FutureFuel Corp.
Form 4
April 09, 2009

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
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(Print or Type Responses)

1. Name and Address of Reporting Person *
Osmium Special Situations Fund Ltd

(Last) (First) (Middle)

CANON'S COURT, 22 VICTORIA STREET

(Street)

HAMILTON, D0 HM 11

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
FutureFuel Corp. [FTFL]

3. Date of Earliest Transaction (Month/Day/Year)
03/20/2009

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director __X__ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	03/20/2009		P		1,000	A	$ 4.925	3,115,872	D	
Common Stock	03/24/2009		P		70	A	$ 4.9143	3,115,942	D	
Common Stock	03/31/2009		P		231,700	A	$ 5.0224	3,347,642	D	
Common Stock	04/02/2009		P		7,000	A	$ 5	3,354,642	D	
Common Stock	04/03/2009		P		5,000	A	$ 5	3,359,642	D	

Common Stock	04/06/2009		P	5,000	A	$ 5	3,364,642	D
Common Stock	04/07/2009		P	5,000	A	$ 5	3,369,642	D

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Osmium Special Situations Fund Ltd CANON'S COURT 22 VICTORIA STREET HAMILTON, D0 HM 11		X		

Signatures

Osmium Special Situations Fund Ltd by Chris Kuchanny, Chairman and CEO	04/09/2009
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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Federal funds purchased

5.46% 5.67%

Community Bankers   Bank

7.54%

Average interest rate at end of year

FHLB advances

3.25% 4.86%

Federal funds purchased

Community Bankers   Bank

7.60%

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Note 9. Income taxes

The following summarizes the tax effects of temporary differences which compose net deferred tax assets and liabilities at December 31, 2007, 2006 and 2005:

	2007	2006	2005
Deferred tax assets			
Allowance for loan losses	$ 1,099,684	$ 815,466	$ 582,280
Unrealized loss on available-for-sale securities		10,864	14,811
Pension expense	70,695	75,112	
Goodwill	6,781	3,864	2,055
Total deferred tax assets	1,177,160	905,306	599,146
Deferred tax liabilities			
Depreciation	235,447	216,605	213,233
Unrealized gain on available-for-sale securities	11,722		
Other, net	15,049	9,831	7,610
Total deferred tax liabilities	262,217	226,435	220,843
Net deferred tax asset	$ 914,943	$ 678,871	$ 378,303

The income tax expense (benefit) charged to operations for the years ended December 31, 2007, 2006 and 2005 consists of the following:

	2007	2006	2005
Current tax expense	$ 778,774	$ 932,391	$ 613,249
Deferred tax benefit	(263,075)	(229,402)	(145,224)
Provision (benefit) for income taxes	$ 515,699	$ 702,990	$ 468,025

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A reconciliation of income taxes computed at the federal statutory income tax rate to total income taxes is as follows for the years ended December 31, 2007, 2006 and 2005:

	2007	2006	2005
Net income (loss) before income taxes	$ 1,516,762	$ 2,102,209	$ 1,699,208
Computed expected tax expense	$ 515,699	$ 714,751	$ 577,731
Cash surrender value of life insurance	(28,148)	(17,764)	(18,788)
Nondeductible expenses	17,580	14,222	11,245
Net operating loss carryforward			(118,006)
Other	10,568	(8,219)	15,843
Provision for income taxes	$ 515,699	$ 702,990	$ 468,025

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded franchise tax expense of $122,000, $120,000 and $116,000 for 2007, 2006 and 2005, respectively.

Note 10. Lease commitments

Certain premises and equipment are leased under various operating leases. Total rent expense charged to operations was $406,000, $348,000 and $235,000 in 2007, 2006 and 2005, respectively. At December 31, 2007, the minimum total rental commitment under such non-cancelable operating leases was as follows:

2008	$ 409,600
2009	300,600
2010	230,200
2011	208,700
2012	229,200
	$ 1,378,300

Note 11. Commitments and contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the financial statements. The contract amounts of these instruments reflect the extent of involvement that the Company has in particular classes of instruments.

The Company s exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit, and to potential credit loss associated with letters of credit issued, is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans and other such on-balance sheet instruments.

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At December 31, 2007, the Company had outstanding the following approximate off-balance-sheet financial instruments whose contract amounts represent credit risk:

	Contract Amount
Undisbursed credit lines	$ 80,040,000
Commitments to extend or originate credit	30,195,000
Standby letter of credit	5,413,000
Total commitments to extend credit	$ 115,648,000

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 the payment of a fee. Historically, many commitments expire without being drawn upon; therefore, the total commitment amounts shown in the above table are not necessarily indicative of future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the customer. Collateral held varies but may include personal or income-producing commercial real estate, accounts receivable, inventory and equipment.

Concentrations of credit risk All of the Company s loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company s market area. Although the Company is building a diversified loan portfolio, a substantial portion of its clients ability to honor contracts is reliant upon the economic stability of the Richmond, Virginia area, including the real estate markets in the area. The concentrations of credit by type of loan are set forth in Note 3. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

Note 12. Stockholders equity and regulatory matters

In September and October 2002, the Company completed an offering of its common stock through the sale of 817,200 shares at a price of $8.50 per share. Proceeds to the Company from the offering (net of offering expenses of $624,000) were $6,322,000. Attached to each share was a warrant to purchase one share of common stock, at a price of $10.20 per share, at any time through September 27, 2007, unless the warrants are cancelled. The warrants may be cancelled after December 31, 2003 by the Company in whole or in part upon 30 days written notice if for 20 or more trading days within any period of 30 consecutive trading days, including the last day of the period, the bid price of the stock exceeds $12.75 per share. The Company also issued 40,860 warrants to the underwriter of the offering. On April 26, 2006, the Company announced that it would be cancelling these warrants effective June 13, 2006 under this provision of the agreement covering the warrants and, on June 13, 2006, the warrants that were not exercised following this announcement were canceled. The cancellation of the common stock warrants resulted in the issuance of 672,638 shares of common stock and the addition of $6,860,908 in capital in the second quarter of 2006.

The Organizational Investors Warrant Plan made available 140,000 warrants for grant to the Company s initial (organizational) investors for certain risks associated with the establishment of the Bank. The warrants have an exercise price of $10 per share (which approximates the fair value per share of common stock at issuance date) and expire in April 2008. At December 31, 2007, 140,000 warrants had been issued and 2,500 had been exercised.

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

Quantitative measures are established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 Capital to average assets (the Leverage ratio). Management believes that as of December 31, 2007, the Bank meets all capital adequacy requirements to which it is subject.

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically under capitalized. The Bank meets the criteria to be categorized as an adequately capitalized institution as of December 31, 2007. Prior to June 30, 2007, the Bank met the criteria to be classified as a well capitalized institution. When capital falls below the well capitalized requirement, consequences can include: new branch approval could be withheld; more frequent examinations by the FDIC; brokered deposits cannot be renewed without a waiver from the FDIC; and other potential limitations as described in FDIC Rules and Regulations sections 337.6 and 303, and FDIC Act section 29. In addition, the FDIC insurance assessment increases when an institution falls below the well capitalized classification.

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The capital amounts and ratios at December 31, 2007 and 2006 for the Company and the Bank are presented in the table below:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2007						
Total capital (to risk-weighted assets)						
Consolidated	$ 38,296,000	10.13%	$ 30,242,000	8.00%	$ 37,802,000	10.00%
Village Bank	32,940,000	8.90%	29,616,000	8.00%	37,020,000	10.00%
Tier 1 capital (to risk-weighted assets)						
Consolidated	34,827,000	9.21%	15,121,000	4.00%	22,681,000	6.00%
Village Bank	29,471,000	7.96%	14,808,000	4.00%	22,212,000	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Consolidated	34,827,000	9.14%	15,485,000	4.00%	19,357,000	5.00%
Village Bank	29,471,000	7.61%	15,485,000	4.00%	19,357,000	5.00%
December 31, 2006						
Total capital (to risk-weighted assets)						
Consolidated	$ 32,686,000	11.75%	$ 22,247,000	8.00%	$ 27,809,000	10.00%
Village Bank	30,624,000	11.12%	22,026,000	8.00%	27,532,000	10.00%
Tier 1 capital (to risk-weighted assets)						
Consolidated	30,133,000	10.84%	11,124,000	4.00%	16,685,000	6.00%
Village Bank	28,071,000	10.20%	11,013,000	4.00%	16,519,000	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Consolidated	30,133,000	10.58%	11,268,000	4.00%	14,086,000	5.00%
Village Bank	28,071,000	9.96%	11,268,000	4.00%	14,086,000	5.00%

In addition, banking regulations limit the amount of cash dividends that may be paid without prior approval of the Bank s regulatory agencies. Such dividends are limited to the lesser of the Bank s retained earnings or the net income of the previous two years combined with the current year net income.

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Note 13. Stock incentive plan

Prior to January 1, 2006, the Company applied Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees (APB 25), in accounting for stock options granted to employees and directors pursuant to the Incentive Plan. Under APB 25, compensation expense was determined based upon the fair value of the awards at the grant date consistent with the method under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), and the impact of this expense on net income and earnings per share was disclosed in the notes to financial statements. Effective January 1, 2006, the Company adopted SFAS No. 123 (Revised 2004), Share-Based Payment, issued in December 2004, a revision of SFAS 123, and superseding APB 25, and its related implementation guidance. SFAS 123 (Revised 2004) 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 is recognized over the period during which an employee is required to provide service in exchange for the award rather than disclosed in the financial statements. During the years ended December 31, 2007 and 2006, the Company granted 1,000 and 16,500 stock options, respectively, the expense of which was not material to the results of operations for the periods then ended.

The following table summarizes options outstanding under the stock incentive plan at the indicated dates:

	Year Ended December 31,							
	2007				2006			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	251,910	$ 10.22	$ 4.67		241,660	$ 9.80	$ 4.47	
Granted	1,000	13.96	8.04		16,500	12.50	7.35	
Forfeited					(250)	11.77	5.29	
Exercised	(5,500)	8.74	4.07		(6,000)	8.20	3.93	
Options outstanding, end of period	247,410	$ 10.26	$ 4.70	$ 1,295,438	251,910	$ 10.22	$ 4.67	$ 1,002,602
Options exercisable, end of period	229,910				235,410			

The fair value of each option granted is estimated on the date of grant using the Black-Sholes option pricing model with the following assumptions used for grants for the years indicated:

	Year Ended December 31,		
	2007	2006	2005
Risk-free interest rate	4.81%	4.99%	4.30%
Dividend yield	0%	0%	0%
Expected weighted average term	7 years	7 years	7 years
Volatility	50%	50%	25%

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The following table summarizes information about stock options outstanding at December 31, 2007:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
$7.68 - $9.24	134,560	4.1	$ 8.45	134,560	$ 8.45
$11.20 - $13.96	112,850	7.3	12.42	95,350	12.36
	247,410			229,910	

During the first quarter of 2007, the Company granted to certain officers 5,725 restricted shares of common stock and 5,725 performance shares of common stock with a weighted average fair market value of $15.95 at the date of grant. During the second quarter an additional 175 restricted shares of common stock and 175 performance shares of common stock were granted with a weighted average fair market value of $16.75 at the date of grant. These restricted stock awards have three-year graded vesting and the performance shares cliff vest at the end of three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 11,800 at December 31, 2007.

Stock-based compensation expense was $59,735 and $23,007 for the years ended December 31, 2007 and 2006, respectively. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of December 31, 2007 and 2006 was $228,527 and $92,133, respectively. Of the $228,527 of unamortized compensation at December 31, 2007, $94,245 relates to performance based restricted stock awards. The time based unamortized compensation of $134,282 is expected to be recognized over a weighted average period of 1.8 years. The total fair value of shares vested during the years ended December 31, 2007, 2006 and 2005 was $59,735, $23,007 and $202,834, respectively. There were no stock option forfeitures in 2007 or 2006.

Note 14. Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate was 7.14% and 7.51% at December 31, 2007 and 2006, respectively. The securities may be redeemed at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. The principal asset of the Trust is $5.2 million of the Company s junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a five year fixed interest rate of 6.29% payable quarterly, converting after five years

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to a LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.4%) which adjusts and is also payable quarterly. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. The principal asset of the Trust is $3.6 million of the Company s junior subordinated securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust s obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends.

Note 15. Retirement plans

401K Plan: The Bank provides a qualified 401K plan to all eligible employees which is administered through the Virginia Bankers Association Benefits Corporation. Employees are eligible to participate in the plan after three months of employment. Eligible employees may, subject to statutory limitations, contribute a portion of their salary to the plan through payroll deduction. The Bank provides a matching contribution of $.50 for every $1.00 the participant contributes up to the first 4% of their salary. Participants are fully vested in their own contributions and vest equally over three years of service in the Bank s matching contributions. Total contributions to the plan for the years ended December 31, 2007, 2006 and 2005 were $98,705, $76,591 and $48,228, respectively.

Supplemental Executive Retirement Plan: The Bank established the Village Bank Supplemental Executive Retirement Plan (the SERP) on January 1, 2005 to provide supplemental retirement income to certain executive officers as designated by the Personnel Committee and approved by the Board of Directors. The SERP is an unfunded employee pension plan under the provisions of ERISA. An eligible employee, once designated by the Committee and approved by the Board of Directors in writing to participate in the SERP, becomes a participant in the SERP 60 days following such approval (unless an earlier participation date is approved). There are currently four executive officers who participate in the SERP. The retirement benefit to be received by a participant is determined by the Committee and approved by the Board of Directors and is payable in equal monthly installments over a 15 year period, commencing on the first day of the month following a participant s retirement or termination of employment, provided the participant has been employed by the Bank for a minimum of 10 years (6 years in the case of one participant). The Personnel Committee, in its sole discretion, may choose to treat a participant who has experienced a termination of employment on or after attaining age 65 but prior to completing his service requirement as having completed his service requirement. The costs associated with this plan are offset by earnings attributable to the Bank s purchase of Bank Owned Life Insurance (BOLI) on the lives of the participants. At December 31, 2007 and 2006, the Bank s liability under the SERP was $216,421 and $49,925, respectively, and expense for the years ended December 31, 2007, 2006 and 2005 was to $166,495, $30,263 and $14,920, respectively. The increase in cash surrender value of the BOLI related to the participants was $62,410, $35,909 and $32,240 for the years ended December 31, 2007, 2006 and 2005, respectively.

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Directors   Deferral Plan: The Bank established the Village Bank Outside Directors Deferral Plan (the   Directors Deferral Plan) on January 1, 2005 under which non-employee Directors of Village Bank have the opportunity to defer receipt of all or a portion of certain compensation until retirement or departure from the Board of Directors. Deferral of compensation under the Directors Deferral Plan is voluntary by non-employee Directors and to participate in the plan a director must file a deferral election as provided in the plan. A Director shall become an active participant with respect to a plan year (as defined in the plan) only if he is expected to have compensation during the plan year and he timely files a deferral election. A separate account is established for each participant in the plan and each account shall, in addition to compensation deferred at the election of the participant, be credited with interest on the balance of the account, the rate of such interest to be established by the Board of Directors in its sole discretion at the beginning of each plan year. The costs associated with this plan are partially offset by earnings attributable to the Bank s purchase of

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Bank Owned Life Insurance (BOLI) on the lives of the participants. At December 31, 2007 and 2006, the Bank s liability under the Directors Deferral Plan was $180,913 and $106,361, respectively, and expense for the years ended December 31, 2007, 2006 and 2005 was $74,607, $53,946 and $57,268, respectively. The increase in cash surrender value of the BOLI related to the participants was $20,378, $16,554 and $18,054 for the years ended December 31, 2007, 2006 and 2005, respectively.

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Note 16. Fair values of financial instruments

The estimated fair values of the Company s financial instruments at December 31, 2007 and 2006 are as follows:

	2007		2006	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 22,115,004	$ 22,115,004	$ 17,198,503	$ 17,198,503
Investment securities available for sale	13,711,399	13,711,399	12,787,644	12,787,644
Loans held for sale	3,489,886	3,489,886	3,149,178	3,149,178
Loans	323,873,740	324,613,316	238,498,418	239,615,657
Accrued interest receivable	2,752,755	2,752,755	2,301,264	2,301,264
Financial liabilities				
Deposits	339,297,258	339,090,535	253,309,881	252,984,711
FHLB borrowings	12,000,000	11,918,833	4,000,000	3,984,868
Trust preferred securities	8,764,000	8,764,000	5,155,000	5,155,000
Other borrowings	3,972,569	3,972,569	704,265	704,265
Accrued interest payable	587,980	587,980	429,986	429,986
Off-balance-sheet instruments				
Undisbursed credit lines		80,040,000		64,034,000
Commitments to extend or originate credit		30,195,000		30,072,000
Standby letters of credit		5,413,000		3,473,000

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Note 17. Parent corporation only financial statements

Village Bank and Trust Financial Corp.

(Parent Corporation Only)

Balance Sheets

December 31, 2007 and 2006

	2007	2006
Assets		
Cash and due from banks	$ 148,772	$ 62,918
Receivable from subsidiary	411,667	
Investment in subsidiaries	30,037,298	28,581,878
Investment in special purpose subsidiary	264,000	155,000
Premises and equipment, net	6,684,405	
Prepaid expenses and other assets	1,145,382	2,670,880
	$ 38,691,524	$ 31,470,676
Liabilities and Stockholders Equity		
Liabilities		
Long-term debt - trust preferred securities	$ 8,764,000	$ 5,155,000
Payable to subsidiary		435,590
Other Borrowings	2,836,090	
Other liabilities	198,135	235,971
Total liabilities	11,798,225	5,826,561
Stockholders equity		
Preferred stock		
Common stock	10,303,940	10,248,352
Additional paid-in capital	13,726,269	13,588,888
Accumulated other comprehensive income (loss)	(122,607)	(177,759)
Retained earnings	2,985,697	1,984,634
Total stockholders equity	26,893,299	25,644,115
	$ 38,691,524	$ 31,470,676

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Village Bank and Trust Financial Corp.

(Parent Corporation Only)

Statements of Income

Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Expenses			
Interest	$ 447,381	$ 368,478	$ 239,133
Occupancy	11,700		
Advertising and marketing		152	
Supplies	33,850	44,400	56,352
Legal	15,029	64,741	6,186
Other outside services	6,389		8,726
Total expenses	514,349	477,771	310,397
Net loss before undistributed equity in subsidiary	(514,349)	(477,771)	(310,397)
Undistributed equity in subsidiary	1,340,533	1,717,220	1,456,088
Income before income taxes	826,184	1,239,449	1,145,691
Income taxes (benefit)	(174,879)	(159,769)	(85,492)
	$ 1,001,063	$ 1,399,218	$ 1,231,183

Statements of Cash Flows

Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Cash Flows from Operating Activities			
Net income	$ 1,001,063	$ 1,399,218	$ 1,231,183
Adjustments to reconcile net income to net cash provided by operating activities			
Undistributed earnings of subsidiary	(1,340,533)	(1,717,220)	(1,456,088)
(Increase) decrease in other assets	1,004,831	(2,285,442)	(447,898)
Increase (decrease) in other liabilities	(473,426)	546,410	125,151
Net cash provided by (used in) operations	191,935	(2,057,034)	(547,652)
Cash Flows from Investing Activities			
Capital contribution to subsidiary		(6,000,000)	(5,000,000)
Purchase of premises and equipment	(6,684,405)		
Net cash used in investing activities	(6,684,405)	(6,000,000)	(5,000,000)
Cash Flows from Financing Activities			
Proceeds from issuance of long-term debt	3,609,000		5,155,000
Proceeds from issuance of common stock	133,234	7,204,194	947,315

Net increase in other borrowings	2,836,090		
Net cash provided by financing activities	6,578,324	7,204,194	6,102,315
Net increase (decrease) in cash	85,854	(852,840)	554,663
Cash, beginning of period	62,918	915,758	361,095
Cash, end of period	$ 148,772	$ 62,918	$ 915,758

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Note 18. Selected quarterly financial data (unaudited)

Condensed quarterly financial data is shown as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007				
Interest income	$ 5,644,481	$ 6,202,242	$ 6,798,472	$ 7,020,040
Interest expense	2,917,955	3,251,891	3,731,366	3,905,503
Net interest income before provision for loan losses	2,726,526	2,950,351	3,067,106	3,114,537
Provision for loan losses	208,342	359,937	243,730	375,473
Gain on sale of loans	383,789	388,767	387,680	353,082
Fees and other noninterest income	281,119	295,990	263,989	312,540
Noninterest expenses	2,638,623	3,006,047	3,083,211	3,093,351
Income tax expense	185,120	91,501	133,224	105,854
Net income	359,349	177,623	258,610	205,481
Earnings per share				
Basic	$ 0.14	$ 0.07	$ 0.10	$ 0.08
Diluted	$ 0.13	$ 0.07	$ 0.09	$ 0.08
2006				
Interest income	$ 3,942,375	$ 4,395,821	$ 5,213,505	$ 5,467,410
Interest expense	1,720,851	1,879,155	2,479,324	2,707,270
Net interest income before provision for loan losses	2,221,524	2,516,666	2,734,181	2,760,140
Provision for loan losses	217,400	145,761	118,343	314,502
Gain on sale of loans	333,611	424,565	372,855	388,411
Fees and other noninterest income	243,941	210,478	230,225	278,707
Noninterest expenses	2,153,490	2,488,698	2,500,630	2,674,272
Income tax expense	145,583	175,865	244,218	137,324
Net income	282,603	341,385	474,070	301,160
Earnings per share				
Basic	$ 0.15	$ 0.16	$ 0.19	$ 0.12
Diluted	$ 0.13	$ 0.16	$ 0.18	$ 0.11

Note 19. Subsequent event (unaudited)

On March 9, 2008, Village Bank and Trust Financial Corp. and Village Bank entered into a definitive merger agreement with River City Bank (River City) whereby River City will merger with and into Village Bank in a transaction valued at approximately $20.2 million payable in cash and common stock. Under terms of the merger agreement, which was approved by the Board of Directors of both companies, shareholders of River City will be entitled to receive for each share of River City common stock owned, $11.00 in cash or 1 share of Village Bank and Trust Financial Corp. common stock, subject to proration of 20% cash and 80% common stock if either cash or common stock is oversubscribed. It is anticipated that the transaction will be completed in the third quarter of 2008, pending regulatory approval and approval of the shareholders of both companies.

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Annex E

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB/A

(Amendment No. 1)

ANNUAL REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission file number 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.

(Name of small business issuer in its charter)

Virginia **(State or other jurisdiction of** **incorporation or organization)**	**16-1694602** **(I.R.S. Employer** **Identification No.)**
1231 Alverser Drive, P.O. Box 330, Midlothian, Virginia **(Address of principal executive offices)**	**23113** **(Zip Code)**

Issuer s telephone number 804-897-3900

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

Title of each class	**Name of each exchange on which registered**
Common Stock, $4.00 par value	The Nasdaq Stock Market

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

None

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. ¨

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 x No ¨.

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B 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/A or any amendment to this Form 10-KSB/A. ¨

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

State issuer s revenues for its most recent fiscal year. $28,332,000.

The aggregate market value of common stock held by non-affiliates of the registrant as of March 14, 2008 was approximately $25,708,000.

The number of shares of common stock outstanding as of March 14, 2008 was 2,575,985.

DOCUMENTS INCORPORATED BY REFERENCE

Not Applicable

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EXPLANATORY NOTE

The Registrant hereby amends its Annual Report on Form 10-KSB for the fiscal year ended December 31, 2007 (filed on March 27, 2008 with the Securities and Exchange Commission) as set forth in this Annual Report on Form 10-KSB/A (Amendment No. 1) (the Form 10-KSB/A). This Form 10-KSB/A includes the items required in Part III, which had previously been expected to be incorporated by reference to the Registrant s definitive proxy statement for the 2008 annual meeting of shareholders.

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Part III

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PART III

ITEM 9 DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS, CONTROL

PERSONS AND CORPORATE GOVERNANCE; COMPLIANCE WITH SECTION

16(a) OF THE EXCHANGE ACT

General

The business and affairs of Village Bank and Trust Financial Corp. (the Company) are managed under the direction of the Board of Directors in accordance with the Virginia Stock Corporation Act and the Company s Articles of Incorporation and Bylaws. Members of the Board are kept informed of the Company s business through discussions with the President and Chief Executive Officer and other officers, by reviewing materials provided to them and by participating in meetings of the Board of Directors and its committees.

Directors

There are currently nine members on our Board of Directors. The directors are divided into three classes. The following information is current as of May 21, 2008 and describes the business experience of each member of our Board of Directors.

Craig D. Bell, 50, is a founder of the Bank and has been a director since 1998. Mr. Bell is Chairman of the Board of Directors of the Company. He is a partner with the law firm of McGuireWoods LLP, where he is a member of the Business Tax Department and is the head of the State and Local Tax and Tax Litigation Groups. Mr. Bell is on the Board of Directors of the Community Tax Law Project, a non-profit provider of pro bono tax assistance to low income families; a Fellow of the American College of Tax Council; former Chair of both the Virginia State Bar Section of Taxation and the Virginia Bar Association Tax Section; a member of the Edgar J. Murdock Inn of Court for Tax; an adjunct Professor of Law at the College of William and Mary School of Law; and a Trustee of the Virginia War Museum. Mr. Bell retired from the Army Reserves in 2006 as a Lieutenant Colonel after completing 27 years of service.

Thomas W. Winfree, age 63, has been a director since 2001. Mr. Winfree has served as Chief Executive Officer and President of the Company since its inception. He has also served as President and Chief Executive Officer of Village Bank since 2001. Mr. Winfree has over 38 years of banking experience. He served as President of the Chesterfield Chamber of Commerce during 2004 and has recently been appointed to again serve on the Chamber s Board of Directors. Mr. Winfree is also a founding member and Director of the Families of the Wounded Fund, Inc., an organization dedicated to helping families of wounded soldiers. He currently serves on the Dean s Advisory Council for the University of Richmond, the John Tyler Foundation Board, the Chesterfield Business Council Board, and the St. Francis Citizens Board.

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R. T. Avery, III, 58, has been a director since 1998. Mr. Avery is President and co-founder of Chesterfield Construction Services, Inc., which trades as Emerald Homes. This company specializes in the starter-home sector of the residential construction market.

Donald J. Balzer, Jr., 52, has been a director since 1998. Mr. Balzer is Chairman of the Board of Balzer & Associates, Inc., an architectural, engineering, surveying and landscape architectural firm. He is a Licensed Professional Engineer and served as President of Balzer & Associates, Inc. until his retirement in 2005. He currently serves as President of Cross Creek Development Corp.

William B. Chandler, 58, has been a director since 1998. Mr. Chandler is a co-owner in two corporations: Manchester Industries, Inc., which converts board and paper into sheets from roll stock for the printing industries, and Plastex Fabricators, Inc., which is a fabricator of industrial and commercial plastics used for décor in the retail industry. He currently is responsible for engineering, construction, safety and production of Manchester Industries and serves as its Vice President. Mr. Chandler is President of Plastex Fabricators located in Charlotte, North Carolina.

R. Calvert Esleeck, Jr., 63, has been a director since 1998. Mr. Esleeck recently retired as a practicing certified public accountant and President of the Midlothian area firm of Murray & Esleeck, P.C. He is licensed in Virginia and is a member of the American Institute of CPAs and the Virginia Society of CPAs. Mr. Esleeck is a combat veteran of the Vietnam War where he served as a Marine infantry officer. He also serves as President of the Families of the Wounded Fund, Inc., which provides assistance to the families of the wounded servicemen and women being treated at McGuire Veterans Hospital.

Dean T. Patrick, 47, is a founder of the Bank and has been a director since 1998. Mr. Patrick has been President of Patrick Construction for the past 26 years and a developer for 13 years. Mr. Patrick is also a licensed real estate broker and President of Ted Patrick Realty.

Michael L. Toalson, age 55, has been a director since 2004. Mr. Toalson is Executive Vice President of the HomeBuilders Association of Virginia. He heads the HBAV lobbying team before state lawmakers and regulators and is the chief administrative officer of the organization s 6,000 members.

George R. Whittemore, 58, has been a director since 1998. Mr. Whittemore is currently retired. He is a member of the Board of Directors of Supertel Hospitality, Inc. (formerly Humphrey Hospitality Trust, Inc.), a publicly-traded real estate investment trust that owns limited service hotels. He

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was a consultant to Supertel Hospitality, Inc. from August 2004 to August 2005 and its President from November 2001 to August 2004. Mr. Whittemore served as a Director and Senior Vice President/Senior Administrative Officer of Anderson & Strudwick, Inc., a brokerage firm, from November 1996 until November 2001. Mr. Whittemore is a director of Prime Group Realty Trust, Inc., a publicly traded real estate investment trust that primarily owns commercial office buildings. He is also a director of Lightstone Value Plus REIT, a non-publicly traded real estate investment trust that owns various types of income producing real estate.

Executive Officers Who Are Not Directors

Jack M. Robeson, 59, has served as Senior Vice President - Lending of the Bank since August 2001. Mr. Robeson served as Vice President for Bank of Essex from January 1996 to August 2001. Mr. Robeson has over 33 years of banking industry experience.

Raymond E. Sanders, 54, has served as Senior Vice President of the Company since its inception. He has served as Senior Vice President and Chief Operating Officer of the Bank since June 2004 and served as Vice President - Retail Banking from July 2002 to June 2004. Mr. Sanders previously served as President of Seasons Mortgage Group from October 1993 until the company was sold in May 2001. He has over 31 years of experience in retail and mortgage banking.

C. Harril Whitehurst, Jr., 57, has served as Senior Vice President and Chief Financial Officer of the Company since its inception. He has served as Senior Vice President and Chief Financial Officer of the Bank since September 2003. Mr. Whitehurst served as a Director for RSM McGladrey from July 2000 to September 2003. Mr. Whitehurst has over 31 years of banking industry experience.

Dennis J. Falk, 49, has served as Senior Vice President - Commercial Banking of the Bank since April 2006. Prior to that, Mr. Falk served as Senior Vice President for SunTrust Bank and was employed by SunTrust (and its predecessor bank in the MidAtlantic region, Crestar Bank) for 14 years. Mr. Falk has over 27 years of banking industry experience.

Code of Ethics

The Company has a Code of Ethics for directors, officers and all employees of the Company and its subsidiaries, and a Code of Ethics applicable to the Company s Chief Executive Officer, Chief Financial Officer and other principal financial officers. The Code addresses such topics as protection and proper use of Company assets, compliance with applicable laws and regulations, accuracy and preservation of records, accounting and financial reporting and conflicts of interest. A copy of the Code will be provided, without charge, to any shareholder upon written request to the Secretary of the Company, whose address is P.O. Box 330, 1231 Alverser Drive, Midlothian, Virginia 23113.

Board and Committee Meeting Attendance

There were twelve meetings of the Company s Board of Directors in 2007. Each incumbent director attended greater than 75% of the aggregate number of meetings of the Board of Directors and meetings of committees of which the director was a member in 2007.

Committees of the Board

The Company has an Audit Committee and a Compensation Committee. The Company does not have a standing nominating committee.

Audit Committee

The Company s Audit Committee assists the Board of Directors in fulfilling its oversight responsibility to the shareholders relating to the integrity of the Company s financial statements, the Company s compliance with legal and regulatory requirements and the qualifications, independence and the performance of the internal audit function. The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of the work of the independent registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attestation services for the Company. The Board of Directors has adopted a written charter for the Audit Committee. A copy of the charter was attached to our 2007 proxy statement.

The members of the Audit Committee are Messrs. Esleeck, Chandler and Toalson, all of whom the Board of Directors, in its business judgment, has determined are independent as defined by the NASDAQ Stock Market s (NASDAQ) listing standards. The Board of Directors also has determined that all of the members of the Audit Committee have sufficient knowledge in financial and auditing matters to serve on the Audit Committee and that Mr. Esleeck qualifies as an audit committee financial expert as defined by SEC regulations.

The Audit Committee met three times in 2007. For additional information regarding the Audit Committee, see Audit Information Audit Committee Report later in this report.

Compensation Committee

The Company s Compensation Committee assists the Board of Directors in fulfilling their responsibility to the shareholders to ensure that the Company s officers, key executives, and board members are compensated in accordance with the Company s total compensation objectives and executive compensation policy. The Compensation Committee advises and recommends for approval

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compensation policies, strategies, and pay levels necessary to support organizational objectives. The Board of Directors has adopted a written charter for the Compensation Committee. A copy of the charter was attached to our 2007 proxy statement.

The members of the Compensation Committee are Messrs. Avery, Chandler, Balzer, Bell and Whittemore, all of whom the Board in its business judgment has determined are independent as defined by NASDAQ s listing standards.

The Compensation Committee s primary objective is to provide competitive levels of compensation to attract, retain and reward outstanding executive officers. In a highly competitive community banking marketplace, excellent leadership is essential. Our executive officers are expected to manage the business of the Company in a manner that promotes its growth and profitability for the benefit of our shareholders. To that end, we believe that:

Our key executives should have compensation opportunities at levels that are competitive with peer institutions.

Total compensation should include significant at risk components that are linked to annual and longer term performance results.

Stock-based compensation should form a key component of total compensation as a means of linking senior management to the long term performance of the Company and aligning their interests with those of shareholders.

The Compensation Committee s compensation philosophy with respect to its executive officers is one of pay for performance. Accordingly, an executive officer s annual compensation consists of a base salary, an annual monetary bonus and stock-based compensation. The annual monetary bonus is utilized to reward our executives for achieving short-term financial and productivity goals, and stock-based compensation is utilized for achieving long-term financial and productivity goals.

The Compensation Committee met four times in 2007.

Director Nomination Process

The independent members of the Board of Directors perform the functions of a nominating committee. The Board of Directors does not believe it needs a separate nominating committee because the independent directors (as that term is defined in the NASDAQ listing standards) have the time and resources to perform the function of recommending nominees to the Board of Directors. The Board of Directors has adopted a resolution that provides that it will not nominate any person who has not been recommended for nomination by a majority of the independent directors.

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In identifying potential nominees, the Board of Directors takes into account such factors as it deems appropriate, including the current composition of the Board of Directors, the range of talents, experiences and skills that would best complement those that are already represented on the Board of Directors, the balance of management and independent directors and the need for specialized expertise. The Board of Directors considers candidates for Board membership suggested by its members and by management, and the Board of Directors will also consider candidates suggested informally by a shareholder of the Company.

In the consideration of director nominees, including any nominee that a shareholder may submit, the Board of Directors considers, at a minimum, the following factors for new directors, or the continued service of existing directors:

- The ability of the prospective nominee to represent the interests of the shareholders of the Company;
- The prospective nominee s standards of integrity, commitment and independence of thought and judgment;
- The prospective nominee s ability to dedicate sufficient time, energy and attention to the diligent performance of his or her duties, including the prospective nominee s service on other public company boards;
- The extent to which the prospective nominee contributes to the range of talent, skill and expertise appropriate for the Board of Directors; and
- The prospective nominee s involvement within the communities the Company serves.

Shareholders entitled to vote for the election of directors may recommend candidates for the independent directors to consider formally in connection with an annual meeting as long as the recommendation is made on or before the last date on which a shareholder may nominate an individual for election to the Board of Directors under the Company s Bylaws.

Under the process used by the Company for selecting new board candidates, the President and Chief Executive Officer and the Board of Directors identify the need to add a new board member with specific qualifications or to fill a vacancy on the board. The Chairman of the Board of Directors will initiate a search, working with staff support and seeking input from board members and senior management, hiring a search firm, if necessary, and considering any candidates recommended by shareholders. An initial slate of candidates that will satisfy criteria and otherwise qualify for membership on the board may be presented to the Board of Directors. A determination is made as to whether board members have relationships with preferred candidates and can initiate contacts. The President and Chief Executive Officer and the Chairman of the Board of Directors interview prospective candidates. The Board of Directors meets to conduct further interviews of prospective candidates, if necessary or appropriate, and to consider and recommend final candidates for approval.

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Director Compensation

Each member of the Board of Directors receives no fees for their service as Directors of the Company.

All of the directors of the Company serve as directors of the Bank. As compensation for his service to the Bank, each member of the Board of Directors receives fees as follows:

- a retainer fee of $100 for each meeting of the Board ($150 for the Chairman of the Board),
- an attendance fee of $200 for each meeting of the Board that he attends ($300 for the Chairman of the Board), and
- an attendance fee of $100 for each meeting of a committee that he attends ($150 for the chairman of the committee).

Board members who are also officers do not receive any additional compensation above their regular salary for Board service or attending committee meetings.

During the year, all directors of the Company also served on the Board of Village Bank Mortgage Corporation and received $100 per meeting for attending such meetings.

In 2005, the Company adopted the Outside Directors Deferral Plan under which non-employee directors of the Bank have the opportunity to defer receipt of all or a portion of their compensation until retirement or departure from the Board of Directors. Any amounts deferred under this plan are maintained in an account for the benefit of the director and are credited annually with interest on the deferred amount at a rate established by the Board of Directors in its sole discretion prior to the beginning of each plan year.

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The following table provides information concerning the compensation of all non-employee directors for the year ended December 31, 2007:

Director Compensation

Name	*Fees Earned or Paid in Cash*	*Nonqualified Deferred Compensation Earnings (1)*	*Total*
R.T. Avery, III	$ 12,850	$ 1,712	$ 14,562
Donald J. Balzer, Jr.	9,550	1,418	10,968
Craig D. Bell	11,050	1,668	12,718
William B. Chandler	8,500	1,264	9,764
R. Calvert Esleeck, Jr.	9,700	1,393	11,093
Dean T. Patrick	9,900		9,900
Michael L. Toalson	10,500	529	11,029
George R. Whittemore	10,800	1,322	12,122

(1) Represents interest earned on deferred fees for the year ended December 31, 2007.

Annual Meeting Attendance

The Company encourages members of the Board of Directors to attend the annual meeting of shareholders. All of the directors except one attended the 2007 annual meeting.

Communications with Directors

Any director may be contacted by writing to him c/o Village Bank and Trust Financial Corp., P.O. Box 330, 1231 Alverser Drive, Midlothian, Virginia 23113. Communications to the non-management directors as a group may be sent to the same address, c/o the Secretary of the Company. The Company promptly forwards all such correspondence to the indicated directors.

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ITEM 10 EXECUTIVE COMPENSATION

Executive Officer Compensation

The following table presents information concerning the compensation of the named executive officers for services rendered in all capacities to the Company and the Bank.

Summary Compensation Table

Name and Principal Position	*Year*	*Salary ($)*	*Bonus ($)*	*Stock Awards ($)(1)*	*Option Awards ($)(1)*	*Non-Equity Incentive Plan Compensation ($)(2)*	*Nonqualified Deferred Compensation Earnings ($)(3)*	*All Other Compensation ($)(6)*	*Total*
Thomas W. Winfree	2007	$ 190,000	$	$ 4,021	$ 10,317	$	$ 82,334	$ 23,315	$ 309,987
President and Chief Executive Officer	2006	172,500			6,018	45,900	21,936	3,450	249,804
C. Harril Whitehurst, Jr.	2007	121,875		2,120	6,878		19,818	3,771	154,463
Senior Vice President/ Chief Financial Officer	2006	109,313			4,012	17,802	2,907	2,250	136,284
Jack M. Robeson	2007	114,583	250	2,035	6,878		20,806	9,259	153,812
Senior Vice President Lending	2006	104,963			4,012	18,282	3,258	2,220	132,735
Raymond E. Sanders	2007	121,875		2,120	6,878		17,194	5,760	153,828
Senior Vice President/ Chief Operating Officer	2006	109,313			4,012	17,181	2,162	2,267	134,935
Dennis J. Falk (4)	2007	123,333		2,065	7,429		10,330	10,033	153,191
Senior Vice President	2006	90,000			4,953	11,948		600	107,501
Jerry W. Mabrey (5) President, Village Bank Mortgage Corporation	2007	72,533						5,624	78,158

(1) Amounts represent compensation expense for awards and grants made in accordance with FAS 123R. The annual expense of these awards and grants are based on recording the required expense over their vesting period of three years with the exception of performance shares which cliff vest at the end of three years. Assumptions used in the calculation of these amounts are included in Note 13 to the Company s audited financial statements for the year ended December 31, 2007 included in the Form 10-KSB filed with the SEC on March 27, 2008. Starting in 2007, the Company only makes awards of restricted stock.

(2) All executive officers declined any amounts due them under the Incentive Plan for 2007.

(3) Amounts represent the Company s expense for the supplemental executive retirement plan.

(4) Mr. Falk s employment with the Company began in April 2006.

(5) Mr. Mabry s employment with the Company began in April 2007.

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(6) Amounts shown in the All Other Compensation column are detailed in the following table:

All Other Compensation

Name and Principal Position	*Company Match on 401(k)*	*Company Vehicle / Automobile Allowance*	*Cancer Policy Insurance Premium*	*Telephone Expense / Allowance*	*Financial Planning*	*Total*
Thomas W. Winfree	$ 4,082	$ 11,755	$ 378	$ 2,101	$ 5,000	$ 23,315
C. Harril Whitehurst, Jr.	2,793		378	600		3,771
Jack M. Robeson	2,662	6,000	378	219		9,259
Raymond E. Sanders	2,562	2,400	378	420		5,760
Dennis J. Falk	2,706	6,000	427	900		10,033
Jerry W. Mabrey	520	4,250	254	600		5,624

Messrs. Winfree and Whitehurst have employment agreements with the Company. Additional information on these employment agreements is described later in this report. Information on the components of executive compensation is set forth below.

Salary. A competitive salary for senior management is essential. Furthermore, flexibility to adapt to the particular skills of an individual or the specific needs of the Company is required. Proposed salary adjustments for senior management are presented to the Compensation Committee by Mr. Winfree, typically during the second quarter. The Compensation Committee reviews the recommendations, makes any further adjustments and generally approves the recommendations with input from the Compensation Committee s external compensation advisor. Recommendations regarding adjustments to Mr. Winfree s salary are reviewed and, if appropriate, approved by the Compensation Committee in executive session. Salaries for senior management in 2006 were generally deemed to be below the median of the Company s peer group. At the recommendation of the Compensation Committee s external compensation advisor, the Compensation Committee approved the proposed salary adjustments and will consider future increases to annual base salaries to bring senior base pay in line with targeted compensation levels and mix as defined in the Company s executive compensation philosophy, which is described earlier in this report.

Stock-Based Compensation. Prior to 2007, the Compensation Committee awarded stock options to employees under the 2000 Incentive Plan, as amended and restated. These awards of stock options were at the sole discretion of the Board of Directors and were utilized to attract new employees as well as to reward existing employees for performance. Starting in 2007, the Compensation Committee replaced the use of stock options with time-vested and performance-vested restricted stock awards as it believes restricted stock is a more competitive form of compensation to retain and attract new employees.

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The Compensation Committee has implemented a restricted stock award strategy that generally favors a mix (50% / 50%) of time-vested and performance-vested restricted stock awards, each of which vests over three-year periods. Time-vested stock awards will vest on each of three anniversary dates in 25%, 25% and 50% increments. Performance-vested stock awards will vest at the end of a three year performance period if the Company achieves targeted measures of return on equity and return on assets. Performance-share vesting can range from 0%, when all are forfeited, to 100%, when all are earned. The Compensation Committee has not implemented a leverage arrangement where the performance-vested shares can be leveraged beyond the original performance stock award. As with all components of pay, the Compensation Committee will consider future increases to each executive s targeted annual long term grant value to bring total direct compensation levels in line with established compensation levels and mix as defined in the Company s executive compensation philosophy.

In granting restricted stock awards in 2007, the Compensation Committee asked its external compensation advisor to propose a 2007 restricted stock award for senior management. The Compensation Committee s advisor recommended restricted stock awards for each executive based on the Company s executive compensation philosophy statement described elsewhere in this report. In reviewing the compensation advisor s recommendation for the 2007 restricted stock awards, the Compensation Committee also took into consideration historical stock option grant practices and the conversion from stock option grants to more competitive awards of time-vested and performance-vested restricted stock.

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Information on the restricted stock awards in 2007 is provided in the following table:

Grants of Plan Based Awards in 2007

		Estimated Future Payouts Under Equity Incentive Plan Awards				
Name	*Grant Date*	*Time-Vested (1)*	*Performance-Vested (2)*	*Total*	*Grant Date Fair Value Per Share*	*Total*
Thomas W. Winfree	2/15/07	1,100	1,100	2,200	$ 15.95	$ 35,090
C. Harril Whitehurst, Jr.	2/15/07	540	540	1,080	$ 15.95	17,226
	6/1/07	60	60	120	$ 16.75	2,010
Jack M. Robeson	2/15/07	520	520	1,040	$ 15.95	16,588
	6/1/07	55	55	110	$ 16.75	1,843
Raymond E. Sanders	2/15/07	540	540	1,080	$ 15.95	17,226
	6/1/07	60	60	120	$ 16.75	2,010
Dennis J. Falk	2/15/07	565	565	1,130	$ 15.95	18,024

(1) Time-vested stock awards will vest on each of three anniversary dates in 25%, 25% and 50% increments.

(2) Performance-vested stock awards will vest at the end of a three year performance period if the Company achievestargeted measures of return on equity and return on assets. Performance-share vesting can range from 0%, when all are forfeited, to 100%, when all are earned.

Non-Equity Incentive Plan Compensation. We offer senior management an opportunity to receive an annual target non-equity incentive bonus of 15 to 20 percent of their year-end base salary, depending on the executive s responsibilities. To determine an executive officer s non-equity incentive, the Compensation Committee adopted the 2006 Management Incentive Plan (the Plan). Under the Plan, an executive officer can earn a bonus by achieving short-term financial and productivity goals established by the Compensation Committee. These goals are customized for each executive before the beginning of the Plan year to reflect a mix of corporate and individual initiatives and reflect a minimum, target and maximum amount of incentive**.** For example, Mr. Winfree s targeted incentive awards under the Plan are weighted between corporate (70%) and individual (30%) goals. For others in senior management, the mix of corporate and individual weights is generally 60% / 40% or 50% / 50%, respectively, depending on the organizational responsibility of each executive. At a meeting of the Compensation Committee, usually in December, the Compensation Committee s external compensation advisor recommends award targets and the award leverage schedule (minimum to maximum awards and their relationship to performance intervals), for the upcoming year.

For 2007, Mr. Winfree presented performance results for corporate and individual measures and corresponding proposed incentive amounts that were calculated in accordance with the award leverage schedule in the Plan. The

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Compensation Committee reviewed the performance of the Company and each executive s performance against the Plan. At the request of the Compensation Committee, the external compensation advisor validated the award calculations prior to the Compensation Committee s approval of the Plan award amounts. In general, the target award opportunities under the Plan were below comparative practices of our peer group. As with all components of pay, the Compensation Committee will consider future increases to each executive s annual target incentive opportunity to bring total cash compensation in line with targeted compensation levels and mix as defined in the Company s executive compensation philosophy. All executive officers declined any amounts due them under the Plan for 2007.

Non-Qualified Deferred Compensation Plans. We believe that non-qualified deferred compensation plays an important role in retaining key executives, as well as helping them provide for retirement. The Compensation Committee retained an independent consultant to analyze the total retirement benefits provided by the Company and Social Security to employees with various levels of compensation and years of service so that the Compensation Committee could determine the projected replacement ratio of income at retirement compared with active employment. Because of limits under our qualified retirement plan on the amount of deferrals that our executives can make, several of our executives can expect to have a lower retirement replacement ratio than we have targeted for all employees. Consequently, as a matter of pension equity , we have adopted a supplemental plan which should provide a benefit for designated executives that will help approach the targeted retirement replacement ratio.

For that reason, we provide a benefit for senior management, including each of the named executive officers. The Company provides a potential supplemental retirement plan benefit of $50,000 annually for 15 years to Mr. Winfree and a potential benefit of $25,000 annually for 15 years to Messrs. Whitehurst, Sanders, Robeson and Falk. Under the plan s vesting schedule, Mr. Winfree has completed four years of a six year vesting schedule. Messrs. Whitehurst, Sanders, and Robeson have completed three years of a ten year vesting schedule. Mr. Falk has completed one year of a ten year vesting schedule. In the event of a pre-retirement death, vesting is accelerated and the executive s named beneficiary receives the benefit over the 15 year payout schedule. In the event of a post-retirement death, the executive s named beneficiary receives any remaining benefit payments of the 15 year payout schedule. In the event of a termination of employment resulting from a change in control of the Company, vesting is accelerated and the benefit is paid under the 15 year payout schedule.

Outstanding Equity Awards

The following table sets forth certain information with respect to the amount and value of outstanding equity awards on an award-by-award basis held by the named executive officers at December 31, 2007.

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Outstanding Equity Awards at Fiscal Year-end

	Option Awards				*Stock Awards*			
Name	*Number of Securities Underlying Unexercised Options (#) Exercisable*	*Number of Securities Underlying Unexercised Options (#) Unexercisable [1]*	*Option Exercise Price ($)*	*Option Expiration Date*	*Number of Shares or Units of Stock That Have Not Vested*	*Market Value of Shares or Units of Stock That Have Not Vested ($)*	*Equity Incentive Plan Awards: Number of Un-earned Shares, Units or Other Rights that have not Vested*	*Equity Incentive Plan Awards: Market or Payout Value of Un-earned Shares, Units or Other Rights that have not Vested*
Thomas W. Winfree	11,000		$ 8.50	9/18/11	1,100	$ 17,545	1,100	$ 17,545
	1,000		8.50	9/18/11				
	5,000		8.80	8/19/12				
	5,000		7.68	4/18/13				
	10,000		12.50	7/16/14				
	10,000		11.96	4/26/15				
	4,650		13.00	12/20/15				
	1,500	3,000	12.50	6/12/16				
	48,150	3,000						
C. Harril Whitehurst, Jr.	5,000		$ 9.24	9/15/13	600	9,618	600	9,618
	6,000		11.20	1/27/14				
	5,000		12.50	7/16/14				
	5,000		13.00	7/21/15				
	3,100		13.00	12/20/15				
	1,000	2,000	12.50	6/12/16				
	25,100	2,000						
Jack M. Robeson	6,000		$ 8.50	9/18/11	575	9,215	575	9,215
	1,000		8.20	8/18/13				
	5,000		12.50	7/16/14				
	3,000		13.00	7/21/15				
	3,100		13.00	12/20/15				
	1,000	2,000	12.50	6/12/16				
	19,100	2,000						
Raymond E. Sanders	5,000		$ 8.80	8/19/12	600	9,618	600	9,618
	4,000		8.20	8/18/13				
	5,000		12.50	7/16/14				
	5,000		13.00	7/21/15				
	3,100		13.00	12/20/15				
	1,000	2,000	12.50	6/12/16				

	23,100	2,000						
Dennis J. Falk	1,000	2,000	$ 13.50	4/24/16	565	9,012	565	9,012

(1) Award is vested evenly over three years from date of grant.

None of our named executive officers exercised stock options nor did any restricted stock awards vest in 2007.

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Employment and Change-in-Control Agreements

Securing the continued service of key executives is essential to the successful future of the Company. Employment agreements and management continuity agreements (which help retain key executives during a possible change of control situation) assist the Company by providing security to key executives.

The Company has entered into employment agreements with Messrs. Winfree and Whitehurst. Mr. Winfree s employment agreement was entered into May 1, 2001 with an initial term of three years. Under the agreement, Mr. Winfree agrees to perform the services and duties appropriate to his capacity as the Chief Executive Officer of the Company, responsible for all day-to-day operations. Annually, the Board of Directors reviews Mr. Winfree s performance for the immediately preceding year and, after such review, may extend the employment agreement for an additional twelve months. Mr. Winfree s current employment agreement covers the period from May 1, 2006 to April 30, 2009.

Mr. Whitehurst s employment agreement was entered into September 9, 2003 with a term of one year. Under the agreement, Mr. Whitehurst agrees to perform the services and duties appropriate to his capacity as the Chief Financial Officer of the Company. Annually, the Board of Directors reviews Mr. Whitehurst s performance for the immediately preceding year and, after such review, may extend the employment agreement for twelve months by an appropriate written instrument executed by Mr. Whitehurst and on behalf of the Company. If the employment agreement is not extended in writing before the end of its term or expressly terminated, it shall automatically renew for an additional term of twelve months. Mr. Whitehurst s current employment agreement covers the period from September 1, 2007 to August 31, 2008.

Under the terms of both agreements, Messrs. Winfree and Whitehurst are entitled to severance payments equal to his respective salary for the balance of the term if he is terminated without Cause or if he terminates with Good Reason , each as defined in the respective agreement. In addition, for a period of six months, he will continue to receive benefits under all other employee benefit plans or programs in which he was participating prior to termination or, if continued participation is not possible, an equivalent value. At December 31, 2007, the value of Mr. Winfree s and Mr. Whitehurst s severance payments following termination without Cause or with Good Reason is $253,300 and $81,300, respectively.

The agreements also provide for termination benefits following a change in control of the Company. If Mr. Winfree s employment is terminated for any reason other than for Cause during the term of the employment agreement and any renewal term following a change of control of the Company, he will be entitled to a severance payment in an amount equal to 2.99 times his salary and bonus received during the twelve months ending with the termination of the executive s employment to be paid in equal monthly installments over the

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thirty six months succeeding the date of termination. If Mr. Whitehurst s employment is terminated for any reason other than for Cause during the term of the employment agreement and any renewal term following a change of control of the Company, he will be entitled to a severance payment in an amount equal to 1.50 times his salary and bonus received during the twelve months ending with the termination of the executive s employment to be paid in equal monthly installments over the eighteen months succeeding the date of termination. Additionally, for a period of 2.99 and 1.50 years, respectively, following termination or until such time that the executive has secured full time employment with another employer, Messrs. Winfree and Whitehurst are entitled to continued participation in all group, life, health, accident and disability insurance programs and other employee benefit plans that the executive was eligible to participate in prior to his date of termination. Had Mr. Winfree s employment terminated on December 31, 2007 following a change of control of the Company, he would be entitled to approximately $523,250 (2.99 times his 2007 base salary and bonus, given that his agreement restricts payments that would constitute an excess parachute payment within the meaning of Section 280G of the Internal Revenue Code) payable in equal monthly installments over 36 months. Had Mr. Whitehurst s employment terminated on December 31, 2006 following a change of control of the Company, he would be entitled to approximately $172,500 (1.50 times his base salary and 2007 bonus) payable in equal monthly installments over 18 months.

Additionally, Messrs. Sanders, Robeson and Falk have entered into change of control agreements that provide for termination benefits following a change in control of the Company. Messrs. Sanders , Robeson s and Falk s agreements state that, if within one year after a change in control of the Company, the executive resigns after a reduction in salary or the Company terminates the executive without Cause, the executive will receive one year s salary, payable in monthly installments over twelve months or in a single lump sum. Accordingly, Messrs. Sanders , Robeson s and Falk s termination benefit following a change in control of the Company and a termination under the above circumstances is $130,000, $120,000, $125,000, respectively, as of December 31, 2006.

Equity Compensation Plans

The following table sets forth information as of December 31, 2007, with respect to compensation plans under which shares of Common Stock are authorized for issuance.

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Equity Compensation Plan Information

Plan Category	*Number of Securities to Be issued Upon Exercise of Outstanding Options, Warrants and Rights*	*Weighted Average Exercise Price of Outstanding Options, Warrants and Rights*	*Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (1)*
Equity Compensation Plans			
Approved by Shareholders:			
2000 Incentive Plan (2)	259,210	$ 10.26	185,290
Organizational Investors Warrant Plan	137,500	$ 10.00	
Equity Compensation Plans			
Not Approved by Shareholders: (3)		$	
	396,710	$ 10.17	185,290

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

(2) *The 2000 Incentive Plan permits grants of stock options and awards of Common Stock and/or restricted stock, phantom stock or stock appreciation rights. To date, only options have been granted under the Incentive Plan.*

(3) *The Company does not have any equity compensation plans that have not been approved by shareholders.*

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ITEM 11 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Security Ownership of Management

The following table sets forth, as of March 31, 2008, unless otherwise noted, certain information with respect to beneficial ownership of shares of Common Stock by each of the members of the Board of Directors, by the executive officers named in the Summary Compensation Table below, by owners of more than 5% of shares of Common Stock known to the Company, 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.

Name	*Amount and Nature of Beneficial Ownership*	*Percent of Class (%)*
Directors:		
R. T. Avery, III [1]	77,554	3.00%
Donald J. Balzer, Jr. [2]	66,716	2.58%
Craig D. Bell [3]	69,012	2.66%
William B. Chandler [4]	67,411	2.60%
R. Calvert Esleeck, Jr. [5]	34,811	1.34%
Dean T. Patrick [6]	58,798	2.27%
Michael L. Toalson [7]	6,611	0.26%
George R. Whittemore [8]	27,911	1.08%
Thomas W. Winfree [9]	97,054	3.69%
Executive Officers:		
Dennis J. Falk [10]	4,082	0.16%
Jack M. Robeson [11]	21,176	0.82%
Raymond E. Sanders [12]	25,379	0.98%
C. Harril Whitehurst, Jr. [13]	32,028	1.23%
Certain Beneficial Owners:		
John S. Clark [14]	248,419	9.64%
1633 Broadway, 30th Floor		
New York, NY 10019		
Directors and executive officers as a group (13 persons)	588,543	20.98%

(1) Amount disclosed includes 2,500 shares of Common Stock owned by Mr. Avery; 5,200 shares of Common Stock in Mr. Avery s Simplified Employee Pension Plan; 1,200 shares of Common Stock in Mr. Avery s IRA account; 3,200 shares of Common Stock in Mr. Avery s 401(k) account; 3,070 shares of Common Stock owned by Mr. Avery s children; 49,773 shares of Common Stock owned by Mr. Avery s spouse; options to acquire 10,111 shares of Common Stock; and warrants to acquire 2,500 shares of Common Stock.

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(2) Amount disclosed includes 44,240 shares of Common Stock owned by Mr. Balzer; 3,265 shares of Common Stock in Mr. Balzer s IRA account; 5,000 shares of Common Stock owned by DJB Family Ltd. Partnership; 1,100 shares of Common Stock owned by Mr. Balzer s spouse; 3,000 shares of Common Stock owned by Mr. Balzer s children; and options to acquire 10,111 shares of Common Stock.

(3) Amount disclosed includes 41,100 shares of Common Stock owned by Mr. Bell; 8,200 shares of Common Stock in Mr. Bell s IRA account; 1,000 shares owned by Mr. Bell s father; 100 shares owned jointly with Mr. Bell s brother; options to acquire 16,112 shares of Common Stock; and warrants to acquire 2,500 shares of Common Stock.

(4) Amount disclosed includes 46,300 shares of Common Stock owned by Mr. Chandler; 6,000 shares of Common Stock owned by Mr. Chandler s children; options to acquire 10,111 shares of Common Stock; and warrants to acquire 5,000 shares of Common Stock.

(5) Amount disclosed includes 4,900 shares of Common Stock owned by Mr. Esleeck; 190 shares of Common Stock in Mr. Esleeck s Roth IRA account; 1,766 shares of Common Stock in Mr. Esleeck s IRA account; 9,712 shares of Common Stock owned by Mr. Esleeck s spouse; 5,632 shares of Common Stock owned by Mr. Esleeck s children; options to acquire 10,111 shares of Common Stock; and warrants to acquire 2,500 shares of Common Stock.

(6) Amount disclosed includes 17,460 shares of Common Stock owned by Mr. Patrick; 20,927 shares of Common Stock in Mr. Patrick s IRA account; 1,800 shares of Common Stock owned by Mr. Patrick s children and parents; options to acquire 16,111 shares of Common Stock; and warrants to acquire 2,500 shares of Common Stock.

(7) Amount disclosed includes 3,770 shares of Common Stock owned by Mr. Toalson; 1,230 shares of Common Stock in Mr. Toalson s IRA account; and options to acquire 1,611 shares of Common Stock.

(8) Amount disclosed includes 2,600 shares of Common Stock owned by Mr. Whittemore; 1,300 shares of Common Stock in Mr. Whittemore s IRA account; 2,400 shares of Common Stock in Mr. Whittemore s Simple IRA account; 9,000 shares of Common Stock owned by Mr. Whittemore s spouse; options to acquire 10,111 shares of Common Stock; and warrants to acquire 2,500 shares of Common Stock.

(9) Amount disclosed includes 43,715 shares of Common Stock owned by Mr. Winfree; 666 shares of Common Stock in Mr. Winfree s IRA account; 1,323 shares of Common Stock in Mr. Winfree s Roth IRA account; 200 shares of Common Stock owned by Mr. Winfree s son; and options to acquire 51,150 shares of Common Stock.

(10) Amount disclosed includes 1,082 shares of Common Stock owned by Mr. Falk and options to acquire 3,000 shares of Common Stock.

(11) Amount disclosed includes 76 shares of Common Stock owned by Mr. Robeson and options to acquire 21,100 shares of Common Stock.

(12) Amount disclosed includes 279 shares of Common Stock owned by Mr. Sanders and options to acquire 25,100 shares of Common Stock.

(13) Amount disclosed includes 4,928 shares of Common Stock owned by Mr. Whitehurst and options to acquire 27,100 shares of Common Stock.

(14) Mr. Clark beneficially owns 248,419 shares of Common Stock. Mr. Clark has sole voting and dispositive power with respect to 216,419 shares of Common Stock, which includes 12,000 shares of Common Stock held by trusts for which he serves as sole trustee. Mr. Clark has shared voting and dispositive power with respect to 32,000 shares of Common Stock deemed beneficially owned by his spouse.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), requires the Company s directors and executive officers, and any persons who own more than 10% of the outstanding shares of Common Stock, to file reports of ownership and changes in ownership of Common Stock. Officers and directors are required by regulations to furnish the Company with copies of all Section 16(a) reports that they file. Based solely on review of the copies of such reports furnished to the Company and the Bank or written representation that no other reports were required, the Company believes that, during fiscal year 2007, our directors and executive officers complied with all applicable Section 16(a) filing requirements, except that R. T. Avery, III, a Director, inadvertently filed a late report on Form 4 covering the purchases of common stock in August and September 2007; Donald J. Balzer, Jr., a Director, inadvertently filed a late report on Form 4 covering the purchases of common stock in February, May and August 2007; Dean Patrick, a Director, inadvertently filed a late report on Form 4 covering purchases of common stock in March and June 2007; Thomas W. Winfree, a Director, inadvertently filed a late report on Form 4 covering the purchase of common stock in June 2007.

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ITEM 12 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Transactions with Management

Some of the directors and officers of the Company are customers of the Company, and the Company 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, collateral and repayment terms on loans, as those prevailing at the same time for comparable transactions with others. All outstanding loans to such officers and directors and their associates are current as to principal and interest. None of such outstanding loans are classified as non-accrual, past due, restructured or potential problems. As of December 31, 2007, all loans to directors, executive officers and their affiliates totaled approximately $5,435,000 or approximately 20% of stockholders equity at such date.

There are no legal proceedings to which any director, officer or associate is a party that would be material and adverse to the Company.

Independence of the Directors

The Board of Directors has determined that the following 8 individuals of its 9 current members are independent as defined by the listing standards of NASDAQ: R. T. Avery, III, Donald J. Balzer, Jr., Craig D. Bell, William B. Chandler, R. Calvert Esleeck, Jr., Dean T. Patrick, Michael L. Toalson and George R. Whittemore. In reaching this conclusion, the Board of Directors considered that the Company and its subsidiaries conduct business with companies of which certain members of the Board of Directors or members of their immediate families are or were directors or officers.

The Board of Directors considered the following relationships between the Company and two of its directors to determine whether such director was independent under NASDAQ s listing standards:

Donald J. Balzer, Jr. is Chairman of the Board of Balzer & Associates, Inc., an architectural, engineering, surveying and landscape architectural firm. Balzer & Associates is acting as the civil engineer on the construction of a new headquarters building for the Company. The Company estimates that it will pay Balzer & Associates approximately $140,000 to provide civil engineering and landscape design services on this project, of which approximately $97,000 has been paid through April 30, 2008.

Craig D. Bell is a partner with the law firm of McGuire Woods LLP. McGuire Woods LLP represented the Company in its merger negotiations with River City Bank, which is described in Note 19 to

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the Company s audited financial statements included elsewhere herein. Through April 30, 2008 the Company has paid McGuire Woods LLP approximately $90,000 in legal fees related thereto.

There were no other relationships between the Company and its directors.

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ITEM 13 EXHIBITS

Exhibit Number	Description
3.1	Articles of Incorporation of Village Bank and Trust Financial Corp. restated in electronic format only as of May 18, 2005.
3.2	Bylaws of Village Bank and Trust Financial Corp., incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on December 10, 2007.
10.1	Incentive Plan, as amended and restated May 23, 2006, incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-QSB for the period ended June 30, 2006. *
10.2	Organizational Investors Warrant Plan, incorporated by reference to Exhibit 10.2 of the Annual Report on Form 10-KSB for the year ended December 31, 2004.
10.3	Shareholder Loan Referral Warrant Plan, incorporated by reference to Exhibit 10.3 of the Annual Report on Form 10-KSB for the year ended December 31, 2004.
10.4	Executive Employment Agreement, effective as of April 1, 2001, between Thomas W. Winfree and Southern Community Bank & Trust, incorporated by reference to Exhibit 10.4 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
10.5	Form of Incentive Stock Option Agreement, incorporated by reference to Exhibit 10.5 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
10.6	Form of Non-Employee Director Non-Qualified Stock Option Agreement, incorporated by reference to Exhibit 10.6 of the Annual Report on Form 10-KSB for the year ended December 31, 2004. *
21	Subsidiaries of Village Bank and Trust Financial Corp. **
31.1	Section 302 Certification by Chief Executive Officer. **
31.2	Section 302 Certification by Chief Financial Officer. **
31.3	Section 302 Certification by Chief Executive Officer (Amendment No. 1). ***
31.4	Section 302 Certification by Chief Financial Officer (Amendment No. 1). ***
32	Section 906 Certification. **

* Management contracts and compensatory plans and arrangements.

** Previously filed

*** Filed herewith

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ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

Audit Fees

The aggregate fees billed by BDO Seidman, LLP for professional services rendered for the audit of the Company s annual financial statements for the fiscal years ended December 31, 2007 and 2006, and for the review of the financial statements included in the Company s Quarterly Reports on Form 10-QSB, and services that are normally provided in connection with statutory and regulatory filings and engagements, for those fiscal years were $102,000 for 2007 and $91,400 for 2006.

Audit Related Fees

There were no fees billed by BDO Seidman, LLP for professional services for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements and not reported under the heading Audit Fees above for the fiscal year ended December 31, 2007 and 2006.

Tax Fees

The aggregate fees billed by BDO Seidman, LLP for professional services for tax compliance, tax advice and tax planning for the fiscal year ended December 31, 2007 were $19,562. The fees for fiscal year ended December 31, 2006 were $16,946.

All Other Fees

There were no fees billed by BDO Seidman, LLP for any other services rendered to the Company or the Bank for the fiscal years ended December 31, 2007 and December 31, 2006.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VILLAGE BANK AND TRUST FINANCIAL CORP.

Date: May 22, 2008

By: /s/ Thomas W. Winfree
Thomas W. Winfree
President and Chief Executive Officer

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Annex F

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2008

TRANSITION REPORT UNDER SECTION 13 OR 15(d)

OF THE EXCHANGE ACT

For the transition period from _________ to _________

Commission file number: 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.

(Exact name of small business issuer as specified in its charter)

Virginia **(State or other jurisdiction of** **in Company or organization)**	**16-1694602** **(I.R.S. Employer** **Identification No.)**

1231 Alverser Drive, P.O. Box 330, Midlothian, Virginia 23113

(Address of principal executive offices)

804-897-3900

(Issuer s telephone number)

Indicate by check whether the registrant (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 x 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 definition 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 smaller reporting company)	Smaller Reporting Company x

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

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

2,594,725 shares of common stock, $4.00 par value, outstanding as of April 30, 2008.

Village Bank and Trust Financial Corp.

Form 10-Q

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Village Bank and Trust Financial Corp. and Subsidiary

Consolidated Balance Sheets

March 31, 2008 (Unaudited) and December 31, 2007

	March 31, 2008 (Unaudited)	December 31, 2007
Assets		
Cash and due from banks	$ 7,686,160	$ 5,752,332
Federal funds sold	2,449,342	16,362,672
Investment securities available for sale	7,980,169	13,711,399
Loans held for sale	4,772,386	3,489,886
Loans		
Outstandings	347,768,123	327,775,829
Allowance for loan losses	(3,508,865)	(3,469,273)
Deferred fees	(377,661)	(432,816)
	343,881,597	323,873,740
Premises and equipment, net	22,082,502	19,162,054
Accrued interest receivable	2,702,454	2,752,755
Goodwill	689,108	689,108
Other assets	7,959,934	7,470,053
	$ 400,203,652	$ 393,263,999
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Noninterest bearing demand	$ 27,186,508	$ 23,223,246
Now	13,259,947	10,517,393
Money market	28,177,459	22,060,316
Savings	3,541,795	3,372,986
Time deposits of $100,000 and over	91,185,234	92,932,642
Other time deposits	181,560,822	187,190,675
	344,911,765	339,297,258
Trust preferred securities	8,764,000	8,764,000
FHLB advances	10,000,000	12,000,000
Other borrowings	7,606,899	3,972,569
Accrued interest payable	583,664	587,980
Other liabilities	1,287,754	1,748,893
Total liabilities	373,154,082	366,370,700
Stockholders equity		

Preferred stock, $1 par value - 1,000,000 shares authorized; no shares issued and outstanding		
Common stock, $4 par value - 10,000,000 shares authorized; 2,579,725 shares issued and outstanding at March 31, 2008 2,575,985 shares issued and outstanding at December 31, 2007	10,318,900	10,303,940
Additional paid-in capital	13,755,721	13,726,269
Accumulated other comprehensive income (loss)	(104,077)	(122,607)
Retained earnings	3,079,026	2,985,697
Total stockholders equity	27,049,570	26,893,299
	$ 400,203,652	$ 393,263,999

See accompanying notes to consolidated financial statements.

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Village Bank and Trust Financial Corp. and Subsidiary

Consolidated Statements of Income

Three Months Ended March 31, 2008 and 2007

(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Interest income		
Loans	$ 6,508,558	$ 5,317,081
Investment securities	143,318	203,596
Federal funds sold	106,835	123,804
Total interest income	6,758,711	5,644,481
Interest expense		
Deposits	3,695,243	2,787,892
Borrowed funds	277,929	130,063
Total interest expense	3,973,172	2,917,955
Net interest income	2,785,539	2,726,526
Provision for loan losses	249,324	208,342
Net interest income after provision for loan losses	2,536,215	2,518,184
Noninterest income		
Service charges and fees	207,125	169,061
Gain on sale of loans	426,517	383,789
Other	124,749	112,058
Total noninterest income	758,391	664,908
Noninterest expense		
Salaries and benefits	1,846,522	1,565,483
Occupancy	252,603	198,407
Equipment	173,275	157,428
Supplies	96,427	75,235
Professional and outside services	341,088	273,213
Advertising and marketing	48,861	79,827
Other operating expense	394,423	289,030
Total noninterest expense	3,153,199	2,638,623
Income before income taxes	141,407	544,469
Provision for income taxes	48,078	185,120
Net income	$ 93,329	$ 359,349

Earnings per share, basic	$	0.04	$	0.14
Earnings per share, diluted	$	0.04	$	0.13

See accompanying notes to consolidated financial statements.

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Village Bank and Trust Financial Corp.

Consolidated Statements of Stockholders Equity

Three Months Ended March 31, 2008 and 2007

	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2007	2,575,985	$ 10,303,940	$ 13,726,269	$ 2,985,697	$ (122,607)	$ 26,893,299
Issuance of common stock	3,740	14,960	10,040			25,000
Stock based compensation			19,412			19,412
Minimum pension adjustment (net of income taxes of $729)					2,145	2,145
Net income				93,329		93,329
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $5,571)					16,385	16,385
Total comprehensive income (loss)						111,859
Balance, March 31, 2008	2,579,725	$ 10,318,900	$ 13,755,721	$ 3,079,026	$ (104,077)	$ 27,049,570
Balance, December 31, 2006	2,562,088	$ 10,248,352	$ 13,588,888	$ 1,984,634	$ (177,759)	$ 25,644,115
Issuance of common stock						
Net income				359,349		359,349
Change in unrealized gain (loss) on securities available for sale (net of income taxes $1,806)					5,313	5,313
Total comprehensive income (loss)						364,662
Balance, March 31, 2007	2,562,088	$ 10,248,352	$ 13,588,888	$ 2,343,983	$ (172,446)	$ 26,008,777

See accompanying notes to consolidated financial statements.

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Village Bank and Trust Financial Corp. and Subsidiary

Consolidated Statements of Cash Flows

For the Three Months Ended March 31, 2008 and 2007

	2008	2007
Cash Flows from Operating Activities		
Net income	$ 93,329	$ 359,349
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	166,385	170,947
Provision for loan losses	249,324	208,342
Gain on loans sold	(426,517)	(383,789)
Stock compensation expense	19,412	
Gain on securities	(23,194)	
Proceeds from sale of mortgage loans	18,431,482	17,144,190
Origination of mortgage loans for sale	(19,287,465)	(16,990,454)
Amortization of premiums and accretion of discounts on securities, net	(22,374)	(24,654)
Increase in interest receivable	50,301	19,885
Increase in other assets	(496,177)	(1,667,118)
Increase (decrease) in interest payable	(4,316)	33,658
Increase (decrease) in other liabilities	(461,139)	245,082
Net cash used in operating activities	(1,710,949)	(884,563)
Cash Flows from Investing Activities		
Purchases of available for sale securities	(994,374)	(10,967,860)
Maturities and calls of available for sale securities	6,795,999	616,018
Net increase in loans	(20,257,181)	(17,769,955)
Purchases of premises and equipment	(3,086,833)	(376,459)
Net cash used in investing activities	(17,542,390)	(28,498,257)
Cash Flows from Financing Activities		
Issuance of common stock	25,000	
Net increase in deposits	5,614,507	22,855,777
Repayment of Federal Home Loan Bank borrowings	(2,000,000)	
Net increase (decrease) in other borrowings	3,634,330	(214,279)
Net cash provided by financing activities	7,273,837	22,641,498
Net decrease in cash and cash equivalents	(11,979,502)	(6,741,322)
Cash and cash equivalents, beginning of period	22,115,004	17,198,503
Cash and cash equivalents, end of period	$ 10,135,502	$ 10,457,181

See accompanying notes to consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 - Principles of presentation

Village Bank and Trust Financial Corp. (the Company) is the holding company of Village Bank (the Bank). The consolidated financial statements include the accounts of the Company, the Bank and the Bank s three wholly-owned subsidiaries, Village Bank Mortgage Company, Village Insurance Agency, Inc., and Village Financial Services Company. All material intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying condensed consolidated financial statements of the Company have been prepared on the accrual basis in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, all adjustments that are, in the opinion of management, necessary for a fair presentation have been included. The results of operations for the three month period ended March 31, 2008 are not necessarily indicative of the results to be expected for the full year ending December 31, 2008. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Company s Annual Report on Form 10-KSB for the year ended December 31, 2007 as filed with the Securities and Exchange Commission.

Note 2 - Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheets and statements of income for the period. Actual results could differ significantly from those estimates.

Note 3 - Earnings per common share

Basic earnings per common share is computed by dividing the net income by the weighted-average number of common shares outstanding during the period. For the three month periods ended March 31, 2008 and 2007, the weighted-average number of common shares totaled 2,576,548 and 2,562,088, respectively. Diluted earnings per share reflect the potential dilution of securities that could share in the net income of the Company. Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. For the three month periods ended March 31, 2008 and 2007, the weighted-average number of common shares on a fully diluted basis totaled 2,607,777 and 2,688,872, respectively. Options to acquire 98,350 shares of common stock were anti-dilutive for the three month period ended March 31, 2008 and thus excluded from the computation of fully diluted earnings per share, and no options were anti-dilutive for the three month period ended March 31, 2007.

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Note 4 Stock warrant and incentive plans

On March 21, 2000, the Company approved the Organizational Investors Warrant Plan which made available 140,000 warrants for grant to the Company s initial (organizational) investors for certain risks associated with the establishment of the Bank. The warrants have an exercise price of $10 per share (which approximated the fair value per share of common stock at issuance date) and expired on April 30, 2008. Prior to expiration, warrants to purchase 47,500 shares were exercised resulting in $475,000 in additional capital.

Also on March 21, 2000, the Company established the Incentive Plan, a stock incentive plan, which authorizes the issuance of up to 455,000 shares of common stock (increased from 255,000 shares by amendment to the Incentive Plan approved by the Company s shareholders at its 2006 annual meeting on May 23, 2006) to assist the Company in recruiting and retaining key personnel.

The following table summarizes stock options outstanding under the stock incentive plan at the indicated dates:

	Three Months Ended March 31,							
	2008				2007			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	247,410	$ 10.26	$ 4.70		251,910	$ 10.22	$ 4.67	
Granted								
Forfeited								
Exercised								
Options outstanding, end of period	247,410	$ 10.26	$ 4.70	$ 180,609	251,910	$ 10.22	$ 4.67	$ 1,456,040
Options exercisable, end of period	229,910				235,410			

During the first quarter of 2007, we granted to certain officers 5,725 restricted shares of common stock and 5,725 performance shares of common stock with a weighted average fair market value of $15.95 at the date of grant. During the second quarter of 2007 an additional 175 restricted shares of common stock and 175 performance shares of common stock were granted with a weighted average fair market value of $16.75 at the date of grant. These restricted stock awards have three-year graded vesting, and the performance shares cliff vest at the end of the three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 9,860 and 11,092 at March 31, 2008 and 2007, respectively.

Stock-based compensation expense was $19,412 and $15,171 for the three months ended March 31, 2008 and 2007, respectively. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of March 31, 2008 and 2007 was $204,974 and $259,590, respectively. Of the $204,974 of unamortized compensation at March 31, 2008, $91,055 relates to performance based restricted stock awards. The time based unamortized compensation of $113,919 is expected to be recognized over a weighted average period of 1.62 years.

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Note 5 Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate at March 31, 2008 was 4.93%. The securities may be redeemed at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. The principal asset of the Trust is $5.2 million of the Company s junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a five year fixed income rate of 6.29% payable quarterly, converting after five years to a LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.40%) which adjusts, and is also payable, quarterly. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. The principal asset of the Trust is $3.6 million of the Company s junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust s obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends.

Note 6 Pending merger

On March 9, 2008 the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with River City Bank (River City). The Merger Agreement sets forth the terms and conditions of the Company s acquisition of River City through the merger of River City with and into Village Bank (the Merger). Under the terms of the Merger Agreement, Village Bank will acquire all of the outstanding shares of River City. The shareholders of River City will receive, for each share of River City common stock that they own immediately prior to the effective time of the Merger, either $11 per share in cash or 1.0 shares of common stock of the Company. Pursuant to the terms of the Merger Agreement, shareholders of River City will have the opportunity to elect to receive cash, shares of common stock of the Company, or a combination of both, subject to allocation and proration procedures ensuring that 20% of the total merger consideration will be cash and 80% will be common stock of the Company. In addition, at the effective time of the Merger, each outstanding option to purchase shares of River City common stock under any stock plans shall vest pursuant to

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its terms and shall be converted into an option to acquire the number of shares of the Company s common stock equal to the number of shares of River City common stock underlying the option multiplied by 1.0. The exercise price of each option will be adjusted accordingly.

Consummation of the Merger is subject to a number of customary conditions including the approval of the Merger by the shareholders of each of River City, the Company and Village Bank and the receipt of all required regulatory approvals. The Merger is expected to be completed in the third quarter of 2008.

Note 7 Recent accounting pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements. SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. While the Statement applies under other accounting pronouncements that require or permit fair value measurements, it does not require any new fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. In addition, the Statement establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Lastly, SFAS 157 requires additional disclosures for each interim and annual period separately for each major category of assets and liabilities. SFAS 157 became effective for the Company on January 1, 2008. See Note 8 of the accompanying notes to the consolidated financial statements for additional information.

In February 2008, the FASB issued FASB Staff Position No. 157-2. The staff position delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay is intended to allow additional time to consider the effect of various implementation issues with regard to the application of SFAS 157. The new staff position defers the effective date of SFAS No. 157 to January 1, 2009 for items within the scope of the staff position. The Company is currently evaluating the impact of FASB Staff Position No. 157-2 on the consolidated financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 . This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board s long-term measurement objectives for accounting for financial instruments. This Statement became effective for the Company on January 1, 2008. The Company has elected the fair value option for residential mortgage loans originated on or after January 1, 2008 and held for sale. See Note 8 of the accompanying notes to the consolidated financial statements for additional information.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings (SAB 109). SAB 109 expresses the current view of the SEC staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply this guidance on a prospective basis to derivative loan commitments issued or modified in the first quarter of 2008 and thereafter. The adoption of this standard did not have a material impact on the Company s consolidated financial position or results of operations.

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In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, (SFAS 141(R)) which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures 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 acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements-an amendment of ARB No. 51 (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting non-controlling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financials statements and separate from the parent s equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company is currently evaluating the impact, if any; the adoption of SFAS 160 will have on its consolidated financial statements

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB statement No. 133 , SFAS 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under Statement 133 and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. The new standard is effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS No. 161 on the consolidated financial statements.

Note 8 Fair value

Effective January 1, 2008, the Company adopted SFAS 157 and SFAS 159. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

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Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3- Significant unobservable inputs that reflect a company s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted market prices (Level 1).

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Derivative financial instruments: The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date (Level 2).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The use of discounted cash flow models and management s best judgment are significant inputs in arriving at the fair value measure of the underlying collateral and are therefore classified within (Level 3).

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Assets and liabilities measured at fair value under SFAS No. 157 on a recurring and non-recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

		Fair Value Measurement at March 31, 2008 Using (In Thousands)		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets-Recurring				
Available for sale investment securities (1)	$ 7,980	$ 7,980		
Residential loans held for sale	4,772		4,772	
Financial Assets-Non-Recurring				
Impaired loans (2)	6,835			6,835

(1) Excludes restricted stock.

(2) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

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ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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 we expect, we believe or words of similar import. Such forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- interest rate fluctuations;
- risk inherent in making loans such as repayment risks and fluctuating collateral values;
- economic conditions in the Richmond metropolitan area;
- the ability to continue to attract low cost core deposits to fund asset growth;
- changes in general economic and business conditions;
- changes in laws and regulations applicable to us;
- competition within and from outside the banking industry;
- the ability to successfully manage the Company s growth or implement its growth strategies if it is unable to identify attractive markets, locations or opportunities to expand in the future;
- maintaining capital levels adequate to support the Company s growth;
- reliance on the Company s management team, including its ability to attract and retain key personnel;
- new products and services in the banking industry;
- problems with our technology, and
- changing trends in customer profiles and behavior.

- Merger expenses have been incurred even if the Merger is not completed;
- the Merger may distract management from its other responsibilities;
- the Merger might be delayed or changed by regulatory agencies; and
- the Company may not be able to realize all of the anticipated benefits of the Merger.

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

General

The Company was organized under the laws of the Commonwealth of Virginia as a bank holding company whose activities consist of investment in its wholly-owned subsidiary, the Bank. The Bank is engaged in commercial and retail banking. We opened to the public on December 13, 1999. We place special emphasis on serving the financial needs of individuals, small and medium sized businesses, entrepreneurs, and professional concerns.

The Bank has three subsidiaries: Village Bank Mortgage Company, Village Insurance Agency, Inc., and Village Financial Services Company. Through our combined companies, we offer a wide range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans. We are a community-

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oriented and locally owned and managed financial institution focusing on providing a high level of responsive and personalized services to our customers, delivered in the context of a strong direct relationship with the customer. We conduct our operations from our main office/corporate headquarters location and ten branch offices.

Net interest income is our primary source of earnings and represents the difference between interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. The level of net interest income is affected primarily by variations in the volume and mix of those assets and liabilities, as well as changes in interest rates when compared to previous periods of operation. In addition, revenues are generated from fees charged on deposit accounts and gains from sale of mortgage loans to third-party investors.

Our total assets increased to $400,204,000 at March 31, 2008 from $393,264,000 at December 31, 2007, an increase of $6,940,000, or 1.8%. During the first quarter of 2008 liquid assets (cash and due from banks, federal funds sold and investment securities available for sale) decreased by $17,711,000, loans held for sale increased by $1,283,000, net portfolio loans increased by $20,008,000, premises and equipment increased by $2,920,000 and other assets increased by $440,000. The net increase in these assets of $6,940,000 was funded by a $5,615,000 increase in deposit accounts and a net increase in borrowings of $1,634,000.

The following presents management s discussion and analysis of the financial condition of the Company at March 31, 2008 and December 31, 2007, and results of operations for the Company for the three month periods ended March 31, 2008 and 2007. This discussion should be read in conjunction with the Company s Annual Report on Form 10-KSB for the year ended December 31, 2007 as filed with the Securities and Exchange Commission as well as the first quarter 2008 financial statements and notes thereto appearing elsewhere in this report.

Results of operations

Net income totaled $93,000, or $0.04 per share on a fully diluted basis, in the first quarter of 2008 compared to net income of $359,000, or $0.13 per share on a fully diluted basis, in the first quarter of 2007. This represents a decrease in net income of $266,000, or 74%.

In the latter half of 2007, the financial markets experienced significant turmoil due to the collapse of the subprime mortgage asset market which has had a detrimental affect on banking in general. The collapse of the mortgage asset market has led to what many consider a recessionary economy and resulted in extraordinary write-offs of mortgage related assets by many banks. The detrimental affect of the collapse in the mortgage asset market has continued in the first quarter of 2008 depressing bank stock values. In reaction first to the mortgage market collapse and most recently to the real possibility of a recession, the Federal Open Market Committee (FOMC) of the Federal Reserve reduced short-term interest rates significantly in the last three months of 2007 and has continued to decrease rates in 2008. With this significant decline in short-term interest rates and how rapidly in which they were made, our earnings in the fourth quarter of 2007 and now the first quarter of 2008 have declined over prior periods. This decline in our earnings is a result of a significant portion of our loan portfolio, the primary source of revenue to Village Bank, having interest rates that adjust according to the direction of short-term interest rates. Accordingly, as short-term rates are reduced by the FOMC, the income from our loan portfolio is reduced. While the reduction of short-term interest rates will also reduce the rates we pay on deposits, our largest expense, the reduction in interest rates paid on deposits will be slower than the reduction of interest rates on our loan portfolio as deposits generally do not reprice as quickly as loans. Consequently, our net interest income, the primary source of our earnings, will be negatively impacted as long as

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short-term interest rates continue to be reduced by the FOMC. While the decline in short-term interest rates has had a detrimental affect on our profitability in 2008, we have never owned nor have we ever originated subprime mortgage loan product and thus are not exposed to the kinds of write-offs of such assets many banks have had to make.

Net interest income increased only slightly from $2,726,000 for the first quarter of 2007 to $2,785,000 for the first quarter of 2008, and decreased significantly from $3,114,000 for the fourth quarter of 2007. Changes in net interest income are attributable to changes in the volume of interest-sensitive assets and liabilities and changes in interest rates. The following table shows the affect that the significant negative decline in interest rates had on the first quarter of 2008 compared to the first and fourth quarters of 2007:

	First Qtr 2008 vs First Qtr 2007	First Qtr 2008 vs Fourth Qtr 2007
Increase (decrease) in net interest income due to changes in		
Volume	$ 702,000	$ 104,000
Rate	(643,000)	(433,000)
	$ 59,000	$ (329,000)

Our net interest margin for the first quarter of 2008 was 3.09% compared to 4.01% and 3.64% for the first and fourth quarters of 2007, respectively. Margin compression was the single largest factor in our decline in profitability in the first quarter of 2008 compared to 2007.

Noninterest income of $758,000 for the first quarter of 2008 is $93,000 higher than noninterest income of $665,000 for the first quarter of 2007. This increase in noninterest income is primarily a result of higher gain on loan sales and fees from increased loan production by our mortgage banking subsidiary.

Noninterest expense increased by $515,000 from the first quarter of 2007 to the first quarter of 2008. The largest increases in noninterest expense occurred in salaries and benefits of $281,000, occupancy costs of $54,000, audit and accounting costs of $61,000 and the FDIC insurance assessment of $86,000. The increases in salaries and benefits and occupancy costs are a result of the growth of Village Bank; the increase in audit and accounting costs is directly related to implementation of the requirements of the Sarbanes-Oxley Act; and the increase in the FDIC insurance assessment is related to our capital ratios and overall growth.

Net interest income

Net interest income is our primary source of earnings and represents the difference between interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. The level of net interest income is affected primarily by variations in the volume and mix of those assets and liabilities, as well as changes in interest rates when compared to previous periods of operation.

Net interest income for the three months ended March 31, 2008 and 2007 was $2,785,000 and $2,726,000, respectively. This increase of $59,000, or 2%, occurred despite a 92 basis point decline in our net interest margin. The increase in net interest income resulted from growth in our loan portfolio. Loans net of deferred fees increased by $88,612,000, or 34%, from $258,778,000 at

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March 31, 2007 to $347,390,000 at March 31, 2008. Loans net of deferred fees averaged $335,988,000 in the first quarter of 2008 as compared to $250,540,000 in the first quarter of 2007, an increase of $85,448,000, or 34%. Our net interest margin (net interest margin is calculated by dividing net interest income by average earning assets) for the three months ended March 31, 2008 was 3.09% compared to 4.01% for the first three months of 2007. Whether this trend of increasing net interest income continues is dependent upon our ability to grow our loan portfolio as well as any further margin compression resulting from declines in short-term interest rates by the FOMC. For the remainder of 2008, we do not expect our loan portfolio to increase significantly. Accordingly, if the FOMC continues to decrease short-term interest rates in 2008 further compressing our net interest margin, net interest income could decline from previous periods.

Average interest-earning assets for the first three months of 2008 increased by $86,358,000, or 31%, compared to the first three months of 2007. The increase in interest-earning assets was due primarily to the growth of our loan portfolio. The average yield on interest-earning assets decreased to 7.50% for the first three months of 2008 compared to 8.29% for the first three months of 2007. This decline in the average yield from 2007 to 2008 was due to the reduction in short-term interest rates by the FOMC during the last quarter of 2007 and the first quarter of 2008.

Our average interest-bearing liabilities increased by $93,278,000, or 37%, for the first three months of 2008 compared to the first three months of 2007. The growth in interest-bearing liabilities was primarily due to growth in deposits. The average cost of interest-bearing liabilities decreased to 4.67% for the first three months of 2008 from 4.75% for the first three months of 2007. The principal reason for the decrease in liability costs was decreasing interest rates as liabilities reprice. The decreasing interest rates were a result of decreases in short term interest rates by the FOMC. See our discussion of interest rate sensitivity following for more information.

The following table illustrates average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders equity and related income, expense and corresponding weighted-average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances. We had no tax exempt assets for the periods presented.

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Average Balance Sheets

(In thousands)

	Three Months Ended March 31, 2008			Three Months Ended March 31, 2007		
	Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate
Loans net of deferred fees	$ 335,988	$ 6,466	7.74%	$ 250,540	$ 5,285	8.55%
Investment securities	10,861	143	5.31%	14,099	204	5.87%
Loans held for sale	2,780	42	6.10%	2,025	32	6.41%
Federal funds and other	12,822	107	3.35%	9,429	124	5.33%
Total interest earning assets	362,451	6,758	7.50%	276,093	5,645	8.29%
Allowance for loan losses	(3,444)			(2,605)		
Cash and due from banks	6,124			5,069		
Premises and equipment, net	18,950			11,845		
Other assets	10,905			8,168		
Total assets	$ 394,986			$ 298,570		
Interest bearing deposits						
Interest checking	$ 10,918	$ 27	0.99%	$ 9,815	$ 22	0.91%
Money market	25,548	169	2.66%	19,846	157	3.21%
Savings	3,361	10	1.20%	4,110	12	1.14%
Certificates	277,996	3,489	5.05%	205,832	2,597	5.12%
Total deposits	317,823	3,695	4.68%	239,603	2,788	4.72%
Borrowings	24,616	278	4.54%	9,559	130	5.52%
Total interest bearing liabilities	342,439	3,973	4.67%	249,162	2,918	4.75%
Noninterest bearing deposits	23,329			21,860		
Other liabilities	1,991			1,550		
Total liabilities	367,759			272,572		
Equity capital	27,227			25,998		
Total liabilities and capital	$ 394,986			$ 298,570		
Net interest income before provision for loan losses		$ 2,785			$ 2,727	
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities			2.83%			3.54%
Annualized net interest margin (net interest income expressed as percentage of average earning assets)			3.09%			4.01%

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Provision for loan losses

The provision for loan losses for the three months ended March 31, 2008 was $249,000, compared to $208,000 for the three months ended March 31, 2007. The 20% increase from 2007 to 2008 was due to a higher loan volume in 2008 as compared to 2007. Loans net of deferred fees increased by $20,047,000 in the first three months of 2008 compared to an increase of $17,727,000 in the first three months of 2007. The amount of the loan loss provision is determined by an evaluation of the level of loans outstanding, the level of non-performing loans, historical loan loss experience, delinquency trends, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. See our discussion of the allowance for loan losses under *Allowance for loan losses* and *Critical accounting policies* below.

Noninterest income

Noninterest income increased from $665,000 for the first three months of 2007 to $758,000 for the first three months of 2008, a $93,000, or 14%, increase. This increase was attributable to an increase in loan originations in the mortgage company and increased service charges and fees resulting from a larger deposit base. Gains on loan sales increased from $384,000 for the first three months of 2007 to $427,000 for the first three months of 2008, a $43,000, or 11% increase. Service charges and fees increased by $38,000, or 22%, from $169,000 for the first three months of 2007 to $207,000 for the first three months of 2008. If the housing market continues to slow down, it will have a negative effect on our noninterest income as a significant amount of noninterest income is derived from gain on sale and fees from mortgage lending.

Noninterest expense

Noninterest expense for the three months ended March 31, 2008 totaled $3,153,000, an increase of $514,000, or 19%, from $2,639,000 for the three months ended March 31, 2007. The largest increases in noninterest expense occurred in salaries and benefits of $281,000, occupancy costs of $54,000, audit and accounting costs of $61,000 and the FDIC insurance assessment of $86,000. The increases in salaries and benefits and occupancy costs are a result of the growth of Village Bank; the increase in audit and accounting costs is directly related to implementation of the requirements of the Sarbanes-Oxley Act; and the increase in the FDIC insurance assessment is related to our capital ratios and overall growth.

Income taxes

The provision for income taxes of $48,000 for the three months ended March 31, 2008 is based upon the results of operations. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The Company must also evaluate the likelihood that deferred tax assets will be recovered from future taxable income. If any such assets are not likely to be recovered, a valuation allowance must be recognized. We determined that a valuation allowance was not required for deferred tax assets as of March 31, 2008. The assessment of the carrying value of deferred tax assets is based on certain assumptions, changes in which could have a material impact on the Company s financial statements.

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Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded a franchise tax expense of $59,000 and $53,000 for the three months ended March 31, 2008 and 2007, respectively.

Loan portfolio

The following table presents the composition of our loan portfolio (excluding mortgage loans held for sale) at the dates indicated.

Loan Portfolio, Net

(In thousands)

	March 31, 2008		December 31, 2007	
	Amount	%	Amount	%
Commercial	$ 25,204	7.2%	$ 23,152	7.1%
Real estate - residential	55,566	16.0%	51,281	15.6%
Real estate - commercial	143,156	41.2%	140,176	42.8%
Real estate - construction	116,690	33.6%	106,556	32.5%
Consumer	7,152	2.1%	6,611	2.0%
Total loans	347,768	100.0%	327,776	100.0%
Less: unearned income, net	(378)		(433)	
Less: Allowance for loan losses	(3,509)		(3,469)	
Total loans, net	$ 343,881		$ 323,874	

Allowance for loan losses

The allowance for loan losses at March 31, 2008 was $3,509,000, compared to $3,469,000 at December 31, 2007. The ratio of the allowance for loan losses to gross portfolio loans (net of unearned income and excluding mortgage loans held for sale) at March 31, 2008 and December 31, 2007 was 1.01% and 1.06%, respectively. The amount of the loan loss provision is determined by an evaluation of the level of loans outstanding, the level of non-performing loans, historical loan loss experience, delinquency trends, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. See our discussion of the allowance for loan losses under *Critical accounting policies* below.

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The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated.

Analysis of Allowance for Loan Losses

(In thousands)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Beginning balance	$ 3,469	$ 2,553
Provision for loan losses	249	208
Charge-offs		
Commercial	(89)	(20)
Construction	(40)	
Consumer		(23)
Mortgage	(81)	
	(210)	(43)
Recoveries		
Commercial		
Consumer	1	
	1	
Ending balance	$ 3,509	$ 2,718
Loans outstanding at end of period (1)	$ 347,390	$ 258,778
Ratio of allowance for loan losses as a percent of loans outstanding at end of period	1.01%	1.05%
Average loans outstanding for the period (1)	$ 335,988	$ 250,540
Ratio of net charge-offs to average loans outstanding for the period	0.06%	0.02%

(1) Loans are net of unearned income.

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Investment portfolio

At March 31, 2008 and December 31, 2007, all of our securities were classified as available-for-sale. The following table presents the composition of our investment portfolio at the dates indicated.

Investment Securities Available-for-Sale

(in thousands)

	Par Value	Amortized Cost	Unrealized Gain (Loss)	Estimated Fair Value	Average Yield
March 31, 2008					
US Government Agencies					
Within one year	$ 2,600	$ 2,594	$ 2	$ 2,596	3.48%
One to five years	360	360	3	363	4.65%
More than five years	3,000	2,964	36	3,000	5.70%
Total	5,960	5,918	41	5,959	4.67%
Mortgage-backed securities More than five years	34	34	1	35	3.65%
Other investments More than five years	2,000	1,968	18	1,986	5.65%
Total investment securities	$ 7,994	$ 7,920	$ 60	$ 7,980	4.91%
December 31, 2007					
US Government Agencies					
Within one year	$ 1,600	$ 1,579	$ (2)	$ 1,576	4.22%
One to five years	360	360	(3)	357	4.65%
More than five years	9,789	9,730	75	9,805	5.56%
Total	11,749	11,669	70	11,738	5.35%
Mortgage-backed securities More than five years	40	40	1	41	3.61%
Other investments More than five years	2,000	1,968	(36)	1,932	5.65%
Total investment securities	$ 13,789	$ 13,677	$ 35	$ 13,711	5.39%

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Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is evaluated at least annually for impairment by comparing its fair value with its recorded amount and is written down when appropriate. Projected net operating cash flows are compared to the carrying amount of the goodwill recorded and, if the estimated net operating cash flows are less than the carrying amount, a loss is recognized to reduce the carrying amount to fair value.

Goodwill of $689,000 at March 31, 2008 was related to the Bank s acquisition of Village Bank Mortgage in 2003. There was no impairment of goodwill at March 31, 2008.

Deposits

Total deposits increased by $5,615,000, or 2%, during the first three months of 2008 as compared to an increase of $22,856,000, or 9%, during the first three months of 2007. Although the increase in deposits in 2008 was not significant, the change in the mix of deposits is noteworthy. Demand deposit accounts, including money market accounts, increased by $12,823,000 while time deposits decreased by $7,377,000 during the first six months of 2008. This change in the mix of deposits is noteworthy because demand deposit accounts carry lower interest rates than do time deposits and thus this change in mix lowers our cost of funds. The increase in deposits in 2007 resulted primarily from an increase in time deposits of $20,586,000. The increase in time deposits was due primarily to efforts to increase liquidity to fund the large increase in loans in the first quarter of 2007.

The mix of our deposits continues to be weighted toward time deposits, which represent 79% of our total deposits at March 31, 2008 as compared to 83% at December 31, 2007. However, as our branch network has increased and is more convenient to a larger segment of our targeted customer base, we have experienced a move to a higher percentage of our deposits in checking accounts as reflected in the decline in the percentage attributed to time deposits. We are emphasizing checking account deposit growth at our existing branches by providing incentives to branch personnel for reaching new checking account growth goals.

The average cost of interest-bearing deposits for the three months ended March 31, 2008 and 2007 was 4.67% and 4.75%, respectively. This decrease in our average cost of interest-bearing deposits has mirrored the overall decrease in interest rates resulting from the actions by the FOMC to decrease short-term interest rates. But just as importantly, our efforts to increase checking accounts in our branches is working to reduce our cost of interest-bearing deposits. We expect this decrease in our cost of deposits to continue even if the FOMC does not continue to decrease short-term interest rates.

The variety of deposit accounts that we offer has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and is expected to continue to be, significantly affected by money market conditions.

Borrowings

We use borrowings to supplement deposits when they are available at a lower overall cost to us or they can be invested at a positive rate of return.

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As a member of the Federal Home Loan Bank of Atlanta (FHLB), the Bank is required to own capital stock in the FHLB and is authorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. Borrowings from the FHLB were $10,000,000 at March 31, 2008 and $12,000,000 at December 31, 2007. The FHLB advances are secured by the pledge of first mortgage loans, home equity loans and our FHLB stock.

Capital resources

Stockholders equity at March 31, 2008 was $27,050,000, compared to $26,893,000 at December 31, 2007. The $156,000 increase in equity during the first three months of 2008 was primarily due to net income of $93,000 and proceeds from the issuance of common stock in stock options and warrants exercises of $25,000. Stockholders equity at March 31, 2007 was $26,009,000 compared to $25,644,000 at December 31, 2006. The $365,000 increase in equity during the first three months of 2007 was primarily due to net income of $359,000.

During the first quarter of 2005 and the third quarter of 2007, the Company issued $5.2 and $3.6 million, respectively in Trust Preferred Capital Notes. The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion.

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The following table presents the composition of regulatory capital and the capital ratios at the dates indicated.

Analysis of Capital

(*In thousands*)

	March 31, 2008	December 31, 2007
Tier 1 capital		
Common stock	$ 10,319	$ 10,304
Additional paid-in capital	13,756	13,726
Retained earnings	3,079	2,986
Qualifying trust preferred securities	8,764	8,764
Total equity	35,918	35,780
Less: goodwill	(689)	(689)
Total Tier 1 capital	35,229	35,091
Tier 2 capital		
Allowance for loan losses	3,509	3,469
Total Tier 2 capital	3,509	3,469
Total risk-based capital	38,738	38,560
Risk-weighted assets	$ 391,570	$ 378,020
Capital ratios		
Tier 1 capital to risk-weighted assets	9.00%	9.28%
Total capital to risk-weighted assets	9.89%	10.20%
Leverage ratio (Tier 1 capital to average assets)	8.92%	9.20%
Equity to total assets	6.76%	6.84%

Liquidity

Liquidity provides us with the ability to meet normal deposit withdrawals, while also providing for the credit needs of customers. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide for reasonable growth, and fully comply with all regulatory requirements.

At March 31, 2008, cash, cash equivalents and investment securities available for sale totaled $18,116,000, or 4.5% of total assets, which we believe is adequate to meet short-term liquidity needs.

At March 31, 2008, we had commitments to originate $84,467,000 of loans. Fixed commitments to incur capital expenditures were $4,057,000 at March 31, 2008 related to the completion of our 80,000 square foot headquarters building scheduled for completion in July 2008. Time deposits scheduled to mature in the 12-month period ending March 31, 2009 totaled $187,573,000 at March 31, 2008. Based on past experience, we believe that a significant portion of such deposits will remain with us. We further believe that loan repayments and other sources of funds such as deposit growth will be adequate to meet our foreseeable short- and long-term liquidity needs.

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Interest rate sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management s outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

Contractual principal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The average lives of mortgage loans are substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due and payable in the event, among other things, the borrower sells the real property subject to the mortgage and the loan is not repaid. In addition, certain borrowers increase their equity in the security property by making payments in excess of those required under the terms of the mortgage.

The sale of fixed rate loans is intended to protect us from precipitous changes in the general level of interest rates. The valuation of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the value of fixed rate loans. As with other investments, we regularly monitor the appropriateness of the level of adjustable rate mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest the proceeds in other adjustable rate investments.

The data in the following table reflects repricing or expected maturities of various assets and liabilities at March 31, 2008. The gap analysis represents the difference between interest-sensitive assets and liabilities in a specific time interval. Interest sensitivity gap analysis presents a position that existed at one particular point in time, and assumes that assets and liabilities with similar repricing characteristics will reprice at the same time and to the same degree.

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Interest Rate Sensitivity GAP Analysis

March 31, 2008

(*In thousands*)

	Within 3 Months	3 to 6 Months	6 to 12 Months	13 to 36 Months	More than 36 Months	Total
Interest Rate Sensitive Assets						
Loans (1)						
Fixed rate	$ 7,127	$ 10,597	$ 12,483	$ 11,641	$ 83,044	$ 124,892
Variable rate	158,084	4,930	3,375	13,119	43,368	222,876
Investment securities	5,596		363		2,021	7,980
Loans held for sale	4,772					4,772
Federal funds sold	2,449					2,449
Total rate sensitive assets	178,028	15,527	16,221	24,760	128,433	362,969
Cumulative rate sensitive assets	178,028	193,555	209,776	234,536	362,969	
Interest Rate Sensitive Liabilities						
Interest checking (2)				13,260		13,260
Money market accounts	28,177					28,177
Savings (2)				3,542		3,542
Certificates of deposit	61,704	59,672	66,197	66,921	18,252	272,746
FHLB advances				10,000		10,000
Trust Preferred Securities					8,764	8,764
Other borrowings	7,607					7,607
Total rate sensitive liabilities	97,488	59,672	66,197	93,723	27,016	344,096
Cumulative rate sensitive liabilities	97,488	157,160	223,357	317,080	344,096	
Rate sensitivity gap for period	$ 80,540	$ (44,145)	$ (49,976)	$ (68,963)	$ 101,417	$ 18,873
Cumulative rate sensitivity gap	$ 80,540	$ 36,395	$ (13,581)	$ (82,544)	$ 18,873	
Ratio of cumulative gap to total assets	20.1%	9.1%	(3.4)%	(20.6)%	4.7%	
Ratio of cumulative rate sensitive assets to cumulative rate sensitive liabilities	182.6%	123.2%	93.9%	74.0%	105.5%	
Ratio of cumulative gap to cumulative rate sensitive assets	45.2%	18.8%	(6.5)%	(35.2)%	5.2%	

(1) Includes nonaccrual loans of approximately $6,835,000, which are spread throughout the categories.

(2) Management believes that interest checking and savings accounts are generally not sensitive to changes in interest rates and therefore has placed such deposits in the 13 to 36 months category.

At March 31, 2008, our assets that reprice within six months exceeded liabilities that reprice within six months by $36,395,000 and therefore we were in an asset positive position. An asset positive position, or positive gap, can adversely affect earnings in periods of falling interest rates, but can improve earnings in periods of rising interest rates. Accordingly, the recent reductions in the short-term rate by the FOMC will have a negative impact on our earnings during the next six months to

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one year (repricing of assets and liabilities is approximately the same within one year). Any further reduction of the discount rate by the FOMC will also negatively impact earnings.

Critical accounting policies

The financial condition and results of operations presented in the financial statements, accompanying notes to the financial statements and management s discussion and analysis are, to a large degree, dependent upon our accounting policies. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change.

Presented below is a discussion of those accounting policies that management believes are the most important accounting policies to the portrayal and understanding of our financial condition and results of operations. These 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. See also Note 1 of the *Notes to Consolidated Financial Statements* filed with the Company s Annual Report on Form 10-KSB for the year ended December 31, 2007.

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. We maintain 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 they 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.

We evaluate various loans individually for impairment as required by Statement of Financial Accounting Standards (SFAS) 114, *Accounting by Creditors for Impairment of a Loan*, and SFAS 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 5, *Accounting for Contingencies*, with a group of loans that have similar characteristics.

For loans without individual measures of impairment, we make 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 classification 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 is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, 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 our allowance for loan losses 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. We recognize 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.

Impact of inflation and changing prices and seasonality

The financial statements in this document have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars, without consideration of changes in the relative purchasing power of money over time due to inflation.

Unlike industrial companies, most of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution s performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation.

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ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4T CONTROLS AND PROCEDURES

Based upon an evaluation as of March 31, 2008 under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company s disclosure controls and procedures, they have concluded that our disclosure controls and procedures, as defined in Rule 13a-15 and Rule 15d-15 under the Securities Exchange Act of 1934, as amended, are effective in ensuring that all material information required to be disclosed in reports that it files or submits under such Act are made known to them in a timely fashion.

Our management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in our internal control over financial reporting identified in connection with the evaluation of it that occurred during the Company s last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

Not applicable.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5 OTHER INFORMATION

Not applicable.

ITEM 6 EXHIBITS

31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

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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.

	VILLAGE BANK AND TRUST FINANCIAL CORP. (Registrant)
Date: May 14, 2008	By: /s/ Thomas W. Winfree Thomas W. Winfree President and Chief Executive Officer
Date: May 14, 2008	By: /s/ C. Harril Whitehurst, Jr. C. Harril Whitehurst, Jr. Senior Vice President and Chief Financial Officer

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Annex G

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Washington, D. C. 20551

FORM 10-KSB

x **Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2007

¨ **Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ________ to ________

River City Bank

(Name of small business issuer in its charter)

Virginia	**75-3103298**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6127 Mechanicsville Turnpike, Mechanicsville, VA	**23111**
(Address of principal executive offices)	**(Zip Code)**

Issuer s telephone number: 804-730-4100

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

Title of Class	**Name of each exchange on which registered**
Common Stock, $5.00 par value	**The Nasdaq Stock Market**

Securities registered under Section 12(g) of the Exchange Act: None

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. ¨

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 x No ¨

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosures will be contained, to the best of the 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. x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

State issuer s revenues for its most recent fiscal year: $8,191,011

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 sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. $16,660,896 at March 24, 2008.

The number of shares outstanding of the registrant s common stock at March 1, 2008: 1,801,178

DOCUMENTS INCORPORATED BY REFERENCE

Transitional Small Business Disclosure Format (check one): Yes ¨ No x

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RIVER CITY BANK

Form 10-KSB

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PART I

ITEM 1. DESCRIPTION OF BUSINESS
General

River City Bank (we or the Bank) was incorporated in 2003 under the laws of Virginia and conducts general banking business under a Virginia charter. The Bank is regulated by the State Corporation Commission s Bureau of Financial Institutions and the Federal Reserve Bank of Richmond. The Bank s deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The Bank opened its first office (Pebble Creek) on July 1, 2004 at 6127 Mechanicsville Turnpike in Hanover County, Virginia. On September 7, 2005, the Bank opened its second office (Village) at 8051 Mechanicsville Turnpike, also in Hanover County. The Bank opened its third office (Highland Springs) at 109 East Nine Mile Road in Henrico County, Virginia on June 18, 2006.

The Bank also leases space for its deposit and loan operations and administrative functions located at 7482 and 7502 Lee Davis Road, in Hanover County.

The Bank s business primarily consists of accepting deposits and making loans. The Bank provides a broad array of commercial and retail banking services and products, including commercial, residential real estate, mortgage, and consumer installment loans; a broad selection of deposit services, including automatic clearing house activities, sweep services, flexible deposit accounts, and ATM/debit card products; and a variety of personalized banking services targeted at small and medium sized businesses, individuals and related accounts.

On March 9, 2008 the Bank entered into a definitive merger agreement with Village Bank and Trust Financial Corp. and Village Bank whereby the Bank will merger with and into Village Bank in a transaction valued at approximately $20.2 million payable in cash and common stock. Under terms of the merger agreement, which was approved by the Board of Directors of both companies, shareholders of the Bank will be entitled to receive for each share of the Bank s common stock owned, $11.00 in cash or one share of Village Bank and Trust Financial Corporation common stock, subject to proration of 20% cash and 80% common stock if either cash or common stock is oversubscribed. It is anticipated that the transaction will be completed in the third quarter of 2008, pending regulatory approval and approval of the shareholders of both companies. With the addition of the Bank s three branches, Village Bank will have thirteen branch locations.

Business Strategy

The Bank concentrates on several areas (or market niches) to reach its goals. These areas are set forth below.

The Bank emphasizes attracting small and medium sized businesses. We focus on businesses such as small retailers, auto repair shops, auto and equipment dealers, established restaurants, production facilities, building contractors, established site developers, realtors, landscapers, nurseries, civic and charitable organizations, and professionals. The Bank is able to provide special considerations and personal service to these customers by providing low cost demand deposit accounts, automatic clearing

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house activities, sweep services and customized statements. We also provide secured and unsecured loans for office equipment, vehicles, and machines, lines of credit for inventory, accounts receivable and working capital, construction loans for new buildings or renovations to existing buildings and real estate loans for office facilities.

The Bank targets small and medium sized business customers by giving prompt attention and responding to all needs and requests made by its customers within 24 to 48 hours. While the Bank understands the importance of fee income, we want customers to view our fees as reasonable for the services rendered. We have positioned our fee schedule to attract small to medium businesses without adversely affecting shareholder value. The Bank also offers cash management services to small to medium sized businesses. This allows customers to use excess cash to generate interest, which benefits the customers income, and strengthens their relationships with the Bank.

The Bank emphasizes relationship banking to all customers, knowing that its customer retention rate will increase as established customers use more products and services offered by the Bank. The Bank focuses the same marketing attention on civic and charitable organizations as it does on small to medium sized businesses by offering low cost deposit services or customized deposit services.

The Bank recognizes the importance of managing its relationships with its small and medium sized business customers by working and communicating directly with their owners, managers, and key employees. The Bank s commercial loan officers have established positive relationships with business owners and principals, which has led to the development of personal banking relationships.

Location and Market Area

The Bank is located in and considers its primary market to be the Hanover County, Virginia, eastern Henrico County, Virginia and the Greater Richmond (Virginia) Metropolitan Area. Hanover is in the northeast quadrant of the metropolitan area on Interstates 95 and 295, and U. S. Routes 1 and 301 within 80 miles of both Washington, D. C. and the Norfolk/Virginia Beach area and enjoys synergies with both of those markets. The Richmond Metropolitan Statistical Area (MSA) population (2007) of 1.2 million people makes up approximately 15% of Virginia s total population. Hanover County s 2007 population was approximately 101,000. Population growth in the Richmond MSA is projected to be stronger than the national average through the end of the decade.

The Bank operates branches in Hanover and Henrico Counties. Both counties are experiencing strong economic growth through diversified industries such as county government (including the school system), medical and health services, financial services, wholesale and retail trade, manufacturing, agriculture, recreation and construction providing significant employment opportunities for their residents. In Hanover County, the largest employers are the Hanover County government, the Memorial Regional Medical Center, Supervalu (Eastern Region), Wal Mart, Tyson Foods and Kings Dominion. In Henrico County, the largest employers are the Henrico County government, Capital One Bank, Bon Secours Health System, Anthem, Circuit City Stores and Bank of America. According to the Virginia Employment Commission, unemployment rates at December 31, 2007 were as follows: Hanover County, 2.6%; Henrico County, 3.1%; Virginia Capital Area (City of Richmond and the Counties of Hanover, Henrico, Charles City, Goochland, New Kent, and Powhatan), 3.5%; and the state of Virginia, 3.3%.

Hanover County is the northernmost county in the greater Richmond metropolitan area, drawing many commuters to its bucolic setting and exceptional quality of living. With the lowest real estate tax assessment rate in the Richmond metropolitan area and low machinery and tools tax rates, continued expansion of the business economy is anticipated. In addition to Hanover County, the City of Richmond and its surrounding counties are served by strong retail, commercial, and industrial businesses, and a comprehensive transportation and communications network.

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Henrico County, in which the Bank opened an office in 2006, is a thriving, urban community located in central Virginia. With a population of 290,000 and 22,000 businesses, the county is one of the state s most prosperous and growing regions. Henrico County is one of 18 counties nationally to earn an AAA bond rating from each of the nation s three investment-rating agencies. In addition the county is home to one of the few semi-conductor manufacturing facilities built in the United States in the past 15 years, and in 2004 the Short Pump Fashion Mall, built in the western edge of the county, was among the largest newly-constructed shopping centers built in the nation. Low taxes, fast-track business approvals, customer service and quality infrastructure make Henrico County attractive to a variety of industries.

Banking Services

The Bank receives deposits, makes consumer and commercial loans, and provides other services customarily offered by a commercial banking institution, such as business and personal checking and savings accounts, drive-up window, and 24-hour automated teller machines. We have not yet applied for permission to establish a trust department and offer trust services. The Bank is a member of the Federal Reserve System. Our deposits are insured under the Federal Deposit Insurance Act to the limits provided there under.

The Bank currently offers flexible deposit accounts, automatic clearing house services, ATM/Debit card products, telephone banking, check imaging and savings deposit options to the employees and principals of our commercial business customers. To attract consumer business, we offer home equity loans, personal lines of credit, auto loans, student loans, recreational loans, and other banking services and products. The Bank has established a low maintenance fee demand deposit account for all consumers. This product has attracted consumer deposit accounts which have provided a base for the Bank to market additional products, such as individual retirement accounts, certificates of deposit and various loan products, including loans secured by one to four family dwellings and other secured and unsecured loan products. By marketing our personal, hometown service to our customers, we are establishing the Bank as a leader in the Hanover County and eastern Henrico County business community, in addition to establishing personal banking relationships with our corporate accounts.

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 also originates fixed and variable rate mortgage loans and real estate construction and acquisition loans. Fixed rate residential loans are usually sold in the secondary mortgage market, for which the Bank receives a referral fee.

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, for loans that are not secured by readily marketable or other permissible collateral, we are subject to a loans-to-one borrower limit of an amount equal to 15% of our capital and surplus. We may voluntarily choose to impose a policy limit on loans to a single borrower that is less than the legal lending limit. We participate out portions of loans with other community banks or correspondent banks when loan amounts exceed our legal lending limits or internal lending policies.

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Lending Activities

To attract loans, we primarily focus on making loans to small businesses and consumers in our local market area. Our lending activities are directed primarily to customers in Hanover County, Virginia, eastern Henrico County, Virginia and the Greater Richmond (Virginia) Metropolitan area.

Commercial Business Lending

Commercial business loans generally have a higher degree of risk than residential mortgage loans, but have higher yields. To manage these risks, the Bank generally obtains appropriate collateral and personal guarantees from the borrower s principal owners and monitors the financial condition of its business borrowers. Residential mortgage loans generally are made on the basis of the borrower s ability to make repayment from his/her employment and other income and are secured by real estate whose value tends to be readily ascertainable. In contrast, commercial business loans typically are made on the basis of the borrower s ability to make repayment from cash flow from its business and are secured by business assets, such as commercial real estate, accounts receivable, equipment and inventory. As a result, the availability of funds for the repayment of commercial business loans is substantially dependent on the success of the business itself. Furthermore, the collateral for commercial business loans may depreciate over time and generally cannot be appraised with as much precision as residential real estate. The Bank has an outside third party loan review and monitoring process to regularly assess the repayment ability of commercial borrowers.

Commercial Real Estate Lending

Commercial real estate loans are secured by various types of commercial real estate in the Bank s market area, including multi-family residential buildings, commercial buildings and offices, small shopping centers and churches.

In its underwriting of commercial real estate, the Bank may lend, under internal policy, up to 80% of the secured property s appraised value. Commercial real estate lending entails significant additional risk, compared with residential mortgage lending. Commercial real estate loans typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. Additionally, the payment experience on loans secured by income producing properties is typically dependent on the successful operation of a business or a real estate project and thus may be subject, to a greater extent, to adverse conditions in the real estate market or in the general economy. The Bank s commercial real estate loan underwriting criteria require an examination of debt service coverage ratios and the borrower s creditworthiness, prior credit history and reputation. The Bank also evaluates the location of the secured property and typically requires personal guarantees or endorsements of the borrowers principal owners.

Consumer Purpose and Residential Real Estate Loans

Our consumer loans consist primarily of loans for various consumer purposes, as well as the outstanding balances on non-real estate secured and unsecured consumer revolving credit accounts. A majority of these loans are secured by liens on various personal assets of the borrower, but they also may be made on an unsecured basis. Additionally, our real estate loans include loans secured by first or junior liens on real estate which were made for consumer purposes. Consumer loans are generally made at fixed interest rates and with maturities or amortization schedules which generally do not exceed five years. However, consumer loans secured by real estate are made at fixed interest rates and normally have interest rate adjustment features or are callable in five years with an amortization of 20 to 30 years. The Bank offers a variety of residential real estate loans with loan-to-value ratios that generally do not exceed 90% of the value of the collateral.

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Consumer loans generally are secured by personal property and other personal assets of borrowers which often depreciate rapidly or are vulnerable to damage or loss. In cases where damage or depreciation reduces the value of our collateral below the unpaid balance of a defaulted loan, repossession may not result in repayment of the entire outstanding balance. The resulting deficiency often does not warrant further substantial collection efforts against the borrower. In connection with consumer lending in general, the success of our loan collection efforts is highly dependent on the continuing financial stability of our borrowers, so our collection of consumer loans may be more likely to be adversely affected by a borrower s job loss, illness, personal bankruptcy or other change in personal circumstances than is the case with other types of loans.

Mortgage Lending

Management continues to develop and implement financial products to improve market share and to increase fee income, while also focusing on increasing the consumer home equity loan portfolio through cross selling efforts. A mortgage loan program was implemented in the second quarter of 2005 with the purpose to originate and broker the sale of 15 and 30 year fixed rate mortgages in the secondary market. This program was profitable to the Bank in 2007 and Management is optimistic that the program will increase non-interest income through fees related to originating the loans in 2008 and in future years. The Bank earns referral or origination fees from this program and does not actually fund the associated loans.

Loan Commitments and Contingent Liabilities

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities which are disclosed in the footnotes of our annual financial statements, including commitments to extend credit. At December 31, 2007, undisbursed credit lines, standby letters of credit and commitments to extend credit totaled $20,012,947.

Credit Policies and Administration

The Bank has adopted a comprehensive lending policy, which includes stringent underwriting standards for all types of loans. The Bank s lending staff follows pricing guidelines established periodically by our management team. In an effort to manage risk, all credit decisions in excess of the officers lending authority must be approved prior to funding by a management loan committee and/or a board of directors-level loan committee. Any loans above $1,400,000 require full board of directors approval. Management believes that it employs experienced lending officers, secures appropriate collateral and carefully monitors the financial conditions of our borrowers and the concentration of such loans in the portfolio.

Like most community banks, we make loans based, to a great extent, on our assessment of borrowers income, cash flow, character and abilities to repay. The principal risk associated with each of the categories of our loans is the creditworthiness of our borrowers, and our loans may be viewed as involving a higher degree of credit risk than is the case with some other types of loans, such as long-term residential mortgage loans, where emphasis is placed on collateral values. To manage risk, we have adopted written loan policies and procedures, and our loan portfolio is administered under a defined process. That process includes guidelines for loan underwriting standards and risk assessment, procedures for loan approvals, loan exposure and a test for compliance with our credit policies and procedures.

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The underwriting standards that we employ for loans include an evaluation of various factors, including the loan applicant s income, cash flow, payment history on other debts and an assessment of ability to meet existing obligations and payments on the proposed loan. Though creditworthiness and ability to repay the loan are the primary considerations in the loan approval process, in the case of secured loans the underwriting process also includes an analysis of the value of the proposed collateral in relation to the proposed loan amount. We consider the value of collateral, the degree to which that value is ascertainable with any certainty, the marketability of the collateral in the event of foreclosure or repossession, and the likelihood of depreciation in the collateral value.

Our Board of Directors has approved various levels of lending authority based on our aggregate credit exposure to a borrower and the secured or unsecured status of a proposed loan. A loan within a lending officer s assigned authority may be approved by that officer. Loans outside the lending authority of the loan officers are presented for consideration to the directors credit committee, which consists of five outside directors, the President and CEO, the Executive Vice President and Chief Credit Officer and the Executive Vice President and Chief Financial Officer. Unsecured loans that exceed $200,000 and secured loans that exceed $400,000 must be submitted to the directors credit committee and upon their recommendation, subsequently submitted to the full Board of Directors for final approval before the loan can be funded.

After origination, all loans are reviewed by our loan administration personnel for adequacy of documentation and compliance with regulatory requirements. All loans are ultimately reviewed by the Board of Directors. At the time the loan is proposed to be made or renewed, the loan officer assigns a grade to the loan based upon various underwriting and other criteria, and during the life of the loan, its grade is reviewed and validated or modified to reflect changes in circumstances and risk. Any loans in the future will be placed in a non-accrual status if they become 90 days past due or whenever we believe that collection is doubtful; this would result in a downgrade of classification and appropriate allocation of loan loss reserve would be applied. When loans are determined not to be collectable in interest and principal the loans are charged against a reserve for loan losses.

Lending Limit

At December 31, 2007, our legal lending limit for loans to one borrower was $2.45 million. As part of risk management strategy, we maintain internal house limits below our legal lending limit. When we receive customer requests in excess of our legal lending limit, we evaluate the credit risk under our normal guidelines. Approved transactions exceeding our lending limit are sold to and funded by other banks.

Competition

The banking business is highly competitive. We compete with other commercial banks, savings associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions operating in our primary market area and elsewhere.

We have been able to effectively leverage our talents, contacts and location to achieve a strong financial position for a relatively new bank. Competition in our primary market area for loans to small and medium sized businesses, individuals and professionals is intense, and pricing is important. Most of our competitors have substantially greater resources and lending limits than we do and offer extensive and established branch networks and other services that we do not expect to be able to provide in the near future. Moreover, larger institutions operating in our market areas have access to borrowed funds at a

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lower rate than is available to us. Deposit competition is strong among institutions in our market areas. As a result, as a new bank we may pay above-market rates for deposits in order to grow. Despite strong competition, we are experiencing success in our market area because the area is reacting favorably to our community focus and our emphasis on service to the small and medium sized businesses, individuals and professionals.

Recent mergers of community banks into regional banks have increased the presence of large regional bank holding companies in our already competitive marketplace. These mergers have created opportunities for community-focused, prudently managed banks that specialize in serving small and medium sized businesses. However, our Board of Directors is aware of the competition of these larger institutions and they believe it is a significant advantage to be a community owned and operated bank specializing in small and medium sized businesses, individuals and professionals in the Hanover and Henrico markets as well as our secondary market area.

The Bank held $95,055,000 in total deposits at June 30, 2007, or 6.4% of the total deposits held by financial institutions in Hanover County, based on the most recent deposit data from the FDIC.

Effect of Adverse Economic Conditions

Our 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 could have a significant adverse effect on the operations of the Bank as 95% of our loan portfolio is collateralized by real estate. Declines in real estate values can reduce projected cash flows from commercial properties and the ability of borrowers to use home equity to support borrowings and increase the loan-to-value ratios of loans previously made by us, 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.

We anticipate the majority of our depositors will be located in and doing business in the local market and we will lend a substantial portion of our 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 our performance.

Employees

As of December 31, 2007, the Bank had 35 full time employees and five part time employees. None of our employees is represented by any collective bargaining unit, and we believe that relations with our employees are good. Based on the Bank s mission statement of providing superior personal service to our customers, the Bank s employees are well suited for accomplishing its mission and establishing the Bank as a good corporate citizen in the Hanover and Henrico communities.

Supervision and Regulation

General

We are a Virginia state bank and a member of the Federal Reserve System, and our depositors are insured by the Federal Deposit Insurance Corporation. The Federal Reserve and the Virginia State Corporation Commission and its Bureau of Financial Institutions regulate and monitor our operations. We are 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 of Virginia conduct periodic onsite and offsite examinations of us. We must comply with a wide variety of reporting requirements and

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banking regulations. The regulations of these various agencies govern most aspects of our 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 us generally have been promulgated to protect depositors and the deposit insurance funds and not to protect various shareholders. Additionally, we must bear the cost of compliance with the reporting requirements and regulations; these costs can be significant and have an effect on our financial performance.

The Federal Reserve, Commonwealth of Virginia, 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.

The following description summarizes the significant federal and state laws applicable to us. To the extent that statutory or regulatory provisions are described, the description is qualified in its entirety by reference to that particular statutory or regulatory provision.

Insurance of Accounts, Assessments and Regulation by the FDIC

Our deposit accounts are insured by the Bank Insurance Fund of the Federal Deposit Insurance Corporation up to the maximum legal limits of the FDIC. The laws and regulations governing us 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, we are 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

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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, 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-weighing 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

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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 may 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. We presently have 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 our small size and recent organization, we do not expect the Act to materially affect our products, services or other business activities. We do not believe that the Act will have a material adverse impact on our 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 we face from larger institutions and other companies offering financial products and services, many of which may have substantially greater financial resources.

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Payment of Cash Dividends

We are 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 our 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, we must obtain prior written approval for any dividend if the total of all dividends declared in any calendar year would exceed the total of our net profits for that year combined with our retained net profits for the preceding two years. In addition, we 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, we are not permitted to add the balance of our allowance for loan losses account to our undivided profits then on hand, however, we may net the sum of our bad debts as so defined against the balance of our 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. We 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 our financial soundness, and may also permit the payment of dividends not otherwise allowed by Virginia law.

We generated start-up losses in 2003 through 2007, resulting in negative retained earnings. As a result, we are not able to pay cash dividends to the holders of our Common Stock at this time.

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 of our knowledge, we are meeting the obligations under this act.

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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 nonaffiliate. 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 nonaffiliates.

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

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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 our Board of Directors with any interested director not participating in the voting. Our 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.

USA PATRIOT Act of 2001

In October 2001, the President signed into law the USA PATRIOT Act. This act was in direct response to the terrorist attacks on September 11, 2001, and strengthens the anti-money laundering provisions of the Bank Secrecy Act. Most of the new provisions added by this act apply to accounts at or held by foreign banks, or accounts of or transactions with foreign entities. We do not have significant foreign business and have not had our operations materially affected by the act. This act does, however, require the federal banking regulators to consider a bank s record of compliance under the Bank Secrecy Act in acting on any application filed by a bank. As we are subject to the provisions of the Bank Secrecy Act (i.e., reporting of cash transactions in excess of $10,000), our record of compliance in this area will be an additional factor in any applications filed in the future. To our knowledge, our record of compliance in this area is satisfactory and our processes and procedures to ensure compliance with the Bank Secrecy Act are satisfactory.

Other Regulation

We are subject to a variety of other regulations. State and federal laws restrict interest rates on loans, potentially affecting our income. The Truth in Lending Act and the Home Mortgage Disclosure Act impose information requirements on us 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.

Future Regulatory Uncertainty

Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, we cannot forecast how federal regulation of financial institutions may change in the future and impact our operations. Although Congress in recent years has sought to reduce the regulatory burden on financial institutions with respect to the approval of specific transactions, we fully expect 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.

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ITEM 2. DESCRIPTION OF PROPERTY

The following table summarizes certain information about the headquarters of the Bank, its branch offices and administrative offices.

Office Location	Date Opened	Owned or Leased	Lease Terms
Headquarters and Pebble Creek Branch 6127 Mechanicsville Turnpike Mechanicsville, Virginia 23111	July 1, 2004	Leased	Lease term is 15 years, expiring in April, 2019, with purchase options at the beginning of years 5, 10 and 15.
Village Branch Office 8051 Mechanicsville Turnpike Mechanicsville, Virginia 23111	September 7, 2005	Leased	Lease term is 15 years, expiring in September, 2019, with purchase options at the end of year 10.
Operations Center 7482 Lee Davis Road, Suite 9 Mechanicsville, VA 23111	March 1, 2004	Leased	Lease term is three years, expiring in March, 2008. There are no renewal or purchase options.
Highland Springs Branch 109 E. Nine Mile Road Highland Springs, VA 23075	July 1, 2006	Leased	Lease term is five years expiring in April, 2011, with lease renewal and purchase options at the end of years 5 and 10 of lease.
Loan Operations Center 7502 Lee Davis Road, Suite 22 Mechanicsville, VA 23111	November 1, 2007	Leased	Lease term is three years, expiring in November, 2010. There are no renewal or purchase options.

We believe that all of our properties are maintained in good operating condition and are suitable and adequate for our operational needs.

ITEM 3. LEGAL PROCEEDINGS

In the course of its operations, the Bank may become a party to legal proceedings. There are no material pending legal proceedings to which the Bank is a party or of which the property of the Bank is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

Shares of the Bank s Common Stock have traded on the Nasdaq Capital Market (formerly known as the Nasdaq SmallCap Market) under the symbol RCBK since July 7, 2005. Prior to that time, such shares traded though the OTC Bulletin Board under the symbol RCBK and from time to time in privately negotiated transactions.

The high and low trade prices of shares of the Bank s Common Stock for the periods indicated, as known to the Bank, were as follows:

Quarter	High	Low
First Quarter 2006	11.44	10.15
Second Quarter 2006	13.55	10.78
Third Quarter 2006	12.45	10.75
Fourth Quarter 2006	11.75	10.00
First Quarter 2007	11.00	9.76
Second Quarter 2007	10.50	9.50
Third Quarter 2007	10.25	8.15
Fourth Quarter 2007	9.00	6.07

At March 1, 2008, there were approximately 1,310 holders of record of Common Stock.

The Bank has not paid any dividends on its Common Stock. We intend to retain all of our earnings to finance the Bank s operations and we do 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. Banking regulations limit the amount of cash dividends that may be paid without prior approval of the Bank s regulatory agencies. Such dividends are limited to the lesser of the Bank s retained earnings or the net income of the previous two years combined with the current year net income.

The Bank did not purchase any shares of its Common Stock in the fourth quarter of 2007.

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ITEM 6. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION
General

Management s discussion and analysis is intended to assist the reader in evaluating and understanding the financial condition and results of River City Bank (the Bank) for the calendar years ended December 31, 2006 (2006) and 2007 (2007). This discussion should be read in conjunction with the Bank s Financial Statements and the accompanying Notes thereto included in this Form 10-KSB.

As the Bank continues to grow, the Bank expects changes in financial condition and operating results should become more favorable overall, but less dynamic. Many new banks experience a period of operating losses until the growth and balancing of interest income from loans, interest expense from deposits and income from invested securities, along with the active attention to cost controls, will generate operating income. The Bank did not reach this break-even level of profitability during 2006 or 2007.

The primary source of the Bank s revenue is net interest income, which represents the difference between interest income on earning assets and interest expense on liabilities used to fund those assets. Earning assets include loans, securities, interest bearing bank certificates of deposit and federal funds sold. Interest bearing liabilities include deposits and borrowings. Sources of non-interest income include service charges on deposit accounts, mortgage referral fees, gains on the sale of securities and other miscellaneous income.

Overview of Operations and Comprehensive Losses

The Bank recorded comprehensive losses of $(57,420) and $(316,877), for the years ended December 31, 2007 and 2006, respectively. Earnings per share, which relates to net losses, not comprehensive losses, equaled $(0.24) and $(0.16) per basic and diluted share, for the years ended December 31, 2007 and 2006, respectively. The comprehensive losses include net losses of $(438,230) and $(287,469) for 2007 and 2006, respectively, and net unrealized gain or loss on securities available-for-sale of $380,810 and $(29,408) for 2007 and 2006, respectively. The increase in net operational losses in 2007 over 2006 reflects the Bank s increase in provision for loan losses to fund its reserve due to increased loan growth and to replenish the reserve due to loan charge-offs totaling $192,844. Additionally, operational expenses increased due to continued strong deposit growth, not fully offset by an increase in net interest income of $406,997 from 2006 to 2007. The improvement in net unrealized gain on securities available-for-sale reflects the change in the interest rate environment and portfolio growth during 2007 over 2006.

The Bank recorded comprehensive losses of $(316,877) and $(769,298), for the years ended December 31, 2006 and 2005, respectively. Earnings per share were $(0.16) and $(0.44) per basic and diluted share, for the years ended December 31, 2006 and 2005, respectively. The comprehensive losses include net losses of $(287,469) and $(593,011) for 2006 and 2005, respectively, and net unrealized losses on securities available-for-sale of $(29,408) and $(176,287) for 2006 and 2005, respectively. The improvement in net operational losses in 2006 over 2005 reflects the Bank s continued strong deposit and loan growth with management s continued attention to cost controls. The decrease in net unrealized losses on securities available-for-sale reflects the change in the interest rate environment and portfolio growth during 2006 over 2005.

Summary of Financial Condition

Total assets at December 31, 2007 were $121,893,719, an increase of $35,441,828 or 41%, from $86,451,891 at December 31, 2006. Total assets at December 31, 2006 were $86,451,891, an increase of $25,415,345 or 42%, from $61,036,546 at December 31, 2005.

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Cash and cash equivalents decreased by $3,241,322 to $1,962,029 at December 31, 2007 due to the reduction of highly liquid short-term debt instruments used for short-term balancing and investing of excess funds based upon increased deposit and loan activity in 2007 over 2006. In comparing 2006 to 2005, cash and cash equivalents decreased by $689,671 to $5,203,351 at December 31, 2006.

Securities available-for-sale increased $3,518,659 to $21,343,191 at December 31, 2007 due to the available excess invested funds resulting from increased deposit activity at the end of 2007 over 2006. Securities available-for-sale increased $5,907,553 to $17,824,532 at December 31, 2006 over 2005.

Loans, net of allowance for loan losses, increased from $59,257,336 at December 31, 2006 to $94,802,342 at December 31, 2007, an increase of $35,545,006 or 60%. Commercial loans increased $7,898,611 or 63% to $20,375,452; real estate loans increased $27,214,531 or 60%; and consumer and other loans increased $859,180 or 42%. Loans held for investment as a percentage of assets and deposits were 79% and 92%, respectively, at December 31, 2007, compared to 69% and 84% at December 31, 2006. Loans, net of allowance for loan losses, increased from $38,351,866 at December 31, 2005 to $59,257,336 at December 31, 2006, an increase of $20,935,470 or 55%. This increase reflects the Bank s growth in commercial and consumer loan categories.

Bank premises and equipment, net of accumulated depreciation decreased $105,886, or 10%, to $932,557 during 2007, due to depreciation charges exceeding capital expenditures. In comparing 2006 to 2005, Bank premises and equipment, net of accumulated depreciation increased $108,913, or 12%, to $1,038,443 due to the opening of the Highland Springs branch in June, 2006.

Total liabilities at December 31, 2007 were $106,395,314, an increase of $35,488,798 or 50%, from $70,906,516 at December 31, 2006. Total liabilities at December 31, 2006 were $70,906,516, an increase of $25,732,222, or 57%, from $45,174,294 at December 31, 2005.

Total deposits, the primary component of total liabilities, were $104,535,491 at December 31, 2007 an increase of $34,029,568, or 48%, from $70,505,923 at December 31, 2006. This increase in deposits is attributed to the Bank s continuing marketing initiatives implemented during the year. In comparing 2006 to 2005, total deposits were $70,505,923 at December 31, 2006, an increase of $25,574,219, or 57%, from $44,931,704 at December 31, 2005. This increase in deposits was attributed to the Bank s continuing marketing initiatives implemented during the year, as well as the opening of the Highland Springs branch in June, 2006 and the continued deposit growth at the Bank s other branches.

Total stockholders equity amounted to $15,498,405 at December 31, 2007 compared to $15,545,375 at December 31, 2006, a decrease of $46,970. The decrease resulted from a net loss for 2007 of $438,230 offset by increases from net unrealized gains on securities available-for-sale of $380,810 and an exercise of stock options of $10,450. Total stockholders equity amounted to $15,545,375 at December 31, 2005 compared to $15,862,252 at December 31, 2005, a decrease of $316,877. The decrease resulted from a net loss for 2006 of $287,469 and net unrealized losses on securities available-for-sale of $29,408.

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Net Interest Income and Net Interest Margin

Net interest income, the primary source of the Bank s earnings, is the excess of interest income, derived from earning assets classified as loans, securities, certificates of deposit and federal funds sold, over and above interest expense, which are amounts due from the Bank s interest bearing liabilities including customer deposits, time certificates and federal funds purchased. The amount of net interest income is primarily dependent upon the volume and mix of these earning assets and interest bearing liabilities. Interest rate changes can also impact the amount of net interest income, but usually to a much lesser extent. Management develops pricing and marketing strategies to maximize net interest income while maintaining related assets and liabilities accounts within guideline policies as established by the Bank s Board of Directors.

The net interest margin represents net interest income divided by average earning assets. It reflects the average effective rate that we earned on our earning assets. Net interest margin is affected by changes in both average interest rates and average volumes of interest earning assets and interest bearing liabilities.

Prior to 2007, interest rates increased significantly in response to a strong economic environment in the United States and regulatory attempts to manage inflationary pressures. During the latter part of 2007, the Federal Open Market Committee (FOMC) decreased its targeted rate in response to a declining economic environment.

Net interest income increased 26% to $3,649,946 in 2007, from $2,887,949 in 2006. The increase was due to significant changes in earnings assets, primarily loans and investments. The Bank s loan portfolio continued to maintain strong ratios as a percentage of assets and deposits of 79% and 92%, respectively, at December 31, 2007, as compared to 69% and 84%, respectively, at December 31, 2006.

The net interest margin declined to 3.48% for 2007 from 4.02% for 2006. The average rate on earning assets increased 37 basis points from 7.10% for 2006 to 7.47% for 2007. The average rate on interest-bearing liabilities increased 65 basis points from 4.27% for 2006 to 4.92% for 2007. The ratio of average interest earning assets to average interest-bearing liabilities decreased from 139% for 2006 to 123% for 2007.

The net interest margin declined to 4.02% for 2006 from 4.28% for 2005. The average rate on earning assets increased 92 basis points from 6.18% for 2005 to 7.10% for 2006. The average rate on interest-bearing liabilities increased 129 basis points from 2.98% for 2005 to 4.27% for 2006. The ratio of average interest earning assets to average interest-bearing liabilities decreased from 157% for 2005 to 139% for 2006.

The following table illustrates average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders equity and related income, expense and corresponding weighted-average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances. We have no tax exempt assets for the periods presented.

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Average Balances, Interest Income and Expenses and Average Yield and Rates

Year Ended December 31, 2007

(dollar amounts stated in thousands)

	Average Balances(1)	Interest Income/ Expense	Yields/ Rates
ASSETS:			
Interest earning assets:			
Federal funds sold	$ 4,345	$ 224	5.16%
Certificates of deposit	2,058	90	4.37%
Investment securities	20,873	1,082	5.18%
Loans	77,546	6,432	8.29%
Total earning assets	104,822	7,828	7.47%
Non-interest earning assets:			
Cash & due from banks	1,242		
Premises and equipment	906		
Other assets	1,556		
Less: allowance for loan losses	(773)		
Total non-interest earning assets	2,931		
Total Assets	$ 107,753		
Liabilities and Stockholders Equity:			
Interest bearing liabilities:			
Interest bearing demand deposit accounts	$ 11,612	$ 385	3.32%
Savings accounts	28,725	1,448	5.04%
Time deposits	43,927	2,312	5.26%
Federal funds purchased	621	33	5.31%
Total interest bearing liabilities	84,885	4,178	4.92%
Non-interest bearing liabilities:			
Non-interest demand deposit accounts	6,906		
Other liabilities	593		
Stockholders equity	15,369		
Total Liabilities and Stockholders Equity	$ 107,753		
Interest Rate Spread (2)			**2.55%**
Net Interest Income (3)		**$ 3,650**	
Net Interest Margin (4)			**3.48%**

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Average Balances, Interest Income and Expenses and Average Yield and Rates

Year Ended December 31, 2006

(dollar amounts stated in thousands)

	Average Balances(1)	Interest Income/ Expense	Yields/ Rates
ASSETS:			
Interest earning assets:			
Federal funds sold	$ 6,532	$ 329	5.04%
Certificates of deposit	3,060	123	4.02%
Investment securities	13,581	637	4.69%
Loans	48,728	4,013	8.24%
Total earning assets	71,901	5,102	7.10%
Non-interest earning assets:			
Cash & due from banks	1,104		
Premises and equipment	945		
Other assets	937		
Less: allowance for loan losses	(480)		
Total non-interest earning assets	2,506		
Total Assets	$ 74,407		
Liabilities and Stockholders Equity:			
Interest bearing liabilities:			
Interest bearing demand deposit accounts	$ 6,705	$ 126	1.88%
Savings accounts	14,908	651	4.37%
Time deposits	30,202	1,437	4.76%
Federal funds purchased	7		5.71%
Total interest bearing liabilities	51,822	2,214	4.27%
Non-interest bearing liabilities:			
Non-interest demand deposit accounts	6,499		
Other liabilities	384		
Stockholders equity	15,702		
Total Liabilities and Stockholders Equity	$ 74,407		
Interest Rate Spread (2)			**2.83%**
Net Interest Income (3)		**$ 2,888**	
Net Interest Margin (4)			**4.02%**

(1) Average balances are computed on a daily basis.

(2) Total interest earning assets yield less the total interest bearing liabilities rate.

(3) Total interest on earning assets less total interest on interest bearing liabilities.

(4) Net interest margin is net interest income, expressed as a percentage of average earning assets.

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Noninterest Income

Non-interest income includes service charges on deposits and loans, mortgage referral fees, investment fee income, management fee income and gains on sales of investment securities available-for-sale, and continues to be an important factor in our operating results.

Noninterest income increased to $362,980 in 2007 from $284,369 in 2006. The increase in noninterest income was due primarily to the results of the mortgage brokerage division, which started in March 2005 and produced fee income of $203,377 in 2007 compared to $168,433 in 2006, an increase of 21%. Management anticipates that fees derived from this division will continue to constitute a large portion of the Bank s noninterest income.

In 2005, the Bank purchased a membership interest in a limited liability company that issues property title insurance policies. This initiative offers our customers a source for title insurance and provides the Bank with participation profits of the limited liability company.

Noninterest income increased to $284,369 in 2006 from $133,003 in 2005. The increase in noninterest income was due primarily to the benefit of the mortgage brokerage division, which started in March 2005, and increased bank service fees.

Noninterest Expense

Non-interest expense includes, among other things, salaries and benefits, occupancy costs, professional fees, depreciation, data processing, telecommunications and miscellaneous expenses.

Total noninterest expense increased $636,369, or 20%, from $3,249,787 in 2006 to $3,886,156 in 2007. These increases are attributable to these factors: the opening of the Bank s third banking office in Highland Springs in June 2006 and increased marketing and operational expenses to support overall growth in deposits and loans.

Total noninterest expense increased $1,092,939, or 51%, from $2,156,848 in 2005 to $3,249,787 in 2006. These increases are attributable to two main factors: the opening of bank branches during each year and additional expenses relating to overall growth in deposits and loans.

The Bank s management and staff monitor and control operating expenses to provide adequate operational support and enable growth opportunities.

Income Tax Expense

The Bank did not record in its current provision for income tax expense for 2007, 2006, or 2005 any income tax benefits due to the operational losses incurred in each period. The tax benefit of these operational losses may be reflected as a reduction of current tax provisions in future time periods if and when the Bank achieves operational profitability.

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Loans

Our primary source of income is our lending activities. The following table presents the composition of the Bank s loan portfolio at the dates indicated:

	December 31, 2007 Amount	%	December 31, 2006 Amount	%
Secured By Real Estate	$ 72,541,746	75.71%	$ 45,327,215	75.74%
Commerical	20,375,452	21.27%	12,476,841	20.85%
Consumer and other	2,898,358	3.02%	2,039,178	3.41%
Total loans	95,815,556	100%	59,843,234	100%
Less: Allowance for loan losses	(977,156)		(605,000)	
Net deferred loan fees	(36,058)		19,102	
Net loans	$ 94,802,342		$ 59,257,336	

Maturities of Loans December 31, 2007

(in thousands)

Fixed Rate				Variable Rate			
Within 1 Year	1 to 5 Years	After 5 Years	Total	1 to 5 Years	After 5 Years	Total	Total Maturities
$ 4,583	$ 27,811	$ 10,046	$ 42,440	$ 51,392	$ 1,984	$ 53,376	$ 95,816

Provision and Allowance For Loan Losses

Provisions for loan losses amounted to $565,000 in 2007 and $210,000 in 2006. The allowance for loan losses represented 1.02% and 1.01% of the total outstanding loans at December 31, 2007 and 2006 respectively. The provision for loan losses is based upon management s estimate of the amount needed to maintain the allowance for loan losses at an adequate level to cover known and inherent risk of loss in the loan portfolio. In determining the provision amount, management gives consideration to current and anticipated economic conditions, the growth and composition of the loan portfolio, the relationship of the allowance for loan losses to outstanding loans, and other factors. Please refer to Critical Accounting Policies for additional discussion concerning the Bank s practices in this area. Management also classifies loans as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. At December 31, 2007 the Bank had impaired loans of $34,591, and as of December 31, 2006 the Bank had impaired loans of $1,056,726, as described below.

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The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated.

	Year Ended December 31, 2007	2006
Balance at beginning of period	$ 605,600	$ 395,000
Provision charged to operations	565,000	210,000
Loan charge-offs	(192,844)	
Loan recoveries		
Balance at end of period	$ 977,156	$ 605,000
Loans outstanding at end of year	$ 95,815,556	$ 59,843,234
Ratio of allowance for loan losses as a percent of loans outstanding at end of year	1.02%	1.01%

At December 31, 2007, the Bank had not allocated its allowance for loan losses to the categories of its loan portfolio, as such categories continue to evolve in the first 3 years of its operations.

Asset Quality

Interest is accrued on outstanding loan principal balances, unless the Bank considers collection to be doubtful. Commercial and unsecured consumer loans are designated as non-accrual when payment is delinquent 90 days or at the point which the Bank considers collection doubtful, if earlier. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that concern over our ability to collect principal and interest is not significant. When loans are placed in non-accrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received. Interest accruals are resumed on such loans only when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

At December 31, 2007, the Bank had only one non-performing loan with a principal balance of $34,591. Management considers this loan well secured.

At December 31, 2006, the Bank had only one non-performing loan with a principal balance of $1,056,726.

The Bank had no restructured loans, foreclosed properties or loans past due 90 days and still accruing interest at December 31, 2007 or at December 31, 2006.

Total nonperforming assets to loans at December 31, 2007 was .04%, and the allowance for loan losses to nonaccrual loans at December 31, 2007 was 2824.89%.

Total nonperforming assets to loans at December 31, 2006 was 1.77%, and the allowance for loan losses to nonaccrual loans at December 31, 2006 was 57.25%.

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Investment Portfolio

At December 31, 2007 and 2006, all of the Bank s securities were classified as available-for-sale. The following table presents the composition of the investment portfolio at the dates indicated.

A summary of the amortized cost and carrying value of securities available-for-sale at December 31, 2007 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. agency obligations	$ 15,543,626	$ 181,075	$ (1,314)	$ 15,723,387
Mortgage-backed securities	5,627,768	9,257	(17,221)	5,619,804
Total	$ 21,171,394	$ 190,332	$ (18,535)	$ 21,343,191

A summary of the amortized cost and carrying value of securities available-for-sale at December 31, 2006 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. agency obligations	$ 15,579,833	$	$ (169,074)	$ 15,410,759
Mortgage-backed securities	2,453,712		(39,939)	2,413,773
Total	$ 18,033,545	$	$ (209,013)	$ 17,824,532

A summary of the maturity distribution of securities available-for-sale at December 31, 2007 follows:

	Maturity Distribution Investment Securities Available-for-Sale				
	Par Value	Amortizied Cost	Unrealized Gain (Loss)	Estimated Fair Value	Average Yield
December 31, 2007					
U.S. Government Agencies					
One to five years	3,000,000	2,988,643	10,957	2,999,600	4.37%
Five to ten years	3,750,000	3,728,909	47,341	3,776,250	5.23%
Over ten years	8,850,000	8,826,074	121,463	8,947,537	5.98%
Total	15,600,000	15,543,626	179,761	15,723,387	5.49%
Mortgage-backed securities					
One to five years	1,777,341	1,781,528	803	1,782,331	4.54%
Five to ten years	2,346,808	2,339,252	(8,780)	2,330,472	5.37%
Over ten years	1,500,469	1,506,988	13	1,507,001	5.80%
Total	5,624,618	5,627,768	(7,964)	5,619,804	5.22%
Total Investment Securities	$ 21,224,618	$ 21,171,394	171,797	$ 21,343,191	5.40%

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Deposits

The Bank s predominant source of funds is deposit accounts. The Bank s deposit base is comprised of demand deposits, savings and money market accounts, and time deposits. The Bank s deposits are provided by individuals and businesses located in the Bank s market area.

The following table gives the composition of our deposits at the dates indicated.

	December 31,			
	2007		2006	
	Amount	%	Amount	%
Noninterest-bearing deposits				
Demand deposits	$ 7,572,030	7.24%	$ 8,090,229	11.47%
Interest-bearing deposits				
Money market and NOW Accounts	12,789,237	12.23%	8,445,302	11.98%
Savings	31,706,989	30.33%	21,398,358	30.35%
Certificates of deposit				
Less than $100,000	34,146,912	32.67%	20,253,371	28.73%
Greater than $100,000	18,320,323	17.53%	12,318,663	17.47%
	$ 104,535,491	100%	$ 70,505,923	100%

Total deposits increased by 48% from December 31, 2006 to December 31, 2007. The Bank s ability to attract and retain deposits, and our cost of funds, has been, and will continue to be, significantly affected by money market conditions.

Total deposits increased by 57% from December 31, 2005 to December 31, 2006.

The following table is a schedule of average balances and average rates paid for each deposit category for the periods presented:

Average Deposits and Rates Paid (dollar amounts in thousands)

	Year Ended December 31,			
	2007		2006	
	Amount	Average Rate	Amount	Average Rate
Noninterest-bearing deposits				
Demand deposits	$ 6,906	0.00%	$ 6,499	0.00%
Interest-bearing deposits				
Money market and NOW accounts	11,612	3.32%	6,705	1.88%
Savings	28,725	5.04%	14,908	4.37%
Certificates of deposit				
Less than $100,000	28,517	5.22%	17,869	4.92%
Greater than $100,000	15,410	5.34%	12,333	4.53%
Total average deposits	$ 91,170		$ 58,314	

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The following table is a schedule of maturities for time deposits of $100,000 or more at the date indicated:

			December 31, 2007
(Dollars in thousands)			
Due in:	3 months or less	$	4,029
	Over 3 months through 6 months		1,827
	Over 6 months through 12 months		3,451
	Over 12 months		9,013
		$	**18,320**

The following table provides Return on Equity and Assets for the years indicated:

	2007	2006
Return on average assets	(.41%)	(0.39%)
Return on average equity	(2.85%)	(1.83%)
Dividend payout ratio		
Average equity to average assets	14.26%	21.10%

Contractual Obligations and Other Commitments

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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contractual amounts of these instruments reflect the extent of the Bank s involvement in particular classes of financial instruments.

The Bank s exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Unless noted otherwise, the Bank does not require collateral or other security to support financial instruments with credit risk.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

At December 31, 2007, undisbursed credit lines, standby letters of credit and commitments to extend credit totaled $20,012,947.

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The following table summarizes our contractual cash obligations and commitments, including maturing certificates of deposit, at December 31, 2007 and the effect such obligations may have on liquidity and cash flows in future periods.

Contractual Obligations

(dollars in thousands)

	Less Than One Year	1-3 Years	3-5 Years	Over 5 Years	Total
Leased Property	$ 181	$ 317	$ 336	$ 1,330	$ 2,164
Time Deposits (1)	32,191	7,159	13,117		52,467
Unused Commerical Lines of Credit	11,558				11,558
Unused Consumer Lines of Credit	7,732				7,732
Standby letters of credit	723				723
	$ 52,385	$ 7,476	$ 13,453	$ 1,330	$ 74,644

(1) We expect to retain maturing deposits or replace maturing amounts with comparable time deposits based on current market rates.

Capital Resources

To enable future growth of the Bank, there must be an adequate level of capital. Management frequently reviews the Bank s capital to ensure that the amount, composition and quality of the Bank s assets and liabilities satisfy regulatory requirements, meet or exceed industry standards, and support projected Bank growth.

Stockholders equity decreased $46,970 during 2007 to $15,498,405 at December 31, 2007 from $15,545,375 at December 31, 2006 due to operational losses of $438,230 offset by increases from net unrealized gains on securities available-for-sale of $380,810 and exercised stock options of $10,450.

Stockholders equity decreased $316,877 during 2006 to $15,545,375 at December 31, 2006 from $15,862,252 at December 31, 2005 due to losses incurred by the Bank during 2006.

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A summary of the Bank s risk based capital analysis at December 31, 2007 and 2006 follows:

Risk Based Capital Analysis

(Dollars in Thousands)

	At December 31, 2007	2006
Tier 1 Capital:		
Common Stock	$ 9,006	$ 9,001
Additional Paid in Capital	8,833	8,827
Accumulated Deficit	(2,512)	(2,074)
Accumulated Other Comprehensive Income (Loss), Net	172	(209)
Sub total	$ 15,498	$ 15,545
Net Unrealized (Gain) Loss on Securities	(172)	209
Total Tier 1 Capital	$ 15,327	$ 15,754
Tier 2 Capital:		
Allowance for Loan Losses	$ 977	$ 605
Total Risk Based Capital	$ 16,304	$ 16,359
Risk-Weighted Assets	$ 96,453	$ 62,439

	2007	2006
Capital Ratios:		
Tier 1 Risk Based Capital Ratio	15.9%	25.3%
Total Risk Based Capital Ratio	16.9%	26.2%
Leverage ratio (Tier 1 capital to average assets)	12.8%	18.2%
Equity to total assets	12.7%	18.0%

Liquidity and Interest Rate Sensitivity

Liquidity is identified as the ability to generate or acquire sufficient amounts of cash when needed and at a reasonable cost to accommodate withdrawals, payments of debt, and increased loan demand. These events may occur daily or in other short-term intervals in the normal operation of business.

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The Bank s management, under the direction of the Asset/Liability Committee of the Board of Directors, continually reviews the mix of monetary assets and liabilities to ensure the Bank maintains an adequate level of liquidity at all times. This review ensures that the Bank s sources of funds, primarily net fluctuations in customer deposits, investments, securities and correspondent banking relationships, must be balanced with the Bank s obligations, commitments, and operational requirements, to maintain overall liquidity in conjunction with the maximization of interest rate spreads, the difference between interest income and interest expense rates, on a prudent basis that reflects expected changes in market interest rates.

Management prepares and analyzes reports and financial models to insure balancing and interest rate spreads occur according to Bank policies and objectives to minimize liquidity shocks, maximize the Bank s earnings and ultimately protect the Bank s capital. Management believes the Bank is able to meet its liquidity needs.

At December 31, 2007, the Bank had commitments to originate $20,012,947 of loans. Fixed commitments to incur capital expenditures were less than $25,000 at December 31, 2007. Certificates of deposit scheduled to mature in the 12 month period ending December 31, 2007 total $32,191,287. Management believes that a significant portion of such deposits will remain with the Bank. Management further believes that loan repayments and other sources of funds will be adequate to meet the Bank s foreseeable short-term and long-term liquidity needs.

Interest Rate Sensitivity

A financial institution can be exposed to several market risks that may impact its value or future earnings capacity of an organization. These risks include interest rate risk, foreign currency exchange risk, commodity price risk and equity market price risk. Our primary market risk is interest rate risk. Interest rate risk is inherent because as a financial institution, we derive a significant amount of our operating revenue from purchasing funds (customer deposits and possible borrowings) at various terms and rates. These funds are then invested into earning assets (loans and investments) at various terms and rates. This risk is further discussed below.

Interest rate risk is the exposure to fluctuations in our future earnings (earnings at risk) and value (value at risk) resulting from changes in interest rates. This exposure results from differences between the amounts of interest earning assets and interest bearing liabilities that reprice within a specific time period as a result of scheduled maturities and repayment and contractual interest rate changes.

The primary objective of our asset/liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent and appropriate. The goal is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

Management strives to control the exposure to interest rate volatility and operates under policies and guidelines established by the Board of Directors, who set the level of acceptable risk, by understanding, reviewing and making decisions based on our risk position. In addition, pricing, promotion and product development activities are assessed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest risk objectives. We use a variety of analytical systems and balance sheet tools to manage interest rate risk.

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Gap Analysis

Gap analysis tools monitor the gap between interest-sensitive assets and interest-sensitive liabilities. We use simulation modeling to forecast future balance sheet and income statement behavior. By studying the effects on net interest income of rising, stable and falling interest rate scenarios, we can position itself to take advantage of anticipated interest rate movements, by understanding the dynamic nature of our balance sheet components. We evaluate the securities, loans and deposit portfolios to manage our interest rate risk position.

The table Interest Sensitivity Gap Analysis indicates that, on a cumulative basis through twelve months, rate sensitive liabilities exceeded rate sensitive assets, resulting in an liability sensitive position at December 31, 2007 of $12 million for a cumulative gap ratio of (10.2)%, which benefits us in a rising rate environment. A liability interest sensitivity gap results when interest-sensitive liabilities exceed interest-sensitive assets for a specific repricing horizon . The gap is positive when interest-sensitive assets exceed interest-sensitive liabilities. For a bank with a positive gap rising interest rates would be expected to have a positive effect on net interest income and falling rates would be expected to have the opposite effect. The table below reflects the balances of interest earning assets and interest bearing liabilities at the earlier of their repricing or maturity dates. Amounts of fixed rate loans are reflected at the earlier of their contractual maturity date or their contractual repricing date. Time deposits are reflected in the deposits maturity dates. If we had borrowed funds, they would be are reflected in the earliest contractual repricing interval due to the immediately available nature of these funds. Interest bearing liabilities with no contractual maturity, such as interest bearing transaction accounts and savings deposits, are reflected in the earliest repricing interval due to contractual arrangements which give management the opportunity to vary the rates paid on these deposits within a thirty day or shorter period. However, we are under no obligation to vary the rates paid on those deposits within any given period. Fixed rate time deposits are reflected at their contractual maturity dates. Fixed rate advances are reflected at their contractual maturity dates, and variable rate advances are reflected in the earliest repricing interval since they were borrowed under the daily rate credit option, and reprice daily.

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Interest Sensitivity Gap Analysis

As of December 31, 2007

(in thousands)

	Floating(1)	1 3 Months	3 12 Months	1 3 Years	3 5 Years	5 15 Years	Total
Federal funds sold	$ 631	$	$	$	$	$	$ 631
US agency securities					3,000	12,723	