BAY NATIONAL CORP
Form 10QSB
August 13, 2004

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

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004.

Commission file number: 333-87781

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

Maryland	52-2176710
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2328 West Joppa Road, Lutherville, MD 21093
Address of principal executive offices

(410) 494-2580
Issuer's telephone number

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 ____

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

At August 13, 2004, the issuer had 1,866,460 shares of Common Stock outstanding.

Transitional Small Business Disclosure Format (Check One): Yes ____ No X__

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BAY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS
As of June 30, 2004 and December 31, 2003

	June 30, 2004	Decemb 200
	(Unaudited)	
ASSETS		
Cash and due from banks	$ 328,397	$ 57
Federal funds sold and other overnight investments	6,737,768	17,48
Loans held for sale	15,682,918	92
Investment securities available for sale (AFS) - at fair value	1,547,355	1,54
Other equity securities	532,290	48
Loans, net of unearned fees	117,922,938	101,39
Less: Allowance for credit losses	(1,474,000)	(1,26
Loans, net	116,448,938	100,12
Premises and equipment, net	651,270	63
Accrued interest receivable and other assets	790,466	55
Total Assets	$ 142,719,402	$ 122,32
LIABILITIES		
Non-interest-bearing deposits	$ 16,833,405	$ 14,27
Interest-bearing deposits	111,553,022	94,25
Total deposits	128,386,427	108,53
Short-term borrowings	1,550,000	1,22
Accrued expenses and other liabilities	482,092	50
Total Liabilities	130,418,519	110,26
STOCKHOLDERS' EQUITY		
Common stock - $.01 par value, authorized: 9,000,000 shares authorized, 1,862,710 issued and outstanding as of June 30, 2004 and December 31, 2003, respectively:	18,627	1
Surplus	16,850,834	16,85
Accumulated deficit	(4,568,578)	(4,80
Total Stockholders' Equity	12,300,883	12,06
Total Liabilities and Stockholders' Equity	$ 142,719,402	$ 122,32

See accompanying notes to consolidated financial statements.

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BAY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

For the three and six-month periods ended June 30, 2004 and 2003
(Unaudited)

	Three Months Ending June 30		Six Mont Jun
	2004	2003	2004
INTEREST INCOME:			
Interest and fees on loans	$ 1,708,501	$ 1,358,185	$ 3,239,145
Interest on federal funds sold and other overnight investments	26,557	29,782	52,499
Taxable interest and dividends on investment securities	14,890	13,947	19,785
Total interest income	1,749,948	1,401,914	3,311,429
INTEREST EXPENSE:			
Interest on deposits	567,247	494,850	1,075,684
Interest on short-term borrowings	3,532	3,989	6,440
Total interest expense	570,779	498,839	1,082,124
Net interest income	1,179,169	903,075	2,229,305
Provision for credit losses	104,000	138,000	213,721
Net interest income after provision for credit losses	1,075,169	765,075	2,015,584
NON-INTEREST INCOME:			
Service charges on deposit accounts	57,123	50,186	111,578
Gain on sale of mortgage loans	74,172	136,537	131,121
Other income	12,201	8,509	26,124
Total non-interest income	143,496	195,232	268,823
NON-INTEREST EXPENSES:			
Salaries and employee benefits	589,209	539,124	1,183,886
Occupancy expenses	73,194	66,349	143,015
Furniture and equipment expenses	68,467	53,431	122,570
Legal and professional fees	34,500	43,691	73,248

Data processing and other outside services	151,989	122,213	282,660
Advertising and marketing related expenses	41,476	83,820	84,974
Other expenses	86,523	76,368	159,671
Total non-interest expenses	1,045,358	984,996	2,050,024
Income (loss) before income taxes	173,307	(24,689)	234,383
Income tax benefit	-	-	--
NET INCOME (LOSS)	$ 173,307	$ (24,689)	$ 234,383
Per Share Data:			
Cash Dividends Paid	$ --	--	$
Net Income (Loss) (basic)	$ .09	$ (.01)	$ .13
Net Income (Loss) (diluted)	$ .09	$ (.01)	$ .12
Weighted Average shares outstanding (basic)	1,862,710	1,664,908	1,862,710
Effect of Dilution - Stock options and Warrants	71,040	-	62,272
Weighted Average shares outstanding (diluted)	1,933,750	1,664,908	1,924,982

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the six-months ended June 30, 2004 and 2003
(Unaudited)

	Common Stock	Additional Paid in Capital	Accumulated Deficit
Balances at December 31, 2003	$ 18,627	$ 16,850,834	$ (4,802,961) $
Net Income	-	-	234,383
Balances at June 30, 2004	$ 18,627	$ 16,850,834	$ (4,568,578) $

	Common Stock	Additional Paid in Capital	Accumulated Deficit
Balances at December 31, 2002	$ 12,420	$ 12,407,780	$ (4,810,542) $
Issuance of Common Stock	6,207	4,443,054	-
Net Loss	-	-	(231,090)
Balances at June 30, 2003	$ 18,627	$ 16,850,834	$ (5,041,632) $

See accompanying notes to consolidated financial statements.

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BAY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six-months ended June 30, 2004 and 2003
(Unaudited)

	2004
Cash Flows From Operating Activities	
Net income (loss)	$ 234,383
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:	
Depreciation	94,683
Accretion of investment discounts	(7,192)
Provision for credit losses	213,721
Gain on sale of loans held for sale	(131,121)
Origination of loans held for sale	(48,737,479)
Proceeds from sale of loans	34,109,507
Net increase in accrued interest receivable and other assets	(238,115)
Net decrease in accrued expenses and other liabilities	(26,763)
Net cash (used) provided by operating activities	(14,488,376)

Cash Flows From Investing Activities	
Purchases of investment securities - AFS	(2,992,365)
Maturities of investment securities - AFS	3,000,000
Purchase of Federal Home Loan Bank of Atlanta stock	(51,200)
Loan disbursements in excess of principal payments	(16,537,184)
Capital expenditures	(108,341)
Net cash used by investing activities	(16,689,090)
Cash Flows From Financing Activities	
Net increase in deposits	19,855,526
Net increase in short-term borrowings	328,000
Net proceeds from stock issuance	-
Net cash provided by financing activities	20,183,526
Net (decrease) increase in cash and cash equivalents	(10,993,940)
Cash and cash equivalents at beginning of period	18,060,105
Cash and cash equivalents at end of period	$ 7,066,165
Cash paid for:	
Interest	$ 1,054,894
Income taxes	$ --

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. GENERAL

Organization

Bay National Corporation (the "Company") was incorporated on June 3, 1999 under the laws of the State of Maryland to operate as a bank holding company of a national bank with the name Bay National Bank (the "Bank"). On May 12, 2000, the Company purchased all the shares of common stock issued by the Bank. The Bank commenced operations on May 12, 2000 after successfully meeting the conditions of the Office of the Comptroller of the Currency (the "OCC") to receive its charter authorizing it to commence operations as a national bank,

and obtaining the approval of the Federal Deposit Insurance Corporation to insure its deposit accounts, and meeting certain other regulatory requirements.

Basis of Presentation

The accompanying consolidated financial statements include the activity of Bay National Corporation and its wholly owned subsidiary, Bay National Bank. All significant intercompany transactions and balances have been eliminated in consolidation.

The foregoing consolidated financial statements are unaudited; however, in the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. The balances as of December 31, 2003 have been derived from audited financial statements. These statements should be read in conjunction with the financial statements and accompanying notes included in Bay National Corporation's 2003 Annual Report on Form 10-KSB. There have been no significant changes to the Company's Accounting Policies as disclosed in the 2003 Annual Report. The results shown in this interim report are not necessarily indicative of results to be expected for the full year 2004.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America.

Reclassifications

Certain reclassifications have been made to amounts previously reported to conform to the current presentation. These reclassifications had no effect on previously reported results of operations or accumulated deficit.

2. REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital 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 weighting and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios. Management believes, as of June 30, 2004, that the Bank meets all capital adequacy requirements to which it is subject.

As of June 30, 2004, the Bank has been categorized as "Well Capitalized" by the OCC under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios.

3. INCOME TAXES

The Company uses the liability method of accounting for income taxes as

required by SFAS No. 109, "Accounting for Income Taxes." Under the liability method, deferred-tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse. Deferred income taxes will be recognized when it is deemed more likely than not that the benefits of such deferred income taxes will be realized; accordingly, no deferred income taxes or income tax benefits have been recorded by the Company.

4. EARNINGS PER SHARE

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, including any potential dilutive common shares outstanding, such as options and warrants.

For the three and six month periods ended June 30, 2003, the effect of incremental shares from options and warrants of 204,156 have been excluded from diluted weighted average shares as the effect would have been antidilutive.

5. STOCK-BASED COMPENSATION

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" (SFAS No. 148), and applies Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock option plan. No compensation expenses related to the Company's stock option plan were recorded during the three-month and six-month periods ended June 30, 2004 and 2003.

The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123 and SFAS No. 148 to stock-based employee compensation for the three-month and six-month periods ended June 30:

	Three Months Ending June 30		Six Month June
	2004	2003	2004
INTEREST INCOME:			
Net income (loss), as reported	$ 173,307	$ (24,689)	$ 234,383
Less pro forma stock-based compensation expense determined under the fair value method	(56,063)	(50,527)	(71,672)

Pro forma net income (loss)	$ 117,244	$ (75,216)	$ 162,711
Net income (loss) per share:			
Basic - as reported	$ .09	$ (.01)	$ .13
Diluted - as reported	$ .09	$ (.01)	$ .12
Basic - pro forma	$ .06	$ (.05)	$ .09
Diluted - pro forma	$ .06	$ (.05)	$ .08

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis provides an overview of the financial condition and results of operations of Bay National Corporation (the "Parent") and its national bank subsidiary, Bay National Bank (the "Bank"), collectively (the "Company"), as of June 30, 2004 and December 31, 2003 and for the three-month and six-month periods ended June 30, 2004 and 2003.

General

On May 12, 2000 the Parent became a bank holding company by purchasing all of the common stock of the Bank. The Bank opened its first office on May 12, 2000 and its second office on May 26, 2000.

The Bank was formed to serve the business communities of North Baltimore and Salisbury, Maryland.

Overview

The Company continued a pattern of strong growth during the three-month and six-month periods ended June 30, 2004. This growth has resulted in improved operating results as compared to prior periods. Key measurements for the three-month and six-month periods ended June 30, 2004 include the following:

- Total assets at June 30, 2004 increased by 16.67% to $142.7 million as compared to $122.3 million as of December 31, 2003.

- Net loans outstanding increased by 16.30% from $100.1 million as of December 31, 2003 to $116.4 million as of June 30, 2004.

- There were no nonperforming loans at June 30, 2004; however, appropriate reserves for loan losses continue to be maintained.

- Deposits at June 30, 2004 were $128.4 million, an increase of $19.9 million or 18.29% from December 31, 2003.

- The Company realized net income of $173,307 and $234,383 for the three-month and six-month periods ended June 30, 2004. This compares to losses of $24,689 and $231,090 for the three-month and six-month periods ended June 30, 2003.

- Net interest income, the Company's main source of income, was $1.2 million and $2.2 million during the three-month and six-month periods

ended June 30, 2004 compared to $903,075 and $1.6 million for the same periods in 2003. This represents increases of 30.57% and 36.63% for the three-months and six-months ended June 30, 2004 as compared to the same periods in 2003.

- Loan charge-offs were $6,221 for the six-month period ended June 30, 2004. There were no charge-offs for the same period in 2003.

- Non-interest income declined by $51,736 and $58,121, or 26.50% and 17.78%, for the three-month and six-month periods ended June 30, 2004, as compared to the three-month and six-month periods ended June 30, 2003.

- Non-interest expenses increased by $60,362 or 6.13%, and $167,854 or 8.92% for the three-month and six-month periods ended June 30, 2004, as compared to the same periods ended June 30, 2003.

- The market price of common shares ended the quarter at $12.00, up 18.81% from the closing price of $10.10 on December 31, 2003.

A detailed discussion of the factors leading to these changes can be found in the discussion below.

Results of Operations

Overview

The Company recorded net income of $173,307 and $234,383 for the three-month and six-month periods ended June 30, 2004. This compares to net losses of $24,689 and $231,090 for the same periods in 2003. This is an improvement of $197,996 for the three-month period and $465,473 for the six-month period. This significant improvement in results for the periods is due to the continued strong growth of the loan portfolio, which reached the levels necessary to generate sufficient net interest income to cover operating expenses. The losses incurred in the first half of 2003 were expected since loan and deposit growth initially were not expected to produce net interest income sufficient to cover operating expenses. On average, community banks do not achieve profitability for the first 24 to 36 months of operation. The Company achieved marginal monthly profitability for the month of June 2003, its 37th full month of operations. This milestone was achieved during a very challenging economic environment in which interest margins have been compressed by historically low interest rates.

Bay National Bank's mortgage division, based in Salisbury, Maryland, originates conventional first and second residential mortgage loans. Bay National Bank sells most of its first and second residential mortgage loans in the secondary market and typically recognizes a gain on the sale of these loans after the payment of commissions to the loan origination officer. Since its inception in February 2001, the mortgage division has been a significant contributor to operating results. For the three-month periods ended June 30, 2004 and 2003, gains on the sale of mortgage loans totaled $74,172 and $136,537, respectively. For the six-month period ended June 30, 2004 and 2003, gains on the sale of mortgage loans totaled $131,121 and $218,516, respectively. The level of gains on the sale of mortgage loans has declined in 2004 due to the strengthening of economic conditions and the resulting increase in long-term

interest rates as compared to the rates in effect during the first half of 2003. An increase in rates traditionally has a negative impact on mortgage loan production due to a reduction in the incentive for borrowers to refinance existing mortgages or purchase new homes.

During the second quarter of 2004, the Company introduced a new loan program for conventional first and second residential mortgage loans. Under this program the Company purchases a 100% participation in mortgage loans originated by a mortgage company in the Baltimore metropolitan area. These participations are for loans that a secondary market investor has committed to purchase. The participations are typically held for a period of three to four weeks before being sold to the secondary market investor. This holding period represents the amount of time taken by the secondary market investor to review the loan files for completeness and accuracy. The Company earns interest on these loans at a rate indexed to the prime rate. The primary risk to the Company is that the secondary market investor may decline to purchase the loans due to documentary deficiencies or errors. The Company attempts to manage this risk by conducting a thorough review of the documentation prior to purchasing the participation. If the secondary market investor declined to purchase the loan, the Company could attempt to sell the

loan to other investors or could hold the loan in its loan portfolio. As of June 30, 2004 the Company held $14.7 million of these loans which were classified as held for sale. The Company earned $70,633 of interest on this program for the three-month period ended June 30, 2004.

Management expects continued improvement in operating results over the remainder of 2004; however, actual results will be subject to the volatility of the provision for credit losses, which is related to loan growth, and the volatility of mortgage loan production, which is sensitive to economic and interest rate fluctuations.

Net Interest Income

Net interest income is the difference between income on assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans, investments, and federal funds sold. Interest-bearing deposits and other short-term borrowings make up the cost of funds. Non-interest bearing deposits and capital are also funding sources. Changes in the volume and mix of earning assets and funding sources along with changes in associated interest rates determine changes in net interest income.

As previously stated, net interest income was $1.2 million and $2.2 million during the three-month and six-month periods ended June 30, 2004 compared to $903,075 and $1.6 million for the same periods in 2003. This represents increases of 30.57% and 36.63% for the three-month and six-months ended June 30, 2004 as compared to the same periods in 2003.

Interest income from loans and investments for the three-month and six-month periods ended June 30, 2004 was $1,749,948 and $3,311,429, respectively, compared to $1,401,914 and $2,571,246 for the three-month and six-month periods ended June 30, 2003. The 24.83% and 28.79% increase over the same periods in 2003 is directly related to the 34.36% increase in average interest-earning assets for the six-months ended June 30, 2004 as compared to the same period in 2003. The increase in average earning assets was somewhat offset by declines in average yields due to a declining interest rate environment. The yields on these assets declined from 5.27% for the six months

ended June 30, 2003 to 5.05% for the six months ended June 30, 2004.

The percentage of average interest-earning assets represented by loans was 86.87% and 85.26% for the six-month periods ended June 30, 2004 and 2003, respectively. Stability in the percentage of interest-earning assets represented by the loan portfolio would normally be expected to result in stability in average yields on interest-earning assets. However, loan yields have declined as a result of actions taken by the Federal Reserve to reduce its target for the federal funds rate from 1.25% at December 31, 2002 to 1.00% effective June 25, 2003. For the six-month period ended June 30, 2004, the average yield on the loan portfolio decreased to 5.69% from 6.02% for the six-month period ended June 30, 2003. This decrease is primarily due to the difference in the target federal funds rate in effect for the periods. The Federal Reserve increased its target for the federal funds rate to 1.25% effective June 30, 2004 and then increased the target to 1.50% effective August 10, 2004. These increases had no effect on the Company's results for the three-month and six-month periods ended June 30, 2004.

The average yield on the investment portfolio, including overnight investments, was .84% for the six-month period ended June 30, 2004 as compared to .96% for the same period in 2003. The decline in the average yields was a direct result of the Federal Reserve actions discussed above, which was somewhat offset by an increase in the holdings of Federal Reserve and Federal Home Loan bank stocks, which pay dividend yields that are higher than the prevailing federal funds rates. The percentage of average interest-earning assets represented by investments was 13.13% and 14.74% for the six-month periods ended June 30, 2004 and 2003, respectively.

Interest expense from deposits and short-term borrowings for the three-month and six-month periods ended June 30, 2004 was $570,779 and $1,082,124, respectively. This compares to $498,839 and $939,610 for the comparable periods in 2003. The 14.42% and 15.17% increases over the three and six month periods in 2003 are a result of the 33.68% increase in average interest-bearing liabilities for the six-month period ended June 30, 2004 as compared to the same period in 2003. The increase in average interest-bearing liabilities was significantly offset by declines in average rates paid due to the declining interest rate environment. The average rates paid on these liabilities declined from 2.41% for the six-month period ended June 30, 2003 to 2.08% for the six-month period ended June 30, 2004.

The following tables set forth, for the periods indicated, information regarding the average balances of interest-earning assets and interest-bearing liabilities, the amount of interest income and interest expense and the resulting yields on average interest-earning assets and rates paid on average interest-bearing liabilities. Average balances are also provided for non-interest-earning assets and non-interest-bearing liabilities.

	Six Months Ended June 30, 2004	
	Average	Interest

	Balance	and fees
ASSETS		
Loans	$ 113,905,280	$ 3,239,145
Investment Securities	1,991,440	19,785
Federal funds sold and other overnight investments	15,227,504	52,499
Total Earning Assets	131,124,224	3,311,429
Less: Allowance for credit losses	(1,354,026)	
Cash and due from banks	804,855	
Premises and equipment, net	654,798	
Accrued interest receivable and other assets	518,384	
Total Assets	$ 131,748,235	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 42,164,785	218,923
Regular savings deposits	3,700,434	11,984
Time deposits	56,924,186	844,777
Short-term borrowings	1,340,357	6,440
Total interest-bearing liabilities	104,129,762	1,082,124
Non-interest-bearing demand deposits	15,018,908	
Accrued expenses and other liabilities	435,452	
Stockholders' equity	12,164,113	
Total Liabilities and Stockholders' Equity	$ 131,748,235	
Net interest income and spread		$ 2,229,305
Interest and fee income/earning assets	5.05 %	
Interest expense/earning assets	1.65	
Net interest margin	3.40 %	

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Six Months Ended June 30, 2003

	Average Balance	Interest and fees
ASSETS		
Loans	$ 83,200,358	$ 2,502,510
Investment Securities	1,650,873	17,907

Federal funds sold and other overnight investments	12,738,004	50,829
Total Earning Assets	97,589,235	2,571,246
Less: Allowance for credit losses	(983,751)	
Cash and due from banks	824,963	
Premises and equipment, net	699,558	
Accrued interest receivable and other assets	416,012	
Total Assets	$ 98,546,017	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 30,479,387	189,404
Regular savings deposits	2,406,317	8,819
Time deposits	43,969,773	735,562
Short-term borrowings	1,039,536	5,825
Total interest-bearing liabilities	77,895,013	939,610
Non-interest-bearing demand deposits	10,626,935	
Accrued expenses and other liabilities	321,354	
Stockholders' equity	9,702,715	
Total Liabilities and Stockholders' Equity	$ 98,546,017	
Net interest income and spread		$ 1,631,636
Interest and fee income/earning assets	5.27 %	
Interest expense/earning assets	1.93	
Net interest margin	3.34 %	

Provision for Credit Losses

The provision for credit losses was $104,000 and $213,721 for the three-month and six-month periods ended June 30, 2004, as compared to $138,000 and $307,500 for the three-month and six-month periods ended June 30, 2003. The provisions for each period were the direct result of growth in loan balances outstanding in all segments of the portfolio. The provisions for the three-month and six-month periods ended June 30, 2004 were lower than the same periods in the prior year due to fact that gross loans outstanding increased by approximately $16.5 million during the six months ended June 30, 2004 as compared to an increase of approximately $20.0 million for the same period in 2003. The fluctuations are reflective of the high concentration of revolving credit facilities in the loan portfolio and the unpredictable nature of customer needs to draw on these facilities. For additional information regarding the methodology used to determine the provision for credit losses see the Management Discussion and Analysis section entitled "Allowance for Credit Losses and Credit Risk Management."

Non-Interest Income

Non-interest income consists primarily of gains on the sale of mortgage loans, deposit account service charges and cash management fees. For the

three-month period ended June 30, 2004, the Company realized non-interest income in the amount of $143,496 as compared to $195,232 for the three-month period ended June 30, 2003. Gains on the sale of mortgage loans of $74,172 comprise 51.69% of the total for the three-month period ended June 30, 2004. This

compares to gains on the sale of mortgage loans of $136,537, or 69.94% of total non-interest income, for the three-month period ended June 30, 2003.

For the six-month period ended June 30, 2004, the Company realized non-interest income in the amount of $268,823 as compared to $326,944 for the six-month period ended June 30, 2003. Gains on the sale of mortgage loans of $131,121 comprised 48.78% of the total for the six-month period ended June 30, 2004. This compares to gains on the sale of mortgage loans of $218,516, or 66.84% of total non-interest income, for the six-month period ended June 30, 2003.

The level of gains on the sale of mortgage loans has declined due to recent increases in long-term interest rates driven by stronger economic conditions. Additional increases in interest rates, or a slow down in the housing market, could further impact the Company's ability to maintain the same level of income associated with mortgage loan production.

Service charges on deposit accounts totaled $57,123 and $111,578 for the three-month and six-month periods ended June 30, 2004, as compared to $50,186 and $90,752 for the three-month and six-month periods ended June 30, 2003. The increases of 13.82% and 22.95% for the three and six-month periods as compared to the same periods in 2003 can be directly attributed to the ongoing growth in the Company's deposit portfolio.

The Company will continue to seek ways to expand its sources of non-interest income. In the future, the Company may enter into fee arrangements with strategic partners that offer investment advisory services, risk management and employee benefit services. No assurance can be given that such fee arrangements will be obtained or maintained.

Non-Interest Expense

Non-interest expense for the three-month and six-month periods ended June 30, 2004, totaled $1,045,358 and $2,050,024, respectively. This compares to non-interest expense for the comparable periods in 2003 of $984,996 and $1,882,170, respectively. The increase of $167,854, or 8.92%, for the six-month period resulted from an increase in salaries and benefits of $129,594 related to staffing growth to increase marketing efforts, manage the growth of the loan and deposit portfolios, and support increased operational volume. Occupancy expenses increased by $15,651, or 12.29%, for the six-months ended June 30, 2004 as compared to the same period in 2003. This increase was due to scheduled rent increases as well as a reduction in sublease income of approximately $3,500 due to expansion of the Company's corporate office into previously sublet space and $8,200 of rental expense associated with new space obtained to facilitate the expansion of the Company's corporate offices. The $24,203, or 9.36%, increase in data processing and other outside services for the six-months ended June 30, 2004 as compared to the same period in 2003 is the result of increased data and item processing costs paid to external service providers. These costs are volume-driven based upon the number of customer accounts and related transaction volume. As a result, these costs increase with the growth of the Company. The $36,370, or 29.97%, decrease in advertising and marketing-related expenses for

the six-months ended June 30, 2004 as compared to the same period in 2003 is related to a reduction in the number of events and marketing campaigns conducted. This reduction was made possible through the use of less costly marketing methods and through the success of prior campaigns which increased the visibility of the Bank in its markets. The increase of $34,776, or 10.84%, in all other expenses relates to various costs associated with the increased size and complexity of the Company.

Non-interest expense for the three-month period ended June 30, 2004 increased by $60,362, or 6.13%, as compared to the same period for the prior year. The increase is directly attributable to the same factors that resulted in the increase for the comparable six-month periods.

The rate of increase in non-interest expenses is substantially less than the 33.69% increase in average assets for the six-month period ended June 30, 2004 as compared to average assets for the six-month period ended June 30, 2003. Management believes this indicates that the Company is continuing to effectively leverage its cost structure to generate profitable growth. While management expects that the ongoing growth of the Company's customer base will continue to require additional staffing in order to service customers and manage the business properly, management believes that additional growth in the customer base can continue to be accomplished without proportionate increases in these costs.

Financial Condition

Composition of the Balance Sheet

As of June 30, 2004, total assets were $142,719,402. This represents growth of $20,391,146 or 16.67% since December 31, 2003. The growth in total assets included increases of $14,759,093 in loans held for sale, $51,200 in other equity securities, $16,323,463 in loans net of the allowance for credit losses and $251,773 in other non-earning assets. These increases were offset by decreases of $244,727 in cash and due from banks, $10,749,213 in federal funds sold and other overnight investments and $443 in investment securities available for sale.

During the second quarter of 2004, the Company introduced a new loan program for conventional first and second residential mortgage loans. Under this program the Company purchases a 100% participation in mortgage loans originated by a mortgage company in the Baltimore metropolitan area. These participations are for loans that a secondary market investor has committed to purchase. The participations are typically held for a period of three to four weeks before being sold to the secondary market investor. The Company earns interest on these loans at a rate indexed to the prime rate. As of June 30, 2004, the Company held $14.7 million of these loans which were classified as held for sale.

As of June 30, 2004, loans, excluding loans held for sale (net of a $1,474,000 allowance for credit losses), totaled $116,448,938. The increase of 16.30%, from a balance of $100,125,475 as of December 31, 2003, is a continuation of the growth trend established in prior periods. The Company continues to emphasize prudent growth through the hiring of experienced commercial lenders, and the development and use of referral sources including accountants, lawyers and existing customers, as well as members of the Board of Directors and the Baltimore and Salisbury Advisory Boards.

The composition of the loan portfolio as of June 30, 2004 was approximately $70.0 million of commercial loans, $3.9 million of consumer loans, and $44.0 million of real estate loans (excluding mortgage loans held for sale). The composition of the loan portfolio as of December 31, 2003 was approximately $61.9 million of commercial loans, $1.7 million of consumer loans, and $37.8 million of real estate loans (excluding mortgage loans held for sale). There were $15.7 million and $923,825 of mortgage loans held for sale as of June 30, 2004 and December 31, 2003, respectively.

Funds not extended in loans are invested in cash and due from banks, federal funds sold and other overnight investments, and short-term U.S. Treasury securities. At June 30, 2004, the Company had federal funds sold and other overnight investments totaling $6,737,768 as compared to $17,486,981 as of December 31, 2003. The decline in investments is related to the allocation of liquid funds to the new first and second residential mortgage loan program discussed above. These loans are highly liquid but provide a significantly higher yield than federal funds sold and other overnight investments. Management has made a decision to maintain an appropriate level of liquidity in the investment portfolio in order to ensure that funds are readily available to fund the growth of the loan portfolio and to meet the needs of deposit customers.

The Company held $312,690 of Federal Reserve Bank stock at June 30, 2004 and December 31, 2003, respectively. The Company also held Federal Home Loan Bank of Atlanta stock of $219,600 and $168,400 as of June 30, 2004 and December 31, 2003, respectively, and United States Treasury bills with a maturity value of $1,550,000 as of both June 30, 2004 and December 31, 2003. The Treasury securities are used to collateralize repurchase agreements which are classified as short-term borrowings under which $1,550,000 and $1,222,000 were outstanding as of June 30, 2004 and December 31, 2003, respectively. The growth in assets was funded by deposit growth of $19,855,526, or 18.29%, and an increase in short-term borrowings of $328,000.

Deposits at June 30, 2004 were $128,386,427, of which $7,414,461, or 5.78% are related to two customers in one industry. Deposits at December 31, 2003 were $108,530,901, of which deposits for these same customers stood at $7,749,590 or 7.14% of total deposits. The deposits for these customers tend to fluctuate significantly; as a result, management monitors these deposits on a daily basis to ensure that liquidity levels are adequate to compensate for these fluctuations. The deposit growth resulted from the continued marketing efforts of officers and directors, direct mail campaigns and the listing of money market and certificate of deposit rates in print publications and on the Internet. Management has set the interest rates paid on deposits to be competitive in the market and will continue its marketing activities to generate growth in deposits.

The market in which the Company operates is very competitive; therefore, the rates of interest paid on deposits are affected by rates paid by other depository institutions. Management closely monitors rates offered by other institutions and seeks to be competitive within the market. The Company has chosen to selectively compete for large certificates of deposits. The Company will choose to pursue such deposits when expected loan growth provides for adequate spreads to support the cost of those funds. As of June 30, 2004, the Company had outstanding certificates of deposit of approximately $30.1 million that were obtained through the listing of certificate of deposit rates on two Internet-based listing services (such deposits are sometimes referred to herein as national market certificates of deposit). These certificates of

deposit were issued with an average yield of 2.70% and an average term of 27.4 months. Included in the $30.1 million of Internet-originated certificates of deposit is $593,374 that has been classified as "Brokered Deposits" for bank regulatory purposes. These "Brokered Deposits" were issued in average amounts of approximately $98,896 with an average yield of 3.79% and an average term of 33.05 months. As of December 31, 2003, the total certificates of deposit obtained through the listing of certificate of deposit rates on the Internet-based listing services were approximately $25 million, of which $790,157 were classified as "Brokered Deposits." The Company has never paid broker fees for deposits. Additionally, the Company has not accepted any new "Brokered Deposits" since August 2002.

Core deposits, which management categorizes as all deposits other than national market certificates of deposit and all but $2.0 million of deposits from the two large customers described above (which management considers to be a stable deposit amount from these customers based upon historical trends), stood at $92,852,213 as of June 30, 2004, up 19.44% from $77,742,030 as of December 31, 2003. Core deposits are closely monitored by management because they consider such deposits not only a relatively stable source of funding but also reflective of the growth of commercial and consumer depository relationships.

Short-term borrowings consist of repurchase agreements collateralized by pledges of U.S. Government Treasury Securities, based upon their market values, equal to 100% of the principal and accrued interest of its short-term borrowings. The outstanding balance of short-term borrowings increased from $1,222,000 at December 31, 2003 to $1,550,000 at June 30, 2004, due to increases in the balance of available funds of the customers participating in this program.

Total stockholders' equity at June 30, 2004 was $12,300,883 as compared to $12,066,500 at December 31, 2003. The increase in stockholders' equity is a result of the positive operating results for the six months ended June 30, 2004. Management believes that this level of capital is adequate to support expected asset growth for at least the next 12 months.

Allowance for Credit Losses and Credit Risk Management

Originating loans involves a degree of risk that credit losses will occur in varying amounts according to, among other factors, the type of loans being made, the credit-worthiness of the borrowers over the term of the loans, the quality of the collateral for the loan, if any, as well as general economic conditions. The Company charges the provision for credit losses to earnings to maintain the total allowance for credit losses at a level considered by management to represent its best estimate of the losses known and inherent in the portfolio that are both probable and reasonable to estimate, based on, among other factors, prior loss experience, volume and type of lending conducted, estimated value of any underlying collateral, economic conditions (particularly as such conditions relate to Bay National Corporation's market area), regulatory guidance, peer statistics, management's judgment, past due loans in the loan portfolio and concentrations of risk (if any). The Company charges losses on loans against the allowance when it is believed that collection of loan principal is unlikely. Recoveries on loans previously charged off are added back to the allowance.

Management uses a loan grading system where all loans are graded based upon management's evaluation of the risk associated with each loan. A factor,

based on the loan grading, is applied to the loan balance to reserve for potential losses. In addition, management judgmentally establishes an additional nonspecific reserve. The nonspecific portion of the allowance reflects management's estimate of probable inherent, but undetected losses, within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates and risk factors that have not yet manifested themselves in loss allocation factors.

The reserve factors used are based on management's judgment as to appropriate reserve percentages for various categories of loans, and adjusting those values based on the following: historical losses in each category; historical and current delinquency in each category; underwriting standards in each category; comparison of losses and delinquencies to peer group performance; and an assessment of the likely impact of economic and other external conditions on the performance of each category.

A test of the adequacy of the allowance for credit losses is performed and reported to the Board of Directors on a monthly basis. Management uses the information available to make a determination with respect to the allowance for credit losses, recognizing that the determination is inherently subjective and that future adjustments may be necessary depending upon, among other factors, a change in economic conditions of specific borrowers, or generally in the economy, and new information that becomes available. However, there are no assurances that the allowance for credit losses will be sufficient to absorb losses on nonperforming assets, or that the allowance will be sufficient to cover losses on nonperforming assets in the future.

The allowance for credit losses as of June 30, 2004 and December 31, 2003 was $1,474,000 and $1,266,500, respectively. The amount equates to 1.25% of outstanding loans, net of loans held for sale, as of June 30, 2004 and December 31, 2003. This percentage has remained consistent because no additional information has indicated that the overall level of reserves is inappropriate. Bay National Corporation has no exposure to foreign countries or foreign

borrowers. Management believes that the allowance for credit losses is adequate for each period presented.

As of June 30, 2004 the Company had no loans that were more than 90 days past due. The Company has no loans that are classified as non-accrual loans as of June 30, 2004. The Company had loan charge-offs of $6,221 during the six-months ended June 30, 2004 with no charge-offs occurring during the three-months ended June 30, 2004. These charge-offs were the first losses incurred since the Company's inception in 2000.

Liquidity and Interest Rate Sensitivity

The Company's principal sources of liquidity are cash and assets that can be readily converted into cash, including investment securities, and loans held for sale which can be liquidated in a timeframe which is usually less than 30 days. The Company also has commitments for a total of $4.0 million of borrowing availability under unsecured Federal funds lines of credit with two separate financial institutions, and approximately $9.0 million of borrowing capacity with the Federal Home Loan Bank of Atlanta. The credit facilities can be used in conjunction with the normal deposit strategies, which include pricing

changes to increase deposits as necessary.

As of June 30, 2004, the Company had $328,397 in cash and due from banks, and $6,737,768 in federal funds sold and other overnight investments. This represents a decrease in liquid assets of $10,993,940, or 60.87%, since December 31, 2003, at which time liquid assets consisted of $573,124 in cash and due from banks, and $17,486,981 in federal funds sold and other overnight investments. The decrease in the overall level of liquid assets is the result of the funding of the previously discussed loan program for conventional first and second residential mortgage loans, and the availability of the previously discussed borrowing facilities which have allowed management to carry lower levels of cash and overnight investments.

The Company has sufficient liquidity to meet its loan commitments as well as fluctuations in deposits. The Company will choose to retain maturing certificates of deposit, when necessary, by offering competitive rates. Management is not aware of any demands, trends, commitments, or events that would result in the Company's inability to meet anticipated or unexpected liquidity needs.

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary earnings component, net interest income. Net interest income can fluctuate with significant interest rate movements. To minimize the risk associated with these rate swings, management works to structure the Company's balance sheet so that the ability exists to adjust pricing on interest-earning assets and interest-bearing liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

The measurement of the Company's interest rate sensitivity, or "gap," is one of the principal techniques used in asset/liability management. The interest sensitive gap is the dollar difference between assets and liabilities subject to interest rate pricing within a given time period, including both floating rate or adjustable rate instruments and instruments which are approaching maturity.

The following table sets forth the amount of the Company's interest-earning assets and interest-bearing liabilities as of June 30, 2004, which are expected to mature or reprice in each of the time periods shown:

			Maturity or repricing within		
	Amount	Percent of Total	0 to 3 Months	4 to 12 Months	1 to 5 Years
Interest-earning assets					
Federal funds sold and other overnight investments	$ 6,737,768	4.73%	$ 6,737,768	$ -	$ -
Loans held for sale	15,682,918	11.01	15,682,918		
Loans - Variable rate	82,567,589	57.97	82,567,589	-	-
Loans - Fixed rate	35,355,349	24.83	2,819,666	6,752,018	24,570,00

Other earning assets	2,079,645	1.46	1,547,355	-	-
Total interest-earning assets	$142,423,269	100.00%	$109,355,296	$ 6,752,018	$24,570,00
Interest-bearing liabilities					
Deposits - Variable rate	$50,969,488	45.06%	$50,969,488	$ -	$ -
Deposits - Fixed rate	60,583,534	53.57	8,572,330	25,025,621	26,985,58
Short-term borrowings - Variable rate	1,550,000	1.37	1,550,000	-	-
Total interest-bearing liabilities	$113,103,022	100.00%	$61,091,818	$25,025,621	$26,985,58
Periodic repricing differences					
Periodic gap			$48,263,478	$(18,273,603)	$(2,415,57
Cumulative gap			$48,263,478	$ 29,989,875	$27,574,29
Ratio of rate sensitive assets to rate sensitive liabilities			179.00%	26.98%	91.05

The Company has 73.71% of its interest-earning assets and 46.43% of its interest-bearing liabilities in variable rate balances. Interest-earning assets exceed interest-bearing liabilities by $29,320,247. The majority of this gap is concentrated in items maturing or repricing within 12 months. This gap is generally reflective of the Company's emphasis on originating variable rate loans, and the demand in the market for higher yielding fixed rate deposits. This analysis indicates that the Company generally will benefit from increasing market rates of interest. However, since all interest rates and yields do not adjust at the same pace, the gap is only a general indicator of interest rate sensitivity. The analysis of the Company's interest-earning assets and interest-bearing liabilities presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration the fact that changes in interest rates do not affect all assets and liabilities equally. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities.

Management constantly monitors and manages the structure of the Company's balance sheet, seeks to control interest rate exposure, and evaluate pricing strategies. Strategies to better match maturities of interest-earning assets and interest-bearing liabilities include structuring loans with rate floors and ceilings on variable-rate notes and by providing for repricing opportunities on fixed rate notes. Management believes that a lending strategy focusing on variable-rate loans and short-term fixed rate loans will best facilitate the goal of minimizing interest rate risk. However, management will opportunistically enter into longer term fixed-rate loans and/or investments when, in management's judgment, rates adequately compensate the Company for the interest rate risk. The Company's current investment concentration in federal funds sold and other overnight

investments provides the most flexibility and control over rate sensitivity since it generally can be restructured more quickly than the loan portfolio. On the liability side, deposit products can be restructured so as to offer incentives to attain the maturity distribution desired although competitive factors sometimes make control over deposit maturity difficult.

In theory, maintaining a nominal level of interest rate sensitivity can diminish interest rate risk. In practice, this is made difficult by a number of factors, including cyclical variation in loan demand, different impacts on interest sensitive assets and liabilities when interest rates change, and the availability of funding sources. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments primarily include commitments to extend credit, lines of credit and standby letters of credit. The Company uses these financial instruments to meet the financing needs of its customers. These financial instruments involve, to varying degrees, elements of credit, interest rate, and liquidity risk.

Outstanding loan commitments and lines and letters of credit as of June 30, 2004 and December 31, 2003 are as follows:

	June 30 2004	December 31 2003
Loan commitments	$ 7,031,595	$ 11,458,333
Unused lines of credit	39,874,839	32,234,145
Letters of credit	2,038,001	2,167,501

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 interest rates fixed at current market amounts, fixed expiration dates or other termination clauses and may require payment of a fee. Unused lines of credit represent the unused portion of lines of credit previously extended and available to the customer as long as there is no violation of any contractual condition. These lines generally have variable interest rates. Since many of the commitments are expected to expire without being drawn upon, and since it is unlikely that customers will draw upon their line of credit in full at any time, the total commitment amount or line of credit amount does not necessarily represent future cash requirements. The Company is not aware of any loss it would incur by funding its commitments or lines of credit.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the customer is the contract amount of the commitment.

In general, loan commitments, lines of credit and letters of credit are made on the same terms, including with respect to collateral, as outstanding loans. Each customer's credit-worthiness and the collateral required is evaluated on a case-by-case basis.

The increase in the overall level of loan commitments and unused lines of credit as of June 30, 2004 as compared to loan commitments and unused lines

of credit as of December 31, 2003, is a direct result of the same marketing activities that resulted in the 16.30% increase in outstanding loans.

Capital Resources

The Company had stockholders' equity at June 30, 2004 of $12,300,883 as compared to $12,066,500 at December 31, 2003. The increase in capital is a result of the positive operating results for the six-month period ended June 30, 2004. The Company has declared no cash dividends since its inception.

Banking regulatory authorities have implemented strict capital guidelines directly related to the credit risk associated with an institution's assets. Banks and bank holding companies are required to maintain capital levels based on their "risk adjusted" assets so that categories of assets with higher "defined" credit risks will require more capital support than assets with lower risks. The Bank has exceeded its capital adequacy requirements to date.

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Regulatory approval is required to pay dividends that exceed the Bank's net profits for the current year plus its retained net profits for the preceding two years. The Bank could not have paid dividends to the Company without approval from bank regulatory agencies at June 30, 2004.

Reconciliation of Non-GAAP Measures

Below is a reconciliation of total deposits to core deposits as of June 30, 2004 and December 31, 2003, respectively:

	June 30 2004	December 31 2003
Total deposits	$ 128,386,427	$ 108,530,901
National market certificates of deposit	(30,119,753)	(25,039,281)
Variable balance accounts (2 customers)	(5,414,461)	(5,749,590)
Core deposits	$ 92,852,213	$ 77,742,030

Application of Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements

at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability must be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

Based on the valuation techniques used and the sensitivity of financial statement amounts

to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for credit losses as the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses. The establishment of allowance factors is a continuing exercise and allowance factors may change over time, resulting in an increase or decrease in the amount of the provision or allowance based upon the same volume and classification of loans. Changes in allowance factors or in management's interpretation of those factors will have a direct impact on the amount of the provision, and a corresponding effect on income and assets. Also, errors in management's perception and assessment of the allowance factors could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs, which would adversely affect income and capital.

For additional information regarding the allowance for loan and lease losses, see the "Allowance for Credit Losses and Credit Risk Management" section of this financial review.

Item 3. Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-QSB, Bay National Corporation's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of Bay National Corporation's disclosure controls and procedures. Based upon that evaluation, Bay National Corporation's Chief Executive Officer and Chief Financial Officer concluded that Bay National Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Bay National Corporation in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

In addition, there were no changes in Bay National Corporation's internal controls over financial reporting (as defined in Rule 13a-15 or Rule 15d-15 under the Securities Act of 1934, as amended) during the quarter ended June 30, 2004, that have materially affected, or are reasonably likely to materially affect, Bay National Corporation's internal control over financial reporting.

Information Regarding Forward-Looking Statements

In addition to the historical information contained in Part I of this Quarterly Report on Form 10-QSB, the discussion in Part I of this Quarterly Report on Form 10-QSB contains certain forward-looking statements. Forward-looking statements often use words such as "believe," "expect," "plan," "may," "will," "should," "project," "contemplate," "anticipate," "forecast," "intend" or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Our actual results and the actual outcome of our expectations and strategies could be different from those anticipated or estimated.

The statements presented herein with respect to, among other things, Bay National Corporation's plans, objectives, expectations and intentions, including statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk and financial and other goals are forward looking. These statements are based on Bay National Corporation's beliefs and assumptions, and on information available to Bay National Corporation as of the date of this filing, and involve risks and uncertainties. These risks and uncertainties include, among others, those discussed in this Quarterly Report on Form 10-QSB; Bay National Corporation's limited operating history; dependence on key personnel; risks related to Bay National Bank's

choice of loan portfolio; risks related to Bay National Bank's lending limit; risks of a competitive market; impact of government regulation on operating results; and effect of developments in technology. For a more complete discussion of these risks and uncertainties see the discussion under the caption "Factors Affecting Future Results" in Bay National Corporation's Form 10-KSB.

Bay National Corporation's actual results could differ materially from those discussed herein and you should not put undue reliance on any forward-looking statements. All forward-looking statements speak only as of the date of this filing, and Bay National Corporation undertakes no obligation to make any revisions to the forward-looking statements to reflect events or circumstances after the date of this filing or to reflect the occurrence of unanticipated events.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 2. Changes in Securities.

None

Item 3. Defaults Upon Senior Securities.

Not applicable.

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

At the Company's Annual Meeting of Stockholders held May 25, 2004, the following directors were elected to serve a three-year term expiring upon the date of the Company's 2007 Annual Meeting or until their respective successors are duly elected and qualified.

	Votes Cast		
	For	Withheld	Total
William B. Rinnier	1,433,590	5,000	1,438,590
Edwin A. Rommel III	1,433,590	5,000	1,438,590
Henry H. Stansbury	1,438,590	-	1,438,590
Kenneth H. Trout	1,438,590	-	1,438,590
Eugene M. Waldron, Jr.	1,429,590	9,000	1,438,590

Names of other directors continuing in office:

Carroll A. Bodie
Charles E. Bounds
Gary T. Gill
John R. Lerch
Donald G. McClure, Jr.
Hugh W. Mohler
Robert L. Moore
H. Victor Rieger, Jr.
Margaret K. Riehl
Carl A.J. Wright

At the Company's Annual Meeting of Stockholders held May 25, 2004, the selection of Stegman & Company to serve as independent auditors for the 2004 fiscal year was ratified by the following vote:

Votes Cast			
For	Against	Abstain	Total
1,411,390	20,700	6,500	1,438,590

There were no broker nonvotes on these matters.

Item 5. Other Information.

None

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

Form 8-K filed, dated April 27, 2004, Items 7, 9 and 12.

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.

Bay National Corporation

Date: August 13, 2004

By: /s/ Hugh W. Mohler
Hugh W. Mohler, President
(Principal Executive Officer)

Date: August 13, 2004

By: /s/ Mark A. Semanie
Mark A. Semanie, Treasurer
(Principal Accounting and Financial Officer)