss on securities available for sale, net of deferred taxes	--	--	--	--	208,658	
Change in pension liability, net of deferred taxes	--	--	--	--	7,488	
Other comprehensive income	--	--	--	216,146	<u>\$ 216,146</u>	216,146
Total comprehensive income	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>\$ 282,374</u>	
<b>Balance at March 31, 2008</b>	<u>\$ 3,050,875</u>	<u>\$ 9,130,243</u>	<u>\$ (658,060)</u>	<u>\$ 265,269</u>		<u>\$ 11,788,327</u>
<b>Balance at December 31, 2008</b>	\$ 3,050,875	\$ 9,132,538	\$ (589,350)	\$ 307,708		\$ 11,901,771
Comprehensive income:						
Net income	--	--	53,848	--	\$ 53,848	53,848
Other comprehensive income,						
Change in unrealized gain on securities available for sale, net of deferred taxes	--	--	--	--	46,461	
Reclassification adjustment, net of taxes	--	--	--	--	(3,461)	
Change in pension liability	--	--	--	--	(5,243)	
Other comprehensive income	--	--	--	37,757	<u>\$ 37,757</u>	37,757
Total comprehensive income	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>\$ 91,605</u>	
Stock based compensation	--	2,296	--	--		2,296
<b>Balance at March 31, 2009</b>	<u>\$ 3,050,875</u>	<u>\$ 9,134,834</u>	<u>\$ (535,502)</u>	<u>\$ 345,465</u>		<u>\$ 11,995,672</u>

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Cash Flows**  
**For the Three Months Ended March 31, 2009**  
**and March 31, 2008 (Unaudited)**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	2009	2008
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$ 53,848	\$ 66,228
Net amortization (accretion) on investment securities	2,164	(9,221)
Depreciation and amortization	60,974	64,935
Provision for loan losses	41,050	21,050
Stock based compensation	2,296	-
(Gain) on securities	(5,244)	(63,726)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest and other assets	(67,928)	119,562
Increase in accrued expenses and other liabilities	107,358	93,545
Net cash provided by operating activities	\$ 194,518	\$ 292,373
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
(Purchase) of securities available for sale	\$ (8,134,374)	\$ (8,652,718)
Principal paydowns of securities	1,238,425	735,586
Proceeds from calls and maturities of securities available for sale	2,027,466	6,697,101
Proceeds from calls and maturities of securities held to maturity	300,000	1,347,857
Cancellation of Federal Reserve Stock	-	2,200
(Purchase) of Federal Home Loan Bank Stock	(27,500)	(191,300)
Net (increase) in loans	(2,915,625)	(1,408,380)
(Increase) in bank owned life insurance	(45,204)	(7,200)
(Purchase) of premises and equipment	(309,524)	(28,638)
Net cash (used in) investing activities	\$ (7,866,336)	\$ (1,235,492)
 <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in demand, savings, interest-bearing checking and money market deposits	\$ 577,136	\$ 261,918
Net increase in time deposits	2,006,516	4,088,128
Net increase (decrease) in other borrowings	(2,500,000)	4,000,000
Net cash provided by financing activities	\$ 83,652	\$ 8,350,046
 Net (decrease) increase in cash and cash equivalents	\$ (7,588,166)	\$ 7,406,927
 <b>CASH AND CASH EQUIVALENTS</b>		
Beginning	\$ 13,941,510	\$ 4,930,971
Ending	\$ 6,353,344	\$ 12,337,898
 <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 647,186	\$ 894,197
 <b>SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES</b>		
Unrealized gain on securities available for sale	\$ 65,152	\$ 316,146
Amortization of adjustment to initially apply SFAS No. 158	(5,243)	7,488

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Notes to Financial Statements**  
For the Three Months Ended March 31, 2009  
and March 31, 2008 (Unaudited)

**Note 1. General**

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 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 the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Bank's financial position at March 31, 2009, the statements of income for the three months ended March 31, 2009, and the changes in shareholders' equity and cash flows for the three months ended March 31, 2009. Financial statements are prepared in accordance with generally accepted accounting principles. Operating results for the three month period ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. The statements should be read in conjunction with the Notes to Financial Statements included in the Bank's Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Federal Reserve System.

**Note 2. Securities**

Amortized cost and fair values of securities available for sale at March 31, 2009, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Securities of U.S. government and federal agencies	\$ 5,689,625	\$ 43,430	\$ (55,496)	\$ 5,677,559
Mortgage backed securities	23,529,166	709,193	(28,890)	24,209,469
Securities of states and political subdivisions	398,828	5,375	(6,624)	397,579
Restricted stock	1,054,150	-	-	1,054,150
Total	<u>\$ 30,671,769</u>	<u>\$ 757,998</u>	<u>\$ (91,010)</u>	<u>\$ 31,338,757</u>

Amortized cost and fair values of securities held to maturity at March 31, 2009, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Mortgage backed securities	\$ 462,989	\$ 19,666	\$ -	\$ 482,655
Total	<u>\$ 462,989</u>	<u>\$ 19,666</u>	<u>\$ -</u>	<u>\$ 482,655</u>

Amortized cost and fair values of securities available for sale at December 31, 2008, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Securities of U.S. government and federal agencies	\$ 4,000,011	\$ 64,771	\$ (12,141)	\$ 4,052,641
Mortgage backed securities	20,628,698	564,117	(17,735)	21,175,080
Securities of states and political subdivisions	98,763	2,824	-	101,587
Restricted stock	1,017,850	-	-	1,017,850
Total	<u>\$ 25,745,322</u>	<u>\$ 631,712</u>	<u>\$ (29,876)</u>	<u>\$ 26,347,158</u>

Amortized cost and fair values of securities held to maturity at December 31, 2008, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Securities of U.S. government and federal agencies	\$ 299,862	\$ 2,259	\$ -	\$ 302,121
Mortgage backed securities	490,511	14,657	-	505,168
Total	<u>\$ 790,373</u>	<u>\$ 16,916</u>	<u>\$ -</u>	<u>\$ 807,289</u>

At March 31, 2009 and December 31, 2008, approximately \$1,605,000 of securities were pledged, respectively, to secure deposits of the Commonwealth of Virginia. At March 31, 2009 and December 31, 2008, approximately \$11,256,243 and \$12,750,044 of securities were pledged, respectively, to secure advances at the Federal Home Loan Bank.

For the three months ended March 31, 2009 and March 31, 2008, proceeds from calls of securities available for sale totaled \$2,000,000 and \$5,185,588, respectively. There were no proceeds from sales of securities available for sale for the three months ended March 31, 2009 and March 31, 2008.

For the three months ended March 31, 2009 and March 31, 2008, proceeds from calls of securities held to maturity totaled \$0 and \$1,347,857, respectively.

At March 31, 2009, 14 investment securities had an unrealized loss. 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. There was one investment security held at March 31, 2009 that had been in an unrealized loss position for greater than 12 months. This bond had a total unrealized loss of \$766 and a market value of \$60,700 at March 31, 2009. The remaining 13 securities had a total unrealized loss of \$90,244 and a market value of \$7,184,548 at March 31, 2009. The Bank has the intent and the ability to hold these securities until such time as there is a recovery of the unrealized loss or until maturity.

March 31, 2009	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Securities of U.S. government and federal agencies	\$ 3,628,894	(\$ 55,496)	\$ --	\$ --	\$3,628,894	(\$ 55,496)
Mortgage backed securities	3,262,278	(28,124)	60,700	(766)	3,322,978	( 28,890)
Securities of states and political subdivisions	293,376	(6,624)	--	--	293,376	(6,624)
Total temporarily impaired securities	<u>\$ 7,184,548</u>	<u>(\$90,244)</u>	<u>\$ 60,700</u>	<u>(\$ 766)</u>	<u>\$7,245,248</u>	<u>(\$91,010)</u>

  

December 31, 2008	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Securities of U.S. government and federal agencies	\$1,982,500	(\$12,141)	\$ --	\$ --	\$1,982,500	(\$12,141)
Mortgage backed securities	1,002,812	(17,735)	--	--	1,002,812	(17,735)
Total temporarily impaired securities	<u>\$2,985,312</u>	<u>(\$29,876)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$2,985,312</u>	<u>(\$29,876)</u>

### Note 3. Loans

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

	March 31, 2009	December 31, 2008
Mortgage:		
Construction and land development	\$ 15,946,125	\$ 15,071,017
Residential real estate	20,106,880	18,387,347
Nonresidential	12,533,647	12,119,703
Commercial	11,034,800	11,187,153
Agricultural and Other Farm Loans	376,000	519,802
Consumer and All Other Loans	5,748,984	5,579,933
	<u>65,746,435</u>	<u>62,864,955</u>
Unearned income	126,158	122,762
Allowance for loan losses	625,577	622,068
Loans, net	<u>\$ 64,994,700</u>	<u>\$ 62,120,125</u>

Overdrafts totaling \$15,388 and \$31,744 at March 31, 2009 and December 31, 2008, respectively, were reclassified from deposits to loans.

Non-performing assets totaled \$65,099 and \$59,269 at March 31, 2009 and December 31, 2008, respectively.

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

	<u>March 31,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>	<u>March 31,</u> <u>2008</u>
Balance at the beginning of the period (January 1)	\$ 622,068	\$ 491,383	\$ 491,383
Provision for loan losses	41,050	239,200	21,050
Loans charged off	(38,984)	(111,978)	(11,336)
Recoveries on loans previously charged off	1,443	3,463	875
Balance at the end of the period	<u>\$ 625,577</u>	<u>\$ 622,068</u>	<u>\$ 501,972</u>

#### **Note 4. Earnings Per Share**

The following table shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of potential dilutive common stock. Potential dilutive common stock had no effect on income available to common shareholders.

	Three months ended March 31, 2009		Three months ended March 31, 2008	
	Shares	Amount	Shares	Amount
Basic earnings per share	610,175	\$ 0.09	610,175	\$ 0.11
Effect of dilutive securities:				
Stock Options	176		393	
Diluted earnings per share	<u>610,351</u>	\$ 0.09	<u>610,568</u>	\$ 0.11

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 reflect additional common shares that would have been outstanding if potential dilutive common shares had been issued, as well as any adjustment to income that would result from issuance. For the three month period ended March 31, 2009, stock options representing 32,254 potential shares were excluded from the calculation of diluted earnings per share as their effect would have been anti-dilutive.

#### **Note 5. Stock Based Compensation**

As of March 31, 2009, the Bank had a stock based compensation plan. Effective January 1, 2006, the Bank adopted the fair value recognition provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payment”, using the modified prospective application. Under this method, compensation expense is recorded for all awards granted after the date of adoption and for the unvested portion of previously granted awards that were outstanding as of the beginning of the period of adoption.

The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model. There were no options granted in the three month periods ended March 31, 2009 and 2008, respectively. There were no options exercised in the three month periods ended March 31, 2009 and 2008, respectively.

The following summarizes the stock option activity for the three month period ended March 31, 2009:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Intrinsic Value of Unexercised In-the-Money Options (1)</u>
Options outstanding, January 1, 2009	34,604	\$ 20.81		
Granted	-	-		
Exercised	-	-		
Forfeited	-	-		
Options outstanding, March 31, 2009	<u>34,604</u>	<u>\$ 20.81</u>	5.71	
Options exercisable, March 31, 2009	<u>32,354</u>	<u>\$ 21.30</u>	5.45	\$ --

(1)The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on March 31, 2009. This amount changes based on changes in the market value of the Bank's stock.

## **Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of the financial condition and results of operations of the Bank for the three months ended March 31, 2009 should be read in conjunction with the Bank’s Financial Statements and the accompanying Notes to Financial Statements included in this report and in the Bank’s Annual Report on Form 10-K for the year ended December 31, 2008 (the “2008 Form 10-K”).

### **Executive Overview**

The Bank is headquartered in Gloucester, Virginia. The Bank is a community bank principally serving the Virginia county of Gloucester, but also providing banking services in the overall market known as the Middle Peninsula of Virginia, as well as the Peninsula of Virginia. The Bank also has an investment division operating under the name of Colonial Virginia Investment Services. The Bank offers various mortgage products through both banking offices under the name of Colonial Virginia Mortgage, LLC (“CVM”). This entity is structured as a 50-50 joint venture with Johnson Mortgage Company, LLC (“JMC”). JMC is located in Newport News, Virginia.

The Bank’s results of operations are primarily dependent on net interest income, which is the difference between the income earned on our loans and investment portfolio and the cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by our allowance for loan losses, investment activities and other fees. Non-interest expense principally consists of salary and benefits, occupancy and equipment expenses, business development costs, professional fees, data processing expense and other expenses.

### **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 Losses*

The Bank monitors and maintains an allowance for loan losses 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 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 loan 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 or too low. 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. Further discussion of the adequacy and analysis of the level of the allowance for loan losses is included below.

## **Financial Summary**

Net income for the three months ended March 31, 2009 was \$57,548 before taxes and \$53,848 after taxes, or effectively \$0.09 per share assuming dilution, compared to \$66,228 (before and after taxes), or \$0.11 per share assuming dilution, for the same period in 2008. The Bank (which opened November 6, 2003) enjoyed the tax benefit of net operating loss carry forwards during its early years of operation. After fully utilizing these tax benefits through the first quarter of 2008, the Bank expensed \$3,700 during the first quarter of 2009 for current income tax liability.

Several factors contributed to the earnings decline. First, non-interest income declined in several areas. The contribution from the Bank’s mortgage services division, CVM, declined \$27,307 and investment services income declined \$9,471 in the first quarter of 2009, compared to the same period in 2008. In addition, there was a decline in net gains on securities of \$58,482. Second, the Bank experienced an increase in non-interest expenses, including salaries and employee benefits expense (\$11,512), audit fees (\$14,672) and bad check losses (\$14,262).

The provision for possible loan loss expense was \$41,050 for the three month period ended March 31, 2009, compared to \$21,050 for the same period in 2008. This increase was not prompted by any increase in identified problem loans, but instead in response to nationwide economic conditions that may affect local markets. Therefore, the Bank considers it prudent to recognize these expenses now for the possible need for increased reserves in the future.

For the three months ended March 31, 2009 and March 31, 2008, gross revenues, which are defined as interest income plus other income, were \$1.60 million and \$1.77 million, respectively, while gross expenses, which are defined as interest expense plus other expenses, the provision for loan losses and the provision for income taxes, were \$1.55 million and \$1.71 million, respectively, resulting in actual net income for the quarters ended March 31, 2009 and 2008 of \$53,848 and \$66,228, respectively. Total average assets increased 13.2% from \$98.2 million for the three months ended March 31, 2008 to \$111.2 million for the three months ended March 31, 2009. Average shareholders' equity increased 2.6% from \$11.6 million for the three months ended March 31, 2008 to \$11.9 million for the three months ended March 31, 2009. Annualized return on average assets for the three months ended March 31, 2009 and March 31, 2008 was 0.20% and 0.27%, respectively. Annualized return on average equity for the three months ended March 31, 2009 and March 31, 2008 was 1.84% and 2.28%, respectively.

Total assets for the Bank totaled \$111.1 million at March 31, 2009, compared to \$110.8 million at December 31, 2008, representing an increase of \$0.3 million or 0.3%. Total net loans at March 31, 2009 were \$65.0 million, an increase of \$2.9 million, or 4.7%, from the December 31, 2008 amount of \$62.1 million. Greater growth could occur, but the Bank's philosophy has been to not compromise its underwriting standards and sound credit quality for the sake of growth, in order to foster stable earnings without the interruption of unexpected loan losses. The allowance for loan losses totaled \$625,577, or 0.95% of total loans outstanding, at March 31, 2009. The methodology for assessing the adequacy of the allowance is discussed further below.

The investment portfolio increased 17.3% to \$31.8 million at March 31, 2009 compared to \$27.1 million at December 31, 2008. The current investment strategy is to employ excess liquidity in securities whose yields will enhance overall interest earnings without creating undue interest rate risk. Management continues to believe that yields in the loan portfolio are preferable to general investment yields within the bond market. However, current yields in the bond market have improved slightly relative to the overnight Fed funds rate. The Bank continues its posture of not attempting to forecast interest rates in a vacuum; however, activities of the Federal Open Market Committee ("FOMC") are monitored closely. The levels of interest rate risk and market risk are considered manageable relative to overall balance sheet management. The Bank does not rely on funds from the bond portfolio for primary liquidity beyond the respective maturity of individual bonds. Therefore, any unrealized losses reflected relative to current market value do not represent a risk of actually becoming realized losses during the life of these bonds.

Deposits increased \$2.6 million to \$89.4 million at March 31, 2009 from \$86.8 million at December 31, 2008. Time deposits totaled \$64.6 million at March 31, 2009, an increase of \$2.0 million from \$62.6 million at December 31, 2008. Management has purposely controlled deposit growth, while some larger banks have been driving CD rates up due to their own respective liquidity crises. The costs of some of these higher priced CDs would compress the net interest margin to an unacceptable level. Therefore, the Bank has become more selective in matching competing rates in its local market, especially in circumstances where the depositor maintains no extended relationship with the Bank except for volatile rate-sensitive CDs. As many of these higher priced CDs have reached their maturity, management has been vigilant in aggressively re-pricing them at lower rates or not renewing them. Management continues to avoid growth for the sake of growth, unless pricing decisions on increased funding sources can reasonably result in use of those funds at an appropriate interest spread.

Shareholders' equity totaled \$12.0 million at March 31, 2009. This amount represents an increase of 0.8% from the December 31, 2008 amount of \$11.9 million. Average shareholders' equity increased 2.6% from \$11.6 million for the year ended December 31, 2008 to \$11.9 million for the three months ended March 31, 2009. The March 31, 2009 figure reflects the \$53,848 net income plus a \$37,757 increase in other comprehensive income, including the unrealized loss on securities available for sale and the SFAS No. 158 Supplemental Executive Retirement Plan ("SERP") adjustment. The book value per common share was \$19.66 at March 31, 2009 and \$19.51 at December 31, 2008.

## **Net Interest Income**

Net interest income for the three months ended March 31, 2009 totaled \$859,731, representing an increase of \$123,195 (16.7%) over the same period in 2008. Average earning assets increased \$11.6 million from \$89.9 million for the first three months of 2008 to \$101.5 million for the first three months of 2009. Average interest bearing liabilities increased \$12.2 million from \$79.1 million for the first three months of 2008 to \$91.3 million for the first three months of 2009. The net interest margin (net interest income expressed as a percentage of average earning assets) ("NIM") was 3.39% for the three months ended March 31, 2009 compared to 3.28% for the three months ended March 31, 2008.

Since the third quarter of 2007, the Federal Open Market Committee of the Federal Reserve System ("FOMC") has slashed short-term interest rates a total of 325 basis. The FOMC cut rates 100 basis points between September 18 and December 11, 2007. Then, in a dramatic and unprecedented move, the FOMC exercised an emergency rate cut of 75 basis points January 22, 2008, followed by a 50 basis point cut at its regular meeting January 30, 2008. Subsequent to those cuts, an additional rate cut of 75 basis points was implemented March 18, 2008, with another 25 basis point cut April 30, 2008. The Bank has historically relied heavily on fixed rate consumer certificates of deposits ("CDs") for the majority of its funding. Many of these CDs have maturities of 7 to 17 months, thus restricting the Bank's ability to quickly reduce rates paid, even in an environment of declining rates. Repricing over the past three to six months has helped better match cost of funds to asset yields. The Bank's practice of flooring variable rate loans (contractually limiting how much the individual loan rate can decrease regardless of decreases in market rates) has mitigated the sharp rate decreases by the FOMC, as several variable rate loans have reached their floor rate in the past six months and have not continued to suffer declining yields. The duration of the negative impact of falling rates on net interest income is measurable and quantifiable through interest rate risk models used by the Bank. The compression of the net interest margin has been stabilized. In the face of the current Prime rate of 3.25%, many banks have abandoned "Prime" as a pricing index, without fixing a significant variance to Prime as the base price. Where a loan might have historically been priced at Prime plus 0.50% or Prime plus 1.00%, similar loans are being priced at Prime plus 2.25% to Prime plus 3.50%, with rate floors at the original rate. CD pricing continues to be in the 2.25% to 3.00% range; therefore, loans priced off of the Prime rate require higher variance pricing.

Loan demand has remained stable during the most recent quarter, despite the vast publicity of the weakening economy, which bodes well for overall improving yields on average earning assets. A strategic decision was made to manage liquidity more deliberately through alternative funding sources such as the Federal Home Loan Bank of Atlanta ("FHLB") and rely less on excess levels of asset liquidity in the form of overnight Fed funds sales. Additionally, the Bank began utilizing brokered CDs during the second half of 2008, enjoying pricing lower than typical retail CDs within the local market. These brokered CDs are economically priced and represent an efficient source of liquidity.

The Bank utilizes asset liability management modeling software to aid in the identification and management of interest rate risk. 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.

The Bank's balance sheet structure has evolved into a moderately asset sensitive condition. This condition means that assets may re-price more quickly than liabilities and, in a rising rate environment, interest income would increase more quickly than interest expense. Through the use of the modeling techniques mentioned above, Management is closely monitoring the volumes of interest bearing liabilities that are scheduled for repricing within the next 90 day, 180 day and one year intervals. The Bank markets 10 and 13 month CDs to manage the interest rate risk associated with being asset sensitive, should the FOMC actually decrease short-term rates within the next twelve months. The Bank also continues its practice of including interest rate floors in new variable rate loan instruments. This measure is designed to guard against exposure to reduced interest income associated with possible falling rates in the future.

### **Non-interest Income**

The primary components of non-interest income include service charges on deposit accounts, ATM transaction fees, commissions on credit life insurance, checkbook sales, title insurance, investment services income, mortgage division income and net gains on securities. For the three months ended March 31, 2009, non-interest income of \$99,693 represented a \$57,391 (36.5%) decrease from the same period in 2008, details of which are discussed below. Of particular note, the Bank recorded \$63,726 in gains on securities "called" during the quarter ended March 31, 2008, compared to a \$5,244 gain during the current quarter. Due to the FOMC's dramatic interest rate cuts in the first quarter of 2008, several bonds were redeemed early through the call options of the issuers. When Management purchased these bonds in previous years, with the call risk associated with potential falling rates, they purposely made purchase decisions on bonds that were priced at a discount to "par value", thus, receiving a yield enhancement at early redemption through the calls that were made at par value.

For the three months ended March 31, 2009, investment services income totaled \$3,313 compared to \$12,784 for the three months ended March 31, 2009. The Bank's mortgage services division, CVM, experienced a loss of \$7,060 in the first three months of 2009, compared to income of \$20,247 in the first three months of 2008, a 134.9% decrease. Although refinance activity has begun to increase, mortgage activity generally has been slower due to overall weaker economic conditions and reduced home sales.

### **Non-interest Expense**

Non-interest expense for the three month period ended March 31, 2009 totaled \$860,826 compared to \$806,342 for the three month period ended March 31, 2008. Three primary factors contributed to the increase. First, the Bank experienced an increase in salaries and employee benefits expense of \$11,512 for the three month period ended March 31, 2009, due primarily to annual raises. Second, audit expense for the three months ended March 31, 2009 increased \$14,672 compared to the three month period ended March 31, 2008, resulting from increased audit coverage required by the Sarbanes-Oxley Act. Third, a bad check loss of \$14,262 was recognized during the first quarter 2009.

### **Non-GAAP Financial Measure**

A measure of the extent to which the Bank's revenues are absorbed by non-interest expenses is expressed as the efficiency ratio. The efficiency ratio is calculated by dividing non-interest expenses by the sum of total non-interest income and net interest income for the period. This is a non-GAAP financial

measure, which Management believes provides important information about the Bank's operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the ratio differently. As the Bank matures, an efficiency ratio of 60% to 65% is targeted. For the three months ended March 31, 2009, the Bank's efficiency ratio was 90.12% compared to 97.16% at March 31, 2008.

Still another indicator of the appropriate use of personnel is the measurement of assets expressed as millions of dollars of assets per employee. This measurement was \$4.1 million per employee at March 31, 2009 and \$3.7 million per employee at March 31, 2008.

### **Allowance for Loan Losses**

The allowance for loan losses at March 31, 2009 was \$625,577, compared to \$622,068 at December 31, 2008. The allowance for loan losses was 0.95% of total loans outstanding at March 31, 2009, compared to 0.99% at December 31, 2008. The provision for loan losses was \$41,050 for the three month period ended March 31, 2009, compared to \$21,050 for the same period in 2008. The provision for loan losses represents Management's judgment of the current period cost of credit risk inherent in the Bank's loan portfolio. Specifically, the provision represents the amount charged against current period earnings to achieve an allowance for loan losses that, in Management's judgment, is adequate to absorb probable losses inherent in the Bank's loan portfolio. Accordingly, the provision expense will vary from period to period based on Management's ongoing assessment of the adequacy of the Allowance for Loan and Lease Losses ("ALLL"). The increased expense in the first quarter 2009 was recognized pursuant to the growing loan volume and challenging economic cycle and not from any increase in loss risk imbedded in the loan portfolio. Asset quality continues to be strong. As of March 31, 2009, the Bank had one repossessed property totaling \$5,105, compared to \$35,000 at March 31, 2008. Nonaccrual loans totaled \$59,994 at March 31, 2009, compared to \$0 at March 31, 2008. Loans past due 90 days or more and still accruing interest at the end of the first quarter 2009 totaled \$231,246, compared to \$109,151 at the end of the first quarter 2008. Management believes that the ALLL is adequate to cover credit losses inherent in the loan portfolio at March 31, 2009. The Bank does not engage in "sub-prime lending."

Management uses a risk-rating system that includes six "pass" (or acceptable) grades, as well as four adverse grades. All loans are evaluated and assigned a risk rating at the time the loan is made. Periodic subsequent review assesses the loan's performance as well as changes in the borrower's financial condition. Management incorporates these ratings into its methodology for evaluating the adequacy of the ALLL, as well as its pricing strategies. The methodology was developed as a part of management's compliance with accounting requirements within SFAS No. 5 and SFAS No. 114, discussed above in "Critical Accounting Policies." Pursuant to SFAS No. 114, those loans with whom the borrower's financial condition has deteriorated to a level that results in an adverse risk rating are evaluated individually for impairment. This evaluation is performed monthly and incorporated into the ALLL adequacy analysis, reflecting any respective loss potential for each loan. The methodology also incorporates factors associated with general economic conditions within the Bank's market, such as employment statistics, housing starts, and building permits. Another element incorporates a potential loss factor for concentrations of credit, such as unsecured loans. Although the Bank only extends unsecured credit to its highest rated customers, any unforeseen reversals experienced by a borrower with unsecured credit could result in a higher risk of potential loss. Using the current methodology, the ALLL has a small surplus balance above the identified embedded risk. Management considers it prudent to maintain a moderate surplus until such time as the loan portfolio is more seasoned and the risk rating methodology has been validated by bank regulators and external loan review activities. During the most recent regulatory and internal independent loan review, there were no material disagreements with the Bank's internal risk ratings. There was a general consensus that the Bank's ALLL was below peer group levels but appeared to be adequate for currently identifiable loss risk.

## Capital Resources

Shareholders' equity at March 31, 2009 totaled \$12.0 million compared to \$11.9 million at December 31, 2008. Total common shares outstanding at March 31, 2009 were 610,175.

At March 31, 2009, the Bank's tier 1 and total risk-based capital ratios were 15.09% and 15.71%, respectively, compared to 15.48% and 16.10% at December 31, 2008. The Bank's leverage ratio was 10.48% at March 31, 2009, compared to 10.94% at December 31, 2008. 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.

At March 31, 2009, cash, interest-bearing deposits with financial institutions, federal funds sold and securities available for sale were 35.6% 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 Fed funds and other cash equivalents, market value of securities available for sale, and unused lines of credit) as a percentage of total assets. The policy requires that this ratio be equal to or greater than 15% of total assets. At March 31, 2009, this ratio was 40.3%. This excess, however, is skewed somewhat in that it includes all securities classified as available for sale ("AFS"). Some of these securities (although identified as AFS) experience fluctuations in market values based on interest rate trends and, from time to time, an unrealized loss. Thus, they are not considered first candidates to be sold to generate liquidity. Some of these securities are amortizing mortgage backed issues that produce routine monthly cash flows. Also of note, the mix of liquid assets reflected significant changes between December 31, 2008 and March 31, 2009. Cash and due from banks decreased from \$10.1 million at December 31, 2008 to \$3.3 million at March 31, 2009. The Bank sold approximately \$7.0 million in securities in December 2008. The proceeds of these sales were invested in the daily overnight investment account at year-end. The funds were then employed through reinvestment in the bond portfolio as well as new loans, evidenced by the net increases of these two asset categories of \$4.7 million and \$2.9 million, respectively, at March 31, 2009.

Liability funding sources are also monitored. Demand and savings deposits, interest bearing and non-interest bearing, time deposits under \$100,000 are monitored with a targeted level of 52.5% or greater as a percentage of total assets. At March 31, 2009, this percentage was 55.9%. The Bank also maintains additional sources of liquidity through "Federal funds purchased" guidance lines with correspondent banks, which totaled \$7.1 million at March 31, 2009. In October 2007, the Bank joined the FHLB. The FHLB offers many services, but the primary service utilized by the Bank is the FHLB's loan

programs. As of March 31, 2009, FHLB advances totaled \$8.5 million. The advances include three loans totaling \$2.0 million each, at fixed rates of 1.13% for one year, 2.3625% for two years and 2.67% for three years, respectively. The fourth loan totals \$2.5 million, at a fixed rate of 1.91% for two years. The Bank will not abandon its primary purpose of being a community bank and corporate partner to the markets it serves. However, utilization of alternative funding that is more economically priced will, over the long-term, bode well for net interest earnings.

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

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. During the three months ended March 31, 2009, there has been no material change outside the ordinary course of the Bank's business in the contractual obligations specified in "Note 9." Financial Instruments with Off-Balance Sheet Risk" in the Bank's Annual Report on Form 10-K for the year ended December 31, 2008.

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.

### **Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather, provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. The Bank adopted SFAS 157 on January 1, 2008. The FASB approved a one-year deferral for the implementation of the Statement for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Bank adopted the provisions of SFAS 157 for nonfinancial assets and liabilities as of January 1, 2009 without a material impact on the financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), "Business Combinations" (SFAS 141(R)). The Standard significantly changed the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any

noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008. The Bank does not expect the implementation of SFAS 141(R) to have a material impact on its financial statements, at this time.

In April 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Bank does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. Earlier adoption is permitted for periods ending after March 15, 2009. The Bank does not expect the adoption of FSP FAS 157-4 to have a material impact on its financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Bank does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." FSP FAS 115-2 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Bank does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities." SAB 111 maintains the SEC Staff's previous views related to equity securities and amends Topic 5.M. to exclude debt securities

from its scope. The Bank does not expect the implementation of SAB 111 to have a material impact on its financial statements.

### **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;
- the successful management of interest rate risk;
- changes in general economic and business conditions in the Bank’s market area;
- the ability to continue to attract low cost core deposits to fund asset growth;
- reliance on the Bank’s management team, including its ability to attract and retain key personnel;
- 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;
- managing the cost and implementation on new technology required to compete and to meet increasing regulatory requirements;
- 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;
- changing trends in customer profiles and behavior;
- changes in banking and other laws and regulations applicable to the Bank;
- demand, development and acceptance of new products and services; and
- problems with technology utilized by the Bank;
- 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.

**AVERAGE BALANCES, INTEREST INCOME  
AND EXPENSES, AVERAGE YIELDS AND RATES**

	Three months Ended March 31, 2009			Three months Ended March 31, 2008		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
<b>Assets:</b>						
Interest earning assets:						
Securities						
Taxable	\$28,895,191	\$ 355,917	4.93%	\$27,300,374	\$ 373,425	5.47%
Tax Exempt (1)	179,981	3,021	6.71%	--	--	--
Total securities	29,075,172	358,938	4.94%	27,300,374	373,425	5.47%
Federal funds sold	5,089,667	3,364	0.26%	6,355,100	48,995	3.08%
Deposits at other banks	3,220,835	890	0.11%	872,051	3,142	1.44%
Loans, net	64,148,619	1,142,614	7.12%	55,335,170	1,189,493	8.60%
Total earning assets	101,534,293	1,505,806	5.93%	89,862,695	1,615,055	7.19%
Less: allowance for loan losses	(624,754)			(500,521)		
Total non-earning assets	10,274,286			8,813,258		
Total assets	111,183,825			98,175,432		
<b>Liabilities and Stockholders' Equity:</b>						
Interest bearing liabilities:						
Checking	4,529,014	15,968	1.41%	3,441,432	13,017	1.51%
Savings and money market deposits	12,947,173	66,730	2.06%	9,467,699	48,807	2.06%
Other time	63,660,318	516,729	3.25%	65,647,571	813,059	4.95%
Total interest bearing deposits	81,136,505	599,427	2.96%	78,556,702	874,883	4.45%
Short term borrowings	10,166,667	45,621	1.79%	527,472	3,636	2.76%
Total interest bearing liabilities	91,303,172	645,048	2.83%	79,084,174	878,519	4.44%
Noninterest bearing liabilities:						
Demand deposits	6,813,934			6,424,601		
Other non-interest bearing Liabilities	1,135,970			1,035,176		
Total liabilities	99,253,076			86,543,951		
Stockholders' equity	11,930,749			11,631,481		
Total liabilities and stockholders' equity	\$111,183,825			\$98,175,432		
Net Interest Income		\$ 860,758			\$ 736,536	
Interest rate spread <sup>(2)</sup>			3.10%			2.75%
Net Interest Margin <sup>(3)</sup>			3.39%			3.28%

<sup>(1)</sup> Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

<sup>(2)</sup> Interest spread is the average yield earned on earning assets, calculated on a fully taxable equivalent basis assuming a federal tax rate of 34%, less the average rate incurred on interest-bearing liabilities.

<sup>(3)</sup> Net interest margin is the net interest income, calculated on a fully tax equivalent basis assuming a federal tax rate of 34%, expressed as a percentage of average earning assets.

**AVERAGE BALANCES, INTEREST INCOME  
AND EXPENSES, AVERAGE YIELDS AND RATES**

	Three months Ended March 31, 2009			Year Ended December 31, 2008		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
<b>Assets:</b>						
Interest earning assets:						
Securities						
Taxable	\$28,895,191	\$ 355,917	4.93%	\$31,544,590	\$ 1,686,371	5.35%
Tax Exempt (1)	179,981	3,021	6.71%	--	--	--
Total securities	29,075,172	358,938	4.94%	31,544,590	1,686,371	5.35%
Federal funds sold	5,089,667	3,364	0.26%	3,636,748	85,335	2.35%
Deposits at other banks	3,220,835	890	0.11%	1,864,711	28,528	1.53%
Loans, net	64,148,619	1,142,614	7.12%	58,224,885	4,630,892	7.95%
Total earning assets	101,534,293	1,505,806	5.93%	95,270,934	6,431,126	6.75%
Less: allowance for loan losses	(624,754)			(533,355)		
Total non-earning assets	10,274,286			9,235,486		
Total assets	111,183,825			103,973,065		
<b>Liabilities and Stockholders' Equity:</b>						
Interest bearing liabilities:						
Checking	4,529,014	15,968	1.41%	4,056,411	59,252	1.46%
Savings and money market deposits	12,947,173	66,730	2.06%	10,550,946	218,617	2.07%
Other time	63,660,318	516,729	3.25%	64,508,999	2,763,254	4.28%
Total interest bearing deposits	81,136,505	599,427	2.96%	79,116,356	3,041,123	3.84%
Short term borrowings	10,166,667	45,621	1.79%	4,923,169	125,934	2.56%
Total interest bearing liabilities	91,303,172	645,048	2.83%	84,039,525	3,167,057	3.77%
Noninterest bearing liabilities:						
Demand deposits	6,813,934			7,275,077		
Other non-interest bearing Liabilities	1,135,970			1,083,555		
Total liabilities	99,253,076			92,398,157		
Stockholders' equity	11,930,749			11,574,908		
Total liabilities and stockholders' equity	\$111,183,825			\$103,973,065		
Net Interest Income		\$ 860,758			\$ 3,264,069	
Interest rate spread <sup>(2)</sup>			3.10%			2.98%
Net Interest Margin <sup>(3)</sup>			3.39%			3.43%

<sup>(1)</sup> Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

<sup>(2)</sup> Interest spread is the average yield earned on earning assets, calculated on a fully taxable equivalent basis assuming a federal tax rate of 34%, less the average rate incurred on interest-bearing liabilities.

<sup>(3)</sup> Net interest margin is the net interest income, calculated on a fully tax equivalent basis assuming a federal tax rate of 34%, expressed as a percentage of average earning assets.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable to smaller reporting companies.

**Item 4. 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 March 31, 2009 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

Not applicable to smaller reporting companies.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

- 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

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COLONIAL VIRGINIA BANK**  
(Registrant)

Date: May 14, 2009

By:     /s/ Kenneth E. Smith      
Kenneth E. Smith (on behalf of the Bank and  
as principal financial officer)  
Executive Vice President and  
Chief Financial Officer

## EXHIBIT INDEX

### **Exhibits**

- |      |   |
|------|---|
| 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 |

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

I, William J. Farinholt, certify that:

1. I have reviewed the Quarterly Report on Form 10-Q for the period ended March 31, 2009 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 registrant as of, and for, the periods presented in this report;
4. The registrant'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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant'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
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: May 14, 2009

/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 the Quarterly Report on Form 10-Q for the period ended March 31, 2009 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 registrant as of, and for, the periods presented in this report;
4. The registrant'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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant'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
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: May 14, 2009

/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 Quarterly Report on Form 10-Q for the period ended March 31, 2009 (the "Form 10-Q") 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-Q 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-Q 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-Q.

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

Date: May 14, 2009

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

Date: May 14, 2009