

BUCKHEAD COMMUNITY BANCORP INC

Form 10-Q

August 13, 2008

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**U.S. SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2008

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 333-144138

**BUCKHEAD COMMUNITY BANCORP, INC.**

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

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**Georgia**  
(State or other jurisdiction of  
incorporation or organization)

**58-2265980**  
(IRS Employer

Identification No.)

**415 East Paces Ferry Road**

**Atlanta, Georgia 30305**

(Address of principal executive offices)

**(404) 504-2557**

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of August 8, 2008: Common Stock, \$0.01 par value 6,314,213 shares outstanding.

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**BUCKHEAD COMMUNITY BANCORP, INC.**

**AND SUBSIDIARY**

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**Table of Contents****PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****BUCKHEAD COMMUNITY BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS**

| (Dollars in thousands)   | June 30<br>2008<br>(Unaudited) | December 31<br>2007 | June 30<br>2007<br>(Unaudited) |
|--|--------------------------------|---------------------|--------------------------------|
| <b>ASSETS</b>  |                                |                     |                                |
| Cash and due from banks  | \$ 8,236                       | \$ 19,157           | \$ 7,974                       |
| Interest-bearing deposits in other banks   | 274                            | 2,264               | 389                            |
| Federal funds sold   | 7,309                          | 23,428              | 48,651                         |
| Securities available for sale, at fair value   | 112,456                        | 109,647             | 96,467                         |
| Restricted equity securities, at cost  | 2,508                          | 1,761               | 1,419                          |
| <b>Total investment securities</b>   | <b>114,964</b>                 | <b>111,408</b>      | <b>97,886</b>                  |
| Loans held for sale  | 7,635                          | 1,232               | 3,727                          |
| Loans, net of unearned income  | 708,581                        | 676,119             | 430,788                        |
| Allowance for loan losses  | (10,393)                       | (9,787)             | (5,250)                        |
| <b>Net loans</b>   | <b>698,188</b>                 | <b>666,332</b>      | <b>425,538</b>                 |
| Bank premises and equipment  | 10,724                         | 10,949              | 6,268                          |
| Accrued interest receivable  | 4,169                          | 4,696               | 3,666                          |
| Goodwill   | 32,669                         | 32,655              |                                |
| Other intangible assets  | 2,226                          | 2,367               |                                |
| Other real estate owned  | 25,174                         | 13,437              | 5,348                          |
| Other assets   | 11,522                         | 11,020              | 4,313                          |
| <b>Total assets</b>  | <b>\$ 923,090</b>              | <b>\$ 898,945</b>   | <b>\$ 603,760</b>              |
| <b>LIABILITIES</b>   |                                |                     |                                |
| Noninterest-bearing demand deposits  | \$ 49,628                      | \$ 46,496           | \$ 32,420                      |
| Interest-bearing deposits  | 714,502                        | 709,252             | 495,787                        |
| <b>Total deposits</b>  | <b>764,130</b>                 | <b>755,748</b>      | <b>528,207</b>                 |
| Short-term borrowings  | 31,789                         | 19,570              | 15,052                         |
| Long-term debt   | 20,000                         |                     |                                |
| Junior subordinated debt   | 15,465                         | 15,465              | 15,465                         |
| Accrued interest payable   | 2,982                          | 3,885               | 2,313                          |
| Accrued expenses and other liabilities   | 2,483                          | 14,805              | 1,572                          |
| <b>Total liabilities</b>   | <b>836,849</b>                 | <b>809,473</b>      | <b>562,609</b>                 |
| <b>SHAREHOLDERS EQUITY</b>   |                                |                     |                                |
| Special stock, no par value; 2,000,000 shares authorized; none issued  |                                |                     |                                |
| Common stock, par value \$0.01; 20,000,000 shares authorized; 6,314,213, 6,315,813 and 4,575,166 shares issued and outstanding, respectively | 63                             | 63                  | 46                             |
| Capital surplus  | 72,542                         | 72,584              | 27,591                         |

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|   |                   |            |            |
|---|-------------------|------------|------------|
| Retained earnings                             | <b>15,158</b>     | 17,285     | 15,977     |
| Accumulated other comprehensive income/(loss) | <b>(1,406)</b>    | (279)      | (2,252)    |
| Deferred compensation                         | <b>(116)</b>      | (181)      | (211)      |
| Total shareholders' equity                    | <b>86,241</b>     | 89,472     | 41,151     |
| Total liabilities and shareholders' equity    | <b>\$ 923,090</b> | \$ 898,945 | \$ 603,760 |

*The accompanying notes are an integral part of these financial statements.*

**Table of Contents****BUCKHEAD COMMUNITY BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS**

| (Dollars in thousands, except share and per share data)(Unaudited) | Three Months Ended<br>June 30 |                 | Six Months Ended<br>June 30 |                 |
|--|-------------------------------|-----------------|-----------------------------|-----------------|
|  | 2008                          | 2007            | 2008                        | 2007            |
| <b>INTEREST INCOME</b>   |                               |                 |                             |                 |
| Loans, including fees  | \$ 11,262                     | \$ 10,005       | \$ 23,935                   | \$ 19,422       |
| Securities:  |                               |                 |                             |                 |
| Taxable  | 1,144                         | 1,007           | 2,192                       | 2,005           |
| Tax-exempt   | 232                           | 230             | 467                         | 453             |
| Federal funds sold and short-term investments                      | 123                           | 588             | 407                         | 1,173           |
| Dividends  | 34                            | 23              | 64                          | 43              |
| Total interest income  | 12,795                        | 11,853          | 27,065                      | 23,096          |
| <b>INTEREST EXPENSE</b>  |                               |                 |                             |                 |
| Deposits   | 7,289                         | 5,992           | 15,535                      | 11,569          |
| Short-term borrowings  | 208                           | 111             | 415                         | 205             |
| Junior subordinated debt   | 189                           | 286             | 439                         | 574             |
| Long-term debt   | 196                           |                 | 224                         |                 |
| Total interest expense   | 7,882                         | 6,389           | 16,613                      | 12,348          |
| <b>NET INTEREST INCOME</b>   | <b>4,913</b>                  | <b>5,464</b>    | <b>10,452</b>               | <b>10,748</b>   |
| Provision for loan losses  | 1,370                         | 275             | 3,492                       | 750             |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>         | <b>3,543</b>                  | <b>5,189</b>    | <b>6,960</b>                | <b>9,998</b>    |
| <b>NONINTEREST INCOME</b>  |                               |                 |                             |                 |
| Gain on sale of loans held for sale                                | 39                            | 184             | 5                           | 520             |
| Gain on sale of securities available for sale                      | 134                           |                 | 135                         |                 |
| Other noninterest income   | 107                           | 143             | 355                         | 297             |
| Total noninterest income   | 280                           | 327             | 495                         | 817             |
| <b>NONINTEREST EXPENSE</b>   |                               |                 |                             |                 |
| Salaries and employee benefits                                     | 2,731                         | 2,131           | 5,630                       | 4,187           |
| Occupancy expenses   | 646                           | 416             | 1,229                       | 839             |
| Advertising and marketing  | 177                           | 140             | 333                         | 273             |
| Legal and other professional services                              | 221                           | 128             | 449                         | 245             |
| Other operating expenses   | 2,128                         | 588             | 3,481                       | 1,110           |
| Total noninterest expense  | 5,903                         | 3,403           | 11,122                      | 6,654           |
| <b>(LOSS) INCOME BEFORE INCOME TAXES</b>                           | <b>(2,080)</b>                | <b>2,113</b>    | <b>(3,667)</b>              | <b>4,161</b>    |
| Income tax (benefit)/expense                                       | (872)                         | 732             | (1,540)                     | 1,441           |
| <b>NET (LOSS) INCOME</b>   | <b>\$ (1,208)</b>             | <b>\$ 1,381</b> | <b>\$ (2,127)</b>           | <b>\$ 2,720</b> |
| <b>(LOSS) EARNINGS PER SHARE</b>                                   |                               |                 |                             |                 |
| Basic  | \$ (0.19)                     | \$ 0.30         | \$ (0.34)                   | \$ 0.59         |

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|  |                  |           |                  |           |
|--|------------------|-----------|------------------|-----------|
| Diluted <sup>1</sup>                       | \$ (0.19)        | \$ 0.30   | \$ (0.34)        | \$ 0.59   |
| <b>WEIGHTED-AVERAGE SHARES OUTSTANDING</b> |                  |           |                  |           |
| Basic                                      | <b>6,307,608</b> | 4,565,094 | <b>6,306,696</b> | 4,570,852 |
| Diluted                                    | <b>6,420,939</b> | 4,611,180 | <b>6,421,902</b> | 4,624,560 |
| <b>CASH DIVIDENDS PER SHARE</b>            | \$               | \$        | \$               | \$        |

<sup>1</sup> Calculated using average basic common shares for the three and six months ended June 30, 2008  
*The accompanying notes are an integral part of these financial statements.*

**Table of Contents****BUCKHEAD COMMUNITY BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

| (Dollars in thousands)(Unaudited)   | Three Months Ended |                 | Six Months Ended  |                 |
|---|--------------------|-----------------|-------------------|-----------------|
|   | June 30            |                 | June 30           |                 |
|   | 2008               | 2007            | 2008              | 2007            |
| <b>Net (loss) income</b>  | <b>\$ (1,208)</b>  | <b>\$ 1,381</b> | <b>\$ (2,127)</b> | <b>\$ 2,720</b> |
| <b>Other comprehensive income (loss):</b>   |                    |                 |                   |                 |
| Unrealized holding gains (losses) arising during period on securities available for sale, net of tax (benefits) of \$(885), \$(891), \$(537), and \$(710), respectively | <b>(1,712)</b>     | <b>(1,730)</b>  | <b>(1,038)</b>    | <b>(1,378)</b>  |
| Reclassification adjustment for (gains) losses realized in net income, net of tax (benefits) of \$46, \$0, \$46 and \$0, respectively                                   | <b>(88)</b>        |                 | <b>(89)</b>       |                 |
| Other comprehensive income (loss)   | <b>(1,800)</b>     | <b>(1,730)</b>  | <b>(1,127)</b>    | <b>(1,378)</b>  |
| <b>Comprehensive (loss) income</b>  | <b>\$ (3,008)</b>  | <b>\$ (349)</b> | <b>\$ (3,254)</b> | <b>\$ 1,342</b> |

*The accompanying notes are an integral part of these financial statements.*



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## BUCKHEAD COMMUNITY BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

| (Dollars in thousands, except share data) | Common Stock |           |                 | Retained Earnings | Accumulated Other Comprehensive Income (Loss) |                       | Total Shareholders Equity |
|---|--------------|-----------|-----------------|-------------------|---|-----------------------|---------------------------|
|   | Shares       | Par Value | Capital Surplus |                   | Income  | Deferred Compensation |                           |
| <b>Balance, December 31, 2006</b>         | 4,567,344    | \$ 46     | \$ 27,403       | \$ 13,257         | \$ (874)                                      | \$ (41)               | \$ 39,791                 |
| Net income                                |              |           |                 | 2,720             |   |                       | 2,720                     |
| Stock-based compensation                  |              |           | 2               |                   |   | 16                    | 18                        |
| Restricted stock award                    | 7,822        |           | 186             |                   |   | (186)                 |                           |
| Other comprehensive income (loss)         |              |           |                 |                   | (1,378)                                       |                       | (1,378)                   |
| <b>Balance, June 30, 2007 (Unaudited)</b> | 4,575,166    | \$ 46     | \$ 27,591       | \$ 15,977         | \$ (2,252)                                    | \$ (211)              | \$ 41,151                 |
| <b>Balance, December 31, 2007</b>         | 6,315,813    | \$ 63     | \$ 72,584       | \$ 17,285         | \$ (279)                                      | \$ (181)              | \$ 89,472                 |
| Net loss                                  |              |           |                 | (2,127)           |   |                       | (2,127)                   |
| Exercise of stock options                 | 400          |           | 5               |                   |   |                       | 5                         |
| Restricted stock forfeiture               | (2,000)      |           | (50)            |                   |   | 50                    |                           |
| Stock-based compensation                  |              |           | 3               |                   |   | 15                    | 18                        |
| Other comprehensive income (loss)         |              |           |                 |                   | (1,127)                                       |                       | (1,127)                   |
| <b>Balance, June 30, 2008 (Unaudited)</b> | 6,314,213    | \$ 63     | \$ 72,542       | \$ 15,158         | \$ (1,406)                                    | \$ (116)              | \$ 86,241                 |

*The accompanying notes are an integral part of these financial statements.*

**Table of Contents****BUCKHEAD COMMUNITY BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS**

| (Dollars in thousands)(Unaudited)  | Six Months Ended<br>June 30 |          |
|--|-----------------------------|----------|
|  | 2008                        | 2007     |
| <b>OPERATING ACTIVITIES</b>  |                             |          |
| Net (loss) income  | \$ (2,127)                  | \$ 2,720 |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: |                             |          |
| Depreciation, amortization and accretion   | 545                         | 286      |
| Amortization of intangible assets  | 141                         |          |
| Provision for loan losses  | 3,492                       | 750      |
| Provision for foreclosed property  | 1,069                       | 25       |
| Net gains on sales of securities   | (135)                       |          |
| Gains on sales of loans  | (5)                         | (520)    |
| Losses on sales of other real estate   | 110                         |          |
| Stock-based compensation   | 18                          | 18       |
| (Increase) decrease in loans held for sale   | (6,398)                     | 367      |
| Decrease (increase) in interest receivable   | 527                         | (1,142)  |
| (Decrease) increase in interest payable  | (903)                       | 358      |
| Net other operating activities   | (3,685)                     | 1,517    |
| Net cash (used in) provided by operating activities  | (7,351)                     | 4,379    |
| <b>INVESTING ACTIVITIES</b>  |                             |          |
| Net decrease (increase) in interest-bearing deposits in banks                                      | 1,990                       | (2)      |
| Purchases of securities available for sale   | (79,078)                    | (2,967)  |
| Proceeds from sales of securities available for sale   | 12,953                      |          |
| Proceeds from calls and maturities of securities available for sale                                | 61,684                      | 2,079    |
| Net purchases of restricted equity securities  | (747)                       | (10)     |
| Net decrease (increase) in federal funds sold  | 16,119                      | (8,066)  |
| Net increase in loans  | (55,451)                    | (56,125) |
| Proceeds from sale of other real estate  | 7,315                       |          |
| Purchases of bank premises and equipment   | (261)                       | (318)    |
| Cash used for business combination   | (13,375)                    |          |
| Net cash used in investing activities  | (48,851)                    | (65,409) |
| <b>FINANCING ACTIVITIES</b>  |                             |          |
| Net increase in deposits   | 8,382                       | 56,118   |
| Net change in short-term borrowings  | 12,219                      | 5,017    |
| Net proceeds from long-term debt   | 20,000                      |          |
| Proceeds from issuance of common stock   | 4,680                       |          |
| Net cash provided by financing activities  | 45,281                      | 61,135   |
| Change in cash and due from banks  | (10,921)                    | 105      |
| Cash and due from banks at beginning of period   | 19,157                      | 7,869    |
| Cash and due from banks at end of period   | \$ 8,236                    | \$ 7,974 |

**Supplemental Disclosures:**

Cash paid during the period for:

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|  |           |           |
|--|-----------|-----------|
| Interest                                     | \$ 17,516 | \$ 11,989 |
| Income taxes                                 | \$        | \$ 670    |
| Non-cash investing activities:               |           |           |
| Transfer of loans to other real estate owned | \$ 20,103 | \$ 3,645  |

*The accompanying notes are an integral part of these financial statements.*

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**Buckhead Community Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1 Accounting Policies and Recent Accounting Pronouncements**

The accompanying unaudited consolidated financial statements of Buckhead Community Bancorp, Inc. ( Buckhead or the Company ) and its subsidiary, The Buckhead Community Bank ( the Bank ) have been prepared in accordance with generally accepted accounting principles for interim information and with the instructions to Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations are not necessarily indicative of the results of operations for the full year or any other interim periods.

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 provides a framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States ( US GAAP ). Previously, US GAAP hierarchy had been defined in the American Institute of Public Accountants Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The new FASB guidance specifies that the US GAAP hierarchy should be directed to entities, because the entity, not its auditor, is responsible for selecting appropriate accounting principles. This statement is effective 60 days after the SEC 's approval of the Public Company Accounting Oversight Board Auditing amendments to SAS No. 69. The impact of this standard is not expected to be material to the Company 's financial position or results of operations.

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts*. SFAS No. 163 clarifies how SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*, applies to financial guarantee insurance contracts issued by insurance enterprises, and addresses the recognition and measurement of premium revenue and claim liabilities. It also requires expanded disclosures about these types of contracts. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. The impact of this standard is not expected to be material to the Company 's financial position or results of operations.

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)****Note 2 Acquisitions**

On December 4, 2007, the Company acquired 100 percent of the outstanding common shares of Allied Bancshares, Inc. ( Allied ) and its subsidiary, First National Bank of Forsyth County. The merger enhanced the Company's geographic position in counties with high growth potential. The acquisition was accounted for under the purchase method of accounting with the results of operations for Allied included in our consolidated financial results beginning December 4, 2007. Under the purchase method of accounting the assets and liabilities of Allied were recorded at their respective fair values as of December 4, 2007.

The consideration for the acquisition was a combination of cash and stock with a purchase price of approximately \$53.8 million. The total consideration consisted of approximately \$13.4 million in cash and approximately 1.5 million Buckhead Community Bancorp shares.

The calculation of the purchase price is as follows:

**(Dollars in thousands, except per share data)**

|  |           |
|--|-----------|
| Total Buckhead Community Bancorp common stock issued       | 1,534,553 |
| Purchase price per Buckhead Community Bancorp common share | \$ 25.00  |
| Value of Buckhead Community Bancorp stock issued           | 38,364    |
| Cash payable to shareholders                               | 13,375    |
| Estimated fair value of employee stock options assumed     | 2,108     |
| Total purchase price                                       | \$ 53,847 |

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)**

The following unaudited condensed income statements disclose the pro forma results of the Company as though the Allied acquisition had occurred at the beginning of the periods presented.

| (Dollars in thousands, except share data)                           | Three months ended June 30, 2007 (Unaudited)        |   |                                       |                       |
|---|---|---|---------------------------------------|-----------------------|
|   | Buckhead<br>Community<br>Bancorp, Inc. <sup>1</sup> | Allied<br>Bancshares, Inc. <sup>2</sup> | Pro Forma<br>Adjustments <sup>3</sup> | Pro Forma<br>Combined |
| Interest and dividend income  | \$ 11,853   | \$ 4,257                                | \$ (160)                              | \$ 15,950             |
| Interest expense  | 6,389   | 2,253                                   | (46)                                  | 8,596                 |
| Net interest income   | 5,464   | 2,004                                   | (114)                                 | 7,354                 |
| Provision for loan losses   | 275   | 432                                     |                                       | 707                   |
| Net interest income after provision for loan losses                 | 5,189   | 1,572                                   | (114)                                 | 6,647                 |
| Noninterest income  | 327   | 74                                      |                                       | 401                   |
| Noninterest expense   | 3,403   | 986                                     | 78                                    | 4,467                 |
| Income from continuing operations before provision for income taxes | 2,113   | 660                                     | (192)                                 | 2,581                 |
| Provision for income taxes  | 732   | 238                                     | (67)                                  | 903                   |
| Income from continuing operations                                   | \$ 1,381  | \$ 422                                  | \$ (125)                              | \$ 1,678              |
| Average shares:   |   |   |                                       |                       |
| Basic   | 4,565,094   | 1,528,804                               | (152,880) <sup>4</sup>                | 5,941,018             |
| Diluted   | 4,611,180   | 1,726,332                               | (172,633) <sup>4</sup>                | 6,164,879             |
| Income from continuing operations per average common share:         |   |   |                                       |                       |
| Basic   | 0.30  | 0.28                                    |                                       | 0.28                  |
| Diluted   | 0.30  | 0.24                                    |                                       | 0.27                  |

<sup>1</sup> Represents results of Buckhead Community Bancorp, Inc. from April 1, 2007 through June 30, 2007.

<sup>2</sup> Represents results of Allied Bancshares, Inc. from April 1, 2007 through June 30, 2007.

<sup>3</sup> Pro forma adjustments include the following items: loss of interest on federal funds sold used to fund the acquisition of \$97 thousand; amortization of core deposit intangible of \$71 thousand; amortization of loan purchase accounting adjustment of \$38 thousand; amortization of investment securities purchase accounting adjustment of \$25 thousand; depreciation of building purchase accounting adjustment of \$7 thousand; and accretion of deposit purchase accounting adjustment of \$46 thousand; net tax effect of all pro-forma adjustments at 35%.

<sup>4</sup> Assumes 75% stock merger consideration at an exchange ratio of 1.20.



**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)**

| (Dollars in thousands, except share data)                           | Six months ended June 30, 2007 (Unaudited)          |   |                                       |                       |
|---|---|---|---------------------------------------|-----------------------|
|   | Buckhead<br>Community<br>Bancorp, Inc. <sup>1</sup> | Allied<br>Bancshares, Inc. <sup>2</sup> | Pro Forma<br>Adjustments <sup>3</sup> | Pro Forma<br>Combined |
| Interest and dividend income  | \$ 23,096   | \$ 8,253                                | \$ (322)                              | \$ 31,027             |
| Interest expense  | 12,348  | 4,286                                   | (93)                                  | 16,541                |
| Net interest income   | 10,748  | 3,967                                   | (229)                                 | 14,486                |
| Provision for loan losses   | 750   | 547                                     |                                       | 1,297                 |
| Net interest income after provision for loan losses                 | 9,998   | 3,420                                   | (229)                                 | 13,189                |
| Noninterest income  | 817   | 150                                     |                                       | 967                   |
| Noninterest expense   | 6,654   | 2,078                                   | 157                                   | 8,889                 |
| Income from continuing operations before provision for income taxes | 4,161   | 1,492                                   | (386)                                 | 5,267                 |
| Provision for income taxes  | 1,441   | 541                                     | (135)                                 | 1,847                 |
| Income from continuing operations                                   | \$ 2,720  | \$ 951                                  | \$ (251)                              | \$ 3,420              |
| Average shares:   |   |   |                                       |                       |
| Basic   | 4,570,852   | 1,517,001                               | (151,700) <sup>4</sup>                | 5,936,153             |
| Diluted   | 4,624,560   | 1,729,992                               | (172,999) <sup>4</sup>                | 6,181,553             |
| Income from continuing operations per average common share:         |   |   |                                       |                       |
| Basic   | 0.59  | 0.63                                    |                                       | 0.58                  |
| Diluted   | 0.59  | 0.55                                    |                                       | 0.55                  |

<sup>1</sup> Represents results of Buckhead Community Bancorp, Inc. from January 1, 2007 through June 30, 2007.

<sup>2</sup> Represents results of Allied Bancshares, Inc. from January 1, 2007 through June 30, 2007.

<sup>3</sup> Pro forma adjustments include the following items: loss of interest on federal funds sold used to fund the acquisition of \$197 thousand; amortization of core deposit intangible of \$142 thousand; amortization of loan purchase accounting adjustment of \$75 thousand; amortization of investment securities purchase accounting adjustment of \$50 thousand; depreciation of building purchase accounting adjustment of \$15 thousand; and accretion of deposit purchase accounting adjustment of \$93 thousand; net tax effect of all pro-forma adjustments at 35%.

<sup>4</sup> Assumes 75% stock merger consideration at an exchange ratio of 1.20.



**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)****Note 3 Stock-based Compensation**

The Company has a stock incentive plan under which it may grant stock options or other stock awards to employees, directors and other key persons to purchase shares of common stock. Awards are granted at prices equal to the fair market value of the shares at the date of grant and are exercisable as determined by the plan's administrative committee. Stock options expire ten years from the date of grant. The general terms of the plan also include a vesting period which is usually three to four years for awards granted since January of 2007. Options granted prior to that date generally vested immediately. Through June 30, 2008, incentive stock options, nonqualified stock options and restricted stock awards and units had been granted under the plan.

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised), *Share Based Payment* ( SFAS No. 123(R) ) utilizing the modified prospective method of accounting. Grant date fair value is measured on the date of grant using an option pricing model with market assumptions. The grant date fair value is amortized into expense on a straight-line basis over the vesting period. Option pricing models require the use of highly subjective assumptions, including but not limited to, historical stock price volatility, forfeiture rates, term, annual dividends and interest rates, which if changed could materially affect our fair value estimates. Accordingly, the model does not necessarily provide a reliable single measure of the fair value of our stock options.

**Stock Options**

The following is a summary of the Company's weighted average assumptions used to estimate the weighted average per share fair value of options granted during the three and six months ended June 30, 2008, and 2007, on the date of grant using the Black-Scholes option pricing model. No stock options were granted during 2008.

| (Dollars in Thousands)(Unaudited)      | Three Months Ended<br>June 30 |      | Six Months Ended<br>June 30 |         |
|--|-------------------------------|------|-----------------------------|---------|
|  | 2008                          | 2007 | 2008                        | 2007    |
| Expected volatility                    | N/A                           | N/A  | N/A                         | 18%     |
| Expected dividend yield                | N/A                           | N/A  | N/A                         | 2%      |
| Expected life (in years)               | N/A                           | N/A  | N/A                         | 6.5     |
| Risk-free rate                         | N/A                           | N/A  | N/A                         | 4.6%    |
| Annual forfeiture rate                 | N/A                           | N/A  | N/A                         | 3%      |
| Weighted average fair value of options | N/A                           | N/A  | N/A                         | \$ 5.04 |

The Company expensed approximately \$1 thousand and \$3 thousand during the three and six months ended June 30, 2008 and \$1 thousand and \$2 thousand during the same period of 2007, related to stock options. The total compensation cost related to nonvested awards not yet recognized was approximately \$9 thousand as of June 30, 2008 and the weighted average period over which it is to be recognized is 1.5 years.

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)**

The following table presents a summary of stock option activity:

| (Dollars in thousands)(Unaudited)    | Shares  | Six months ended June 30, 2007  |   | Aggregate Intrinsic Value |
|--------------------------------------|---------|---------------------------------|---|---------------------------|
|                                      |         | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (years) |                           |
| Options outstanding, January 1, 2007 | 65,197  | \$ 5.95                         |   |                           |
| Granted                              | 3,779   | 22.50                           |   |                           |
| Options outstanding, June 30, 2007   | 68,976  | \$ 6.86                         | 2.9   | \$ 1,251                  |
| Exercisable, June 30, 2007           | 65,197  | \$ 5.95                         | 2.5   | \$ 1,242                  |
|                                      |         |                                 |   |                           |
| (Dollars in thousands)(Unaudited)    | Shares  | Six months ended June 30, 2008  |   | Aggregate Intrinsic Value |
|                                      |         | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (years) |                           |
| Options outstanding, January 1, 2008 | 185,736 | \$ 8.55                         |   |                           |
| Forfeited                            | (6,221) | 11.12                           |   |                           |
| Exercised                            | (400)   | 12.50                           |   |                           |
| Options outstanding, June 30, 2008   | 179,115 | \$ 8.45                         | 5.8   | \$ 2,964                  |
| Exercisable, June 30, 2008           | 177,114 | \$ 8.30                         | 5.8   | \$ 2,958                  |

The total grant-date fair value of options vested during the period was \$5 thousand and zero for the six months ended June 30, 2008 and 2007, respectively. No options vested during the second quarter of 2008 or 2007.

**Restricted Stock**

On April 1, 2006, the Company's President and Chief Executive Officer was awarded 3,000 shares of restricted common stock, with an aggregate fair market value of \$16.67 per share. The restricted stock vests in four equal increments on April 1, 2007, 2008, 2009, and 2010. The total expense associated with this grant of approximately \$49,000 will be recognized over the four year period on a straight-line basis.

On March 27, 2007 and April 25, 2007, the Company's President and Chief Executive Officer and two employees were awarded 3,822 and 4,000 shares of restricted common stock, respectively, with an aggregate per share fair market values of \$22.50 and \$25.00, respectively. The restricted stock will vest annually in four equal increments, beginning on the first anniversary of its grant date. The total expense associated with these grants was originally approximately \$186,000 and scheduled to be recognized over the vesting period on a straight-line basis. In the first quarter of 2008, 2,000 shares of the April 25, 2007 grant were forfeited, lowering the total expense associated with these grants to approximately \$136,000.

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)**

The unamortized balance of the fair value of the restricted stock grant has been recorded as deferred compensation in the equity section of the consolidated balance sheets. As of June 30, 2008, there was approximately \$116 thousand of unrecognized stock-based compensation expense related to restricted stock, which is expected to be recognized over a weighted average period of 2.5 years.

The following tables present restricted stock activity:

| (Dollars in thousands, except per share data)(Unaudited) | Shares  | Weighted-Average<br>Grant Date Fair Value |
|--|---------|---|
| Outstanding, January 1, 2007                             | 3,000   | \$ 16.67                                  |
| Granted  | 7,822   | 23.78                                     |
| Vested   | (750)   | 16.67                                     |
| Outstanding, June 30, 2007                               | 10,072  | \$ 22.19                                  |
|  | Shares  | Weighted-Average<br>Grant Date Fair Value |
| Outstanding, January 1, 2008                             | 10,072  | \$ 22.19                                  |
| Forfeited  | (2,000) | 25.00                                     |
| Vested   | (2,206) | 21.08                                     |
| Outstanding, June 30, 2008                               | 5,866   | \$ 21.65                                  |

The following table summarizes stock-based compensation expense:

| (Dollars in Thousands)(Unaudited) | Three Months Ended<br>June 30 |       | Six Months Ended<br>June 30 |       |
|-----------------------------------|-------------------------------|-------|-----------------------------|-------|
|                                   | 2008                          | 2007  | 2008                        | 2007  |
| Stock-based compensation expense  |                               |       |                             |       |
| Stock options                     | \$ 1                          | \$ 1  | \$ 3                        | \$ 2  |
| Restricted stock                  | 12                            | 13    | 15                          | 16    |
|                                   | \$ 13                         | \$ 14 | \$ 18                       | \$ 18 |

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)****Note 4 (Loss) Earnings Per Share ( EPS )**

The following table reflects the reconciliation of the numerator and denominator of the basic EPS computation to the diluted EPS computation for the three and six months ended June 30, 2008 and 2007. There is no dilution from dilutive securities due to the antidilutive effect of the net loss for the three and six months ended June 30, 2008.

| (Dollars in thousands, except per share data)(Unaudited)          | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|---|-------------------------------|----------|-----------------------------|----------|
|   | 2008                          | 2007     | 2008                        | 2007     |
| <b>Basic</b>  |                               |          |                             |          |
| Net (loss) income available to common shareholders                | \$ (1,208)                    | \$ 1,381 | \$ (2,127)                  | \$ 2,720 |
| Average basic common shares                                       | 6,308                         | 4,565    | 6,307                       | 4,571    |
| (Loss) earnings per average common share - basic                  | \$ (0.19)                     | \$ 0.30  | \$ (0.34)                   | \$ 0.59  |
| <b>Diluted</b>  |                               |          |                             |          |
| Net (loss) income available to common shareholders                | \$ (1,208)                    | \$ 1,381 | \$ (2,127)                  | \$ 2,720 |
| Average basic common shares                                       | 6,308                         | 4,565    | 6,307                       | 4,571    |
| Effect of dilutive securities: Stock options and restricted stock | 113                           | 46       | 115                         | 54       |
| Average diluted common shares                                     | 6,421                         | 4,611    | 6,422                       | 4,625    |
| (Loss) earnings per average common share - diluted <sup>1</sup>   | \$ (0.19)                     | \$ 0.30  | \$ (0.34)                   | \$ 0.59  |

<sup>1</sup> Calculated using average basic common shares for the three and six months ended June 30, 2008

**Note 5 Fair Value**

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances. On February 12, 2008, the FASB issued Staff Position 157-2 which defers the effective date of Statement 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. All other provisions of Statement 157 are effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)**

maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

**Level 1** Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

**Level 2** Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.

**Level 3** Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

***Assets Measured at Fair Value on a Recurring Basis***

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

**Available-for-Sale Securities**

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Currently, all of the Company's available-for-sale securities are considered to be Level 2 securities.

The following table presents financial assets measured at fair value on a recurring basis:

| (Dollars in thousands)(Unaudited) | Fair Value Measurements at June 30, 2008, Using |                                 |   |   |
|-----------------------------------|---|---------------------------------|---|---|
|                                   | Assets/Liabilities Measured at Fair Value       | Quoted Prices in Active Markets |   |   |
|                                   |   | for Identical Assets (Level 1)  | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| June 30, 2008                     | \$ 112,456                                      | \$                              | \$ 112,456                                    | \$  |
| Securities available for sale     | \$ 112,456                                      | \$                              | \$ 112,456                                    | \$  |

**Table of Contents****Buckhead Community Bancorp, Inc. and Subsidiary****Notes to Consolidated Financial Statements (Unaudited)*****Assets Measured at Fair Value on a Non-recurring Basis***

Following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

**Impaired Loans**

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan is confirmed. During the first six months of 2008, certain impaired loans were partially charged-off or re-evaluated for impairment resulting in a remaining balance for these loans, net of specific allowances, of \$33.5 million as of June 30, 2008. This valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

**Other Real Estate Owned**

Other real estate assets acquired through or in lieu of foreclosure are held for sale and are initially recorded at fair value. Any write-downs to fair value at the time of transfer to foreclosed assets are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. This valuation would be considered Level 3, consisting of appraisals of real estate collateral.

The following table presents financial assets measured at fair value on a non-recurring basis, for which impairment was recognized in the current period.

| (Dollars in thousands)(Unaudited) | Fair Value Measurements at June 30, 2008, Using Quoted Prices in Active Markets for Identical Assets |           |   |   |    | Valuation Allowances as of June 30, 2008 |
|-----------------------------------|--|-----------|---|---|----|--|
|                                   | Carrying Value as of June 30, 2008   | (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |    |  |
| Impaired loans                    | \$ 33,467  | \$        | \$  | \$ 33,467                                 | \$ | (5,237)                                  |
| Other real estate owned           | 25,174   |           |   | 25,174                                    |    | (1,316)                                  |

In February, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*. SFAS No. 159 allows companies to report selected financial assets and liabilities at fair value. The changes in fair value are recognized in earnings and the assets and liabilities measured under this methodology are required to be displayed separately on the balance sheet. While SFAS No. 159 became effective for the Company beginning January 1, 2008, the Company has not elected the fair value option that is offered by this statement.

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### **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **General**

The following is management's discussion and analysis of certain significant factors which have affected the financial position and operating results of the Company and the Bank, during the period included in the accompanying consolidated financial statements. The purpose of this discussion is to focus on information about our financial condition and results of operations that are not otherwise apparent from our consolidated financial statements. Reference should be made to those statements and the selected financial data presented elsewhere in this report for an understanding of the following discussion and analysis.

Throughout this Item, the terms we, us and our refer to the Company and the Bank together on a consolidated basis.

The Company is a corporation which was organized under the laws of the state of Georgia to be a holding company for the Bank. Like most community bank holding companies, the Company derives substantially all of its income from the earnings of its subsidiary Bank. The Bank is a bank chartered under the laws of the State of Georgia that opened for business on February 16, 1998. The Bank is a full service commercial bank located in Atlanta, Georgia, with a primary service area consisting of the community of Atlanta and the surrounding areas within Fulton, Cobb, Forsyth and Hall Counties. The principal business of the Bank is to accept deposits from the public and to make loans and other investments.

### **Forward Looking Statements**

Some of the statements in this Report, including, without limitation, matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operation, of Buckhead Community Bancorp, Inc. are forward-looking statements within the meaning of the federal securities laws. Forward-looking statements include statements about the competitiveness of the banking industry, potential regulatory obligations, our entrance and expansion into other markets, integration of recently acquired banks, pending or proposed acquisitions, our other business strategies, our expectations with respect to our allowance for loan losses and impaired loans, and other statements that are not historical facts. When we use words like anticipate, believe, intend, expect, estimate, could, should, will, and similar expressions, you should consider them as identifying forward-looking statements, although we may use other phrasing. These forward-looking statements involve risks and uncertainties and are based on our beliefs and assumptions, and on the information available to us at the time that these disclosures were prepared. Factors that may cause actual results to differ materially from those expressed or implied by such forward-looking statements include, among others, the following possibilities: (1) competitive pressures among depository and other financial institutions may increase significantly; (2) changes in the interest rate environment may reduce margins; (3) general economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduction in demand for credit; (4) legislative or regulatory changes, including changes in accounting standards may adversely affect the businesses in which we are engaged; (5) costs or difficulties related to the integration of our businesses, may be greater than expected; (6) deposit attrition, customer loss or revenue loss following acquisitions may be greater than expected; (7) competitors may have greater financial resources and develop products that enable such competitors to compete more successfully than us; and (8) adverse changes may occur in the equity markets.

Many of such factors are beyond our ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. We disclaim any obligation to update or revise any forward-looking statements contained in this Report, whether as a result of new information, future events or otherwise.

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### **Critical Accounting Estimates**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting judgments and assumptions to be our critical accounting estimates. The judgments and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a material impact on our carrying values of assets and liabilities and our results of operations.

#### ***Allowance for Loan Losses***

We believe the allowance for loan losses is a critical accounting estimate that requires the most significant judgments and assumptions used in preparation of our consolidated financial statements. Because the allowance for loan losses is replenished through a provision for loan losses that is charged against earnings, our subjective determinations regarding the allowance affect our earnings directly. Refer to the portion of this discussion that addresses our allowance for loan losses for a description of our processes and methodology for determining our allowance for loan losses.

A loan is considered impaired, based on current information and events, if it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Uncollateralized loans are measured for impairment based on the present value of expected future cash flows discounted at the historical effective interest rate, while all collateral-dependent loans are measured for impairment based on the fair value of the collateral.

We use several factors in determining if a loan is impaired. The internal asset classification procedures include a thorough review of significant loans and lending relationships and include the accumulation of related data. This data includes loan payment status, borrowers' financial data, and borrowers' operating factors such as cash flows, operating income or loss, etc.

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Increases and decreases in the allowance due to changes in the measurement of the impaired loans are included in the provision for loan losses. Loans continue to be classified as impaired unless they are brought fully current and the collection of scheduled interest and principal is considered probable. When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

Management's periodic evaluation of the adequacy of the allowance also considers impaired loans and takes into consideration our past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay, estimated value of any underlying collateral, and current economic conditions. While management believes that it has established the allowance in accordance with generally accepted accounting principles and has taken into account the views of its regulators and the current economic environment, there can be no assurance that in the future our regulators or the economic environment will not require further increases in the allowance.

#### ***Estimates of Fair Value***

The estimation of fair value is significant to a number of the Company's assets, including, but not limited to, investment securities, impaired loans, other real estate owned (OREO), goodwill and other intangible assets. Investment securities are recorded at fair value while impaired loans, other real estate owned, goodwill and other intangible assets are recorded at either cost or fair value, whichever is lower.



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Fair values for investment securities are based on quoted market prices, and if not available, quoted prices on similar instruments. The fair values of impaired loans and other real estate owned are typically determined based on third-party appraisals less estimated costs to sell. At the time of foreclosure, it is our policy to obtain current appraisals from a list of approved appraisers to assist in the valuation of OREO. We reassess the value of OREO properties at least every 60 days and establish reserves when deemed appropriate. Goodwill and other intangible assets are periodically evaluated to determine if any impairment might exist. The estimation of fair value and subsequent changes of fair value of investment securities, impaired loans, other real estate owned, goodwill and other intangible assets can have a significant impact on the value of the Company, as well as have an impact on the recorded values and subsequently reported net income.

### ***Income taxes***

The determination of our overall income tax provision is complex and requires careful analysis. As part of the overall business strategy, we may enter into business transactions that require management to consider tax laws and regulations that apply to the specific facts and circumstances under consideration. This analysis includes evaluating the amount and timing of the realization of income tax liabilities or benefits. Management continually monitors tax developments as they affect our overall tax position. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

### **Balance Sheet Review**

At June 30, 2008, we had total assets of \$923.1 million as compared to \$898.9 million as of December 31, 2007. The increase in assets was primarily attributable to a \$38.9 million increase in loans and loans held for sale, as well as an \$11.7 million increase in other real estate owned. This increase was partially offset by a \$10.9 million decrease in cash and due from banks and a \$16.1 million decrease in federal funds sold. Total liabilities at June 30, 2008 increased to \$836.8 million from \$809.5 million at December 31, 2007, primarily due to a \$20 million increase in long-term debt. Shareholder's equity totaled \$86.2 million at June 30, 2008, a decrease of \$3.2 million, or 3.6% when compared to December 31, 2007. The decrease was primarily driven by a net loss of \$2.1 million for the first six months of 2008. On December 4, 2007, we completed the acquisition of Allied, which added approximately \$273.8 in total assets to our balance sheet. This transaction is described more fully in Note 2 to the Consolidated Financial Statements included in Item 1.

### ***Investment Portfolio***

The fair value of the investment securities portfolio as of June 30, 2008 was \$112.5 million compared to \$109.6 million as of December 31, 2007. In an effort to improve the yield and lengthen the duration of our investment portfolio, we sold approximately \$7 million in U.S. Treasury and agency securities and approximately \$4 million in mortgage-backed securities during the second quarter of 2008. We purchased approximately \$24 million in mortgage-backed securities to replace these sold investments as well as approximately \$5 million in agency securities that were called during the second quarter. Our portfolio repositioning resulted in a shift from U.S. Treasury and agency securities to mortgage-backed securities. The mortgage-backed securities purchased during the second quarter of 2008 are backed by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Association (FHLMC), and the aggregate total of all mortgage-backed securities does not exceed 60% of the entire portfolio, in accordance with our investment policy. Aside from our repositioning activities, \$34 million in U.S. Treasury securities matured shortly after the end of the first quarter of 2008, related to a temporary customer deposit.

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Because our investment portfolio is managed with consideration of collateral requirements for our overnight sweep product and public deposit balances, we elected to purchase mortgage-backed securities as opposed to other types of securities, such as municipal bonds. Mortgage-backed securities are considered acceptable collateral for these deposits, while municipal bonds are not.

| (Dollars in thousands)(Unaudited)  | June 30, 2008     |                   | December 31, 2007 |                   | June 30, 2007    |                  |
|--|-------------------|-------------------|-------------------|-------------------|------------------|------------------|
|  | Amortized Cost    | Fair Value        | Amortized Cost    | Fair Value        | Amortized Cost   | Fair Value       |
| U.S. Treasury government sponsored securities, agencies and corporations | \$ 36,225         | \$ 35,973         | \$ 62,106         | \$ 62,250         | \$ 59,108        | \$ 57,181        |
| Trust Preferred Securities   | 1,450             | 1,438             | 1,450             | 1,457             | 1,450            | 1,460            |
| Corporate bonds  | 250               | 242               | 250               | 251               | 250              | 250              |
| State and municipal securities   | 22,931            | 22,514            | 24,561            | 24,242            | 23,917           | 23,015           |
| Mortgage-backed securities   | 53,733            | 52,289            | 21,704            | 21,447            | 15,155           | 14,561           |
| <b>Total securities available for sale</b>                               | <b>\$ 114,589</b> | <b>\$ 112,456</b> | <b>\$ 110,071</b> | <b>\$ 109,647</b> | <b>\$ 99,880</b> | <b>\$ 96,467</b> |

The carrying value of investment securities at June 30, 2008, by contractual maturity, is shown below. All of our securities are classified as available-for-sale, which means that we carry them at estimated fair value with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity until realized. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

| (Dollars in thousands)(Unaudited)                               | One Year or Less |       | After One Year Through 5 Years |       | After 5 Years Through 10 Years |       | After 10 Years |       | Totals         |       |
|---|------------------|-------|--------------------------------|-------|--------------------------------|-------|----------------|-------|----------------|-------|
|   | Amount           | Yield | Amount                         | Yield | Amount                         | Yield | Amount         | Yield | Amount         | Yield |
| <b>Carrying value:</b>  |                  |       |                                |       |                                |       |                |       |                |       |
| <b>June 30, 2008</b>  |                  |       |                                |       |                                |       |                |       |                |       |
| U.S. Government sponsored securities, agencies and corporations | \$ 1,013         | 2.03% |                                |       | 15,882                         | 4.79% | 19,078         | 5.70% | 35,973         | 5.19% |
| Trust preferred securities                                      |                  |       |                                |       |                                |       | 1,438          | 6.31% | 1,438          | 6.31% |
| Corporate bonds   |                  |       |                                |       |                                |       | 242            | 5.18% | 242            | 5.18% |
| State and municipal securities <sup>1</sup>                     |                  |       | 777                            | 5.08% | 2,985                          | 5.31% | 18,752         | 5.71% | 22,514         | 5.64% |
| Mortgage-backed securities                                      |                  |       | 4,259                          | 4.86% | 625                            | 4.21% | 47,405         | 5.16% | 52,289         | 5.12% |
| <b>Total securities</b>   | <b>\$ 1,013</b>  |       | <b>5,036</b>                   |       | <b>19,492</b>                  |       | <b>86,915</b>  |       | <b>112,456</b> |       |

<sup>1</sup> Yields are on a tax-equivalent basis

**Table of Contents****Loan Portfolio**

Our intent is to derive a substantial percentage of our earnings from loans. The Company's loan portfolio increased \$32.3 million, or 4.8% from December 31, 2007 to June 30, 2008. The following table presents various categories of loans contained in the loan portfolio of the Company as of June 30, 2008, December 31, 2007, and June 30, 2007:

| (Dollars in thousands)(Unaudited)     | June 30<br>2008   |                | December 31<br>2007 |                | June 30<br>2007   |                |
|---------------------------------------|-------------------|----------------|---------------------|----------------|-------------------|----------------|
|                                       | Amount            | % of<br>Loans  | Amount              | % of<br>Loans  | Amount            | % of<br>Loans  |
| <b>Breakdown of loan receivables:</b> |                   |                |                     |                |                   |                |
| Commercial                            | \$ 86,077         | 12.14%         | \$ 77,837           | 11.50%         | \$ 68,386         | 15.84%         |
| Real estate - mortgage                | 251,027           | 35.39%         | 213,248             | 31.50%         | 96,922            | 22.46%         |
| Real estate - construction            | 359,318           | 50.66%         | 371,506             | 54.88%         | 262,740           | 60.88%         |
| Consumer                              | 12,807            | 1.81%          | 14,358              | 2.12%          | 3,538             | 0.82%          |
| <b>Total loans</b>                    | <b>709,229</b>    | <b>100.00%</b> | <b>676,949</b>      | <b>100.00%</b> | <b>431,586</b>    | <b>100.00%</b> |
| Less: Allowance for loan losses       | 10,393            |                | 9,787               |                | 5,250             |                |
| Less: Unearned loan fees              | 648               |                | 830                 |                | 798               |                |
| <b>Net loans</b>                      | <b>\$ 698,188</b> |                | <b>\$ 666,332</b>   |                | <b>\$ 425,538</b> |                |

Ratio of the allowance for loan losses to total loans **1.47%** 1.45% 1.22%

The major components of the loan portfolio at June 30, 2008 were real estate construction and mortgage and represented 86.1% of the loan portfolio. In the context of this discussion, we define a real estate mortgage loan and a real estate construction loan as any loan, secured by real estate, regardless of the purpose of the loan. We follow the common practice of financial institutions in our market area of obtaining a security interest in real estate whenever possible, in addition to any other available collateral. We take this collateral to reinforce the likelihood of the ultimate repayment of the loan; however, this tends to increase the magnitude of our real estate loan portfolio component. Generally, we target our loan-to-value ratio to be consistent with the supervisory loan to value limit guidelines provided by the banking regulators. In order to reduce collateral risk, we attempt to maintain a relatively diversified portfolio.

**Maturities and sensitivity of loans to changes in interest rates**

The information in the following table is based on the contractual maturities of individual loans, including loans that may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity. Actual repayments of loans may differ from maturities reflected below because borrowers have the right to prepay obligations with or without prepayment penalties.

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The following table summarizes major classifications of portfolio loans by maturities as of June 30, 2008:

| (Dollars in thousands)(Unaudited) | One Year<br>or Less | After One,<br>but within<br>Five Years | After<br>Five<br>Years | Total             |
|-----------------------------------|---------------------|--|------------------------|-------------------|
| Commercial                        | \$ 60,858           | 19,177                                 | 6,042                  | \$ 86,077         |
| Real estate mortgage              | 163,630             | 71,951                                 | 15,446                 | 251,027           |
| Real estate construction          | 344,520             | 14,798                                 |                        | 359,318           |
| Consumer                          | 9,037               | 3,640                                  | 130                    | 12,807            |
| <b>Total</b>                      | <b>\$ 578,045</b>   | <b>109,566</b>                         | <b>21,618</b>          | <b>\$ 709,229</b> |

The following table represents the rate structure for loans as of June 30, 2008:

| (Dollars in thousands)(Unaudited) | Variable<br>Rate  | Fixed<br>Rate     |
|-----------------------------------|-------------------|-------------------|
| Commercial                        | \$ 65,825         | \$ 20,252         |
| Real estate mortgage              | 159,732           | 91,295            |
| Real estate construction          | 351,432           | 7,886             |
| Consumer                          | 6,638             | 6,169             |
| <b>Total</b>                      | <b>\$ 583,627</b> | <b>\$ 125,602</b> |

***Provision and Allowance for Loan Losses***

We have developed policies and procedures for evaluating the overall quality of the credit portfolio and the timely identification of potential credit problems. Additions to the allowance for loan losses are made to maintain the allowance at an appropriate level based on our analysis of the potential risk in the loan portfolio. Our judgment about the adequacy of the allowance is based upon a number of assumptions about future events which we believe to be reasonable, but which may or may not be accurate. Because of the inherent uncertainty of assumptions made during the evaluation process, there can be no assurance that loan losses in future periods will not exceed the allowance for loan losses or that additional allocations will not be required. Our actual losses will undoubtedly vary from our estimates to some degree, and there is a possibility that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time.

As of June 30, 2008 the allowance for loan losses was \$10.4 million or 1.47% of outstanding loans, as compared to \$9.8 million or 1.45% at December 31, 2007. The Company's current economic environment is turbulent, and the real estate values of our loan collateral are rapidly shifting. We continually monitor the adequacy of our allowance and we have employed independent external loan review consultants to

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complement management's evaluation of the allowance. The Company is committed to following generally accepted accounting principles, including the December 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, as it determines the level of the allowance. As of June 30, 2008, management believes the allowance for loan losses is adequate.

Our judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrower's ability to pay, overall portfolio quality, and review of specific problem loans. In determining the adequacy of the allowance for loan losses, we use a loan grading system that rates loans in different categories. Certain grades representing criticized or classified loans are assigned allocations of loss based on management's estimate of potential loss that is generally based on historical losses and/or collateral deficiencies. Other loans are graded by type and allocated loss ranges based on management's perceived inherent loss for the loan type. The combination of these results is compared monthly to the recorded allowance for loan losses and material differences are adjusted by increasing or decreasing the provision for loan losses.

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The following table shows an analysis of allowance for loan loss, including charge-off activity, for the three and six months ended June 30, 2008 and 2007:

| (Dollars in thousands)(Unaudited)   | Three Months Ended<br>June 30 |                 | Six Months Ended<br>June 30 |                 |
|---|-------------------------------|-----------------|-----------------------------|-----------------|
|   | 2008                          | 2007            | 2008                        | 2007            |
| Balance at beginning of period  | \$ 11,167                     | \$ 5,021        | \$ 9,787                    | \$ 4,518        |
| Loans charged off:  |                               |                 |                             |                 |
| Commercial  | 95                            |                 | 421                         |                 |
| Real estate - mortgage  | 122                           |                 | 122                         |                 |
| Real estate - construction  | 1,912                         | 25              | 2,328                       | 25              |
| Consumer  | 15                            | 21              | 15                          | 21              |
| <b>Total loans charged off</b>  | <b>2,144</b>                  | <b>46</b>       | <b>2,886</b>                | <b>46</b>       |
| Recoveries of losses previously charged off:                                  |                               |                 |                             |                 |
| Commercial  |                               |                 |                             | 28              |
| Real estate - mortgage  |                               |                 |                             |                 |
| Real estate - construction  |                               |                 |                             |                 |
| Consumer  |                               |                 |                             |                 |
| <b>Total recoveries</b>   |                               |                 |                             | <b>28</b>       |
| <b>Net loans charged off</b>  | <b>2,144</b>                  | <b>46</b>       | <b>2,886</b>                | <b>18</b>       |
| Provision for loan losses   | 1,370                         | 275             | 3,492                       | 750             |
| <b>Allowance for loan losses at end of period</b>                             | <b>\$ 10,393</b>              | <b>\$ 5,250</b> | <b>\$ 10,393</b>            | <b>\$ 5,250</b> |
| Net loans charged off, as a percent of average loans outstanding (annualized) | 1.24%                         | 0.04%           | 0.84%                       | 0.01%           |

Our provision for loan losses for the three and six months ended June 30, 2008 was \$1.4 million and \$3.5 million, which was \$0.8 million less than net charge-offs for the three months ended June 30, 2008 and \$0.6 million higher than net charge-offs for the six months ended June 30, 2008. The comparable provision and net charge-off amounts for the three and six months ended June 30, 2007 were \$0.3 million and \$0.8 million and \$46 thousand and \$18 thousand, respectively. The loan loss provision increased from 2007 to 2008, due to increases in non-performing loans and net charge-offs. Net charge-offs for the three and six months ended June 30, 2008 represented 1.24% and 0.84% of average loans, compared to 0.04% and 0.01% of average loans for the three and six months ended June 30, 2007. The Company has been and will continue to be aggressive in dealing with nonperforming assets, moving loans to nonaccrual status, charging them off and foreclosing on collateral, as necessary.

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The following tables show the allocation of the allowance and the percentage of the allowance allocated to each category of total loans:

| (Dollars in thousands)(Unaudited) | June 30<br>2008  |                | December 31<br>2007 |                | June 30<br>2007 |                |
|-----------------------------------|------------------|----------------|---------------------|----------------|-----------------|----------------|
|                                   | Amount           | Percent        | Amount              | Percent        | Amount          | Percent        |
| Commercial                        | \$ 1,092         | 10.51%         | \$ 1,231            | 12.58%         | \$ 814          | 15.50%         |
| Real estate mortgage              | 1,502            | 14.45%         | 3,234               | 33.04%         | 1,093           | 20.82%         |
| Real estate construction          | 7,727            | 74.35%         | 5,181               | 52.94%         | 3,277           | 62.42%         |
| Consumer                          | 72               | 0.69%          | 141                 | 1.44%          | 66              | 1.26%          |
| <b>Total</b>                      | <b>\$ 10,393</b> | <b>100.00%</b> | <b>\$ 9,787</b>     | <b>100.00%</b> | <b>\$ 5,250</b> | <b>100.00%</b> |

**Non-performing Assets**

It is our policy to classify loans as non-accrual generally when they are past due in principal or interest payments for more than 90 days or if it is otherwise not reasonable to expect collection of principal and interest under the original terms. Exceptions are allowed for 90 days past due loans when such loans are well secured and in the process of collection. Generally, payments received on non-accrual loans are applied directly to principal.

We have adopted the principles of SFAS No. 114 and No. 118 relating to accounting for impaired loans and as of June 30, 2008, our impaired loans, totaled \$38.7 million and had associated reserves of approximately \$5.2 million. This is compared to impaired loans and associated reserves of \$8.3 million and approximately \$760 thousand, respectively, as of December 31, 2007. A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans are measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any and any subsequent changes are included in the allowance for loan losses. Interest on accruing impaired loans is recognized as long as such loans do not meet the criteria for nonaccrual status.

Non-performing assets, comprised of non-accrual loans, other real estate owned, other repossessed assets and loans for which payments are more than 90 days past due totaled \$54.0 million at June 30, 2008, compared to \$25.2 million at December 31, 2007. Non-accrual loans were \$28.4 million at June 30, 2008, an increase of \$20.1 million from non-accrual loans of \$8.3 million at December 31, 2007. The Company had loans ninety days past due and still accruing at June 30, 2008 of \$136 thousand as compared to \$3.4 million as of December 31, 2007. We have been aggressive in dealing with nonperforming loans, quickly moving them to nonaccrual status, other real estate owned, and/or charging them off, as deemed necessary. As mentioned above, our policy allows for us to continue accruing interest on loans that are 90 days past due loans when such loans are well secured and in the process of collection. Net other real estate owned totaled \$25.2 million as of June 30, 2008, compared to \$13.4 million at December 31, 2007.

The current credit deterioration has been driven by a real estate slowdown that accelerated in mid to late 2007 and has continued into 2008. This slowdown has had a greater impact on community banks in the Company's trade area than previous downturns in the economic cycle.

At June 30, 2008, we had non-performing loans, defined as non-accrual and accruing loans past due more than 90 days, of \$28.5 million or 4.02% of total loans. Non-performing loans for December 31, 2007 were \$11.7 million or 1.74% of total loans. Interest that would have been recorded on non-accrual loans had they performed in accordance with their original terms, amounted to \$628.0 thousand and \$1.1

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million for the three and six months ended June 30, 2008, compared to \$148.8 thousand and \$275.7 thousand for the same periods in 2007. Interest income on non-accrual loans included in the results of operations for the three and six months ended June 30, 2008, totaled \$78.0 thousand and \$181.8 thousand, respectively. For the same periods ended June 30, 2007, interest income on non-accrual loans included in our results of operations totaled \$9.5 thousand and \$22.6 thousand, respectively.

A summary of nonperforming assets as of June 30, 2008, December 31, 2007 and June 30, 2007 is presented below:

**Non-performing Assets**

| (Dollars in thousands)(Unaudited)  | June 30<br>2008  | December 31<br>2007 | June 30<br>2007  |
|--|------------------|---------------------|------------------|
| Non-accrual loans  | \$ 28,374        | \$ 8,310            | \$ 4,468         |
| Loans 90 days or more past due and still accruing  | 136              | 3,439               | 1,868            |
| <b>Total non-performing loans</b>  | <b>28,510</b>    | <b>11,749</b>       | <b>6,336</b>     |
| All other real estate owned, net   | 25,174           | 13,437              | 5,348            |
| All other repossessed assets   | 271              |                     |                  |
| <b>Total non-performing assets</b> <sup>1</sup>  | <b>\$ 53,955</b> | <b>\$ 25,186</b>    | <b>\$ 11,684</b> |
| <b>As a percent of total loans at end of period:</b>                                     |                  |                     |                  |
| Non-accrual loans  | 4.00%            | 1.23%               | 1.04%            |
| Loans 90 days or more past due and still accruing  | 0.02%            | 0.51%               | 0.43%            |
| <b>Total non-performing assets to total loans plus OREO and other repossessed assets</b> | <b>7.34%</b>     | <b>3.65%</b>        | <b>2.67%</b>     |

1 Total non-performing assets includes non-performing loans guaranteed by the Small Business Administration. At June 30, 2008, December 31, 2007 and June 30, 2007, the guaranteed portion of these loans amounted to \$4.1 million, \$3.6 million and \$0, respectively

The increase to our non-accrual loans during the first six months of 2008 is the net result of the following changes:

| (Dollars in thousands)(Unaudited)                        | June 30<br>2008  |
|--|------------------|
| Balance at December 31, 2007                             | \$ 8,310         |
| Loans reclassified to non-accrual status in 2008         | 36,923           |
| Payments received on non-accrual loans during 2008       | (1,257)          |
| Non-accrual loans charged-off during 2008                | (2,274)          |
| Non-accrual loans reclassified to other real estate      | (12,751)         |
| Non-accrual loans reclassified to repossessed collateral | (577)            |
| <b>Balance at June 30, 2008</b>                          | <b>\$ 28,374</b> |



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During 2008, additions to loans on nonaccrual status consisted of 45 real estate secured loans totaling \$34.6 million and 5 commercial SBA loans totaling \$2.3 million. At June 30, 2008, non-accrual loans consisted of 28 construction loans, three commercial and industrial loans, six SBA real estate loans, one real estate mortgage loan, and two consumer loans, totaling approximately \$22.3 million, \$1.2 million, \$4.7 million, \$157.6 thousand and \$6.3 thousand, respectively.

At June 30, 2008, the Company's Other Real Estate Owned consisted of 40 properties totaling \$25.2 million, compared to 15 properties totaling \$13.4 million as of December 31, 2007. The increase in OREO during the first six months of 2008 was the result of the foreclosure of 32 construction loan properties and one SBA real estate loan. Eight properties were sold during the first six months of 2008.

At June 30, 2008, the Company's OREO consisted of the following:

| <b>(Dollars in thousands)(Unaudited)</b> | <b>June 30<br/>2008</b> |
|--|-------------------------|
| Construction and land development        | \$ 22,517               |
| 1-4 family residential properties        | 1,222                   |
| Commercial properties                    | 1,435                   |
| <b>Total other real estate owned</b>     | <b>\$ 25,174</b>        |

The following is a summary of OREO activity for the first six months of 2008:

| <b>(Dollars in thousands)(Unaudited)</b>    |                  |
|---|------------------|
| Balance at December 31, 2007                | \$ 13,437        |
| Transfers into OREO                         | 20,103           |
| Sales of OREO                               | (7,315)          |
| Loss on sale of OREO                        | (110)            |
| Capitalized improvements net of charge-offs | (123)            |
| Change in valuation allowance               | (818)            |
| <b>Ending Balance - June 30, 2008</b>       | <b>\$ 25,174</b> |

Our OREO procedures currently determine disposition value, the valuation used to place the property into OREO, based upon the most recent appraisal of the property that we have at the time, less estimated costs to sell the property. Any difference between the disposition value and the loan balance is recommended for charge off. Once the property is in OREO, the property is listed with a realtor to begin sales efforts.

Management continually monitors the loan portfolio to ensure that all loans potentially having a material adverse impact on future operating results, liquidity or capital resources have been classified as non-performing. Should economic conditions deteriorate, the inability of distressed customers to service their existing debt could cause higher levels of non-performing loans.

It is our general policy to stop accruing interest income and place the recognition of interest on a cash basis when a loan is placed on non-accrual status and any interest previously accrued but not collected is reversed against current income. Generally, a loan is placed on non-accrual status when it is over 90 days past due and there is reasonable doubt that all principal will be collected.

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In addition to loans formally classified as non-accrual or non-performing, management maintains a list of monitored loans which may eventually become so classified. Individual loan officers are responsible for assessing business and credit risk for each loan in their respective portfolios. The monitored loan list exists as a vehicle measuring and monitoring identified assets with heightened risk characteristics. Heightened risk characteristics would include a history of poor payment performance, poor financial performance, as well as the potential for adverse earnings impact from deteriorating collateral values. Management meets monthly to re-assess the ongoing status of credits on this list. As of June 30, 2008, there were loans totaling \$75.2 million on the monitored loan list, \$28.4 million on nonaccrual status and \$136 thousand that were past due 90 days or more and still accruing. The \$75.2 million on the monitored loan list includes \$1.3 million representing the portion of loans guaranteed by the Small Business Administration ( SBA ). As of December 31, 2007, there were loans totaling \$46.4 million on the monitored loan list, \$8.3 million on nonaccrual status, and \$3.4 million that were past due 90 days or more and still accruing. The \$46.4 million on the December 31, 2007 monitored loan list includes \$2.1 million representing the portion of loans guaranteed by the SBA.

***Deposits***

Core deposits, which exclude time deposits of \$100,000 or more, CDARs deposits, and brokered time deposits, provide a relatively stable funding source for our loan portfolio and other earning assets. Core deposits were approximately \$339.2 million at June 30, 2008 compared to \$345.1 million at December 31, 2007. Although we view CDARs as core customers, CDARs balances are not considered to be core deposits under banking regulations. CDARs balances were \$85.4 million at June 30, 2008, compared to \$70.6 million as of December 31, 2007.

The maturity distribution of time deposits of \$100,000 or more as of June 30, 2008 was as follows:

| <b>(Dollars in thousands)(Unaudited)</b> |                   |
|--|-------------------|
| Three months or less                     | \$ 97,622         |
| Over three through six months            | 57,927            |
| Over six through twelve months           | 96,351            |
| Over twelve months                       | 73,706            |
| <b>Total</b>                             | <b>\$ 325,606</b> |

***Borrowed Funds*****Short-term:**

We have access to various short-term borrowings, including the purchase of federal funds and borrowing arrangements from other financial institutions. The Company had \$10 million in federal funds purchased as of June 30, 2008 and \$1.5 million as of December 31, 2007.

Overnight customer sweep agreements totaled \$21.8 million at June 30, 2008 compared to \$15.1 million as of December 31, 2007. These short-term borrowings are collateralized by securities and generally mature within one day from the transaction date. The agreements are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities.

As of June 30, 2008, other borrowings included in short-term borrowings totaled zero compared to \$3.0 million as of December 31, 2007.

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**Long-term:**

We had \$10.0 million in FHLB borrowings as of June 30, 2008, compared to zero at December 31, 2007. These fixed rate advances mature in August of 2009.

As of June 30, 2008, long-term debt also consisted of \$10.0 million in subordinated capital notes. This borrowing has a variable rate and matures on March 31, 2020. For regulatory capital purposes, these notes are included in Tier 2 capital. The December 31, 2007 balance of long-term debt was zero.

***Junior Subordinated Debt***

**Buckhead Community Bancorp Statutory Trust I**

In August, 2004 we formed a wholly-owned grantor trust to issue cumulative trust preferred securities. The grantor trust has invested the proceeds of the trust preferred securities in junior subordinated debentures of the Company. The junior subordinated debentures can be redeemed prior to maturity at the option of the Company on or after August 11, 2009. The sole assets of the guarantor trust are the junior subordinated deferrable interest debentures of the Company (the first series of debentures ) held by the grantor trust. The first series of debentures have the same interest rate (three month LIBOR plus 2.90%, floating) as the trust preferred securities. We have the right to defer interest payments on the first series of debentures at any time or from time to time for a period not exceeding 20 consecutive quarters provided that no extension period may extend beyond the stated maturity of the related first series of debentures. During any such extension period, distributions on the trust preferred certificates would also be deferred.

Payment of periodic cash distributions and payment upon liquidation or redemption with respect to the trust preferred securities are guaranteed by the Company to the extent of funds held by the grantor trust (the Preferred Securities Guarantee I ). The Preferred Securities Guarantee I, when taken together with the Company's other obligations under the first series of debentures, constitute a full and unconditional guarantee, on a subordinated basis, by the Company of payments due on the trust preferred securities.

The trust preferred securities and the related first series of debentures were issued on August 11, 2004. Distributions on the trust preferred securities are paid quarterly on March 31, June 30, September 30 and December 31 of each year, beginning September 30, 2004. Interest on the first series of debentures is paid on the corresponding dates. The aggregate principal amount of the first series of debentures outstanding at June 30, 2008 and December 31, 2007 was \$5,155,000. Certain issue costs have been deferred and recorded in other assets in the accompanying consolidated balance sheets. The issue costs are being amortized over the life of the first series of debentures, and the outstanding balance of the unamortized issue costs at June 30, 2008 and December 31, 2007 was approximately \$90 and \$92 thousand, respectively.

**Buckhead Community Bancorp Statutory Trust II**

In May 2006, we formed a second wholly-owned grantor trust to issue cumulative trust preferred securities. The grantor trust has invested the proceeds of the trust preferred securities in junior subordinated debentures of the Company. The junior subordinated debentures can be redeemed prior to maturity at the option of the Company on or after July 7, 2011. The sole assets of the guarantor trust are the junior subordinated deferrable interest debentures of the Company (the second series of debentures ) held by the grantor trust. The second series of debentures have the same interest rate (LIBOR plus 1.55%, floating) as these trust preferred securities. We have the right to defer interest payments on the second series of debentures at any time or from time to time for a period not exceeding 20 consecutive quarters provided that no extension period may extend beyond the stated maturity of the related second series of debentures. During any such extension period, distributions on the trust preferred certificates would also be deferred.

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Payment of periodic cash distributions and payment upon liquidation or redemption with respect to the trust preferred securities are guaranteed by the Company to the extent of funds held by the grantor trust (the Preferred Securities Guarantee II ). The Preferred Securities Guarantee II, when taken together with our other obligations under the second series of debentures, constitutes a full and unconditional guarantee, on a subordinated basis, by the Company of payments due on the trust preferred securities.

The trust preferred securities and the related second series of debentures were issued on May 24, 2006. Distributions on the trust preferred securities are paid quarterly on April 7, July 7, October 7 and January 7 of each year, beginning July 7, 2006. Interest on the second series of debentures is paid on the corresponding dates. The aggregate principal amount of the second series of debentures outstanding at June 30, 2008 and December 31, 2007 was \$10,310,000. There were no issue costs associated with the issuance of the second series of debentures.

## **Income Statement Review**

We reported a net loss of \$1.2 million for the three months ended June 30, 2008, a decrease in earnings of \$2.6 million compared to the same period of the prior year. Basic and diluted loss per share amounted to \$(0.19) respectively, compared to \$0.30 basic and diluted earnings per share for the three months ended June 30, 2007. Net loss for the first six months of 2008 was \$2.1 million, a decrease in earnings of \$4.8 million compared to the same period of the prior year. Basic and diluted loss per share totaled \$(0.34) for the six months ended June 30, 2008, compared to basic and diluted earnings per share of \$0.59 for the same period of the prior year. Margin compression and increasing costs to carry nonperforming assets, including provisions to associated valuation allowances, had a negative impact on earnings for the second quarter and first six months of 2008.

On December 4, 2007, the Company acquired Allied Bancshares, Inc. The acquisition was accounted for under the purchase method of accounting with the results of operations for Allied included in our consolidated financial results beginning December 4, 2007. This transaction is more fully described in Note 2 to the Consolidated Financial Statements included in Item 1.

## ***Net Interest Income/Margin***

Net interest income for the three months ended June 30, 2008 was \$4.9 million, a decrease of \$551 thousand or 10.1% from the same period of 2007. The decrease in net interest income was driven by declining interest rates and interest reversals on non-performing loans. Our rates on loans have declined more quickly than the rates on our deposits, as our certificates of deposit take longer to reprice. We also had additional borrowings expense in 2008.

Average loans for the second quarter of 2008 were \$696.5 million, compared to \$420.5 million for the same period in 2007. The average yield on loans decreased from 9.44% for the three months ended June 30, 2007 to 6.50% for the three months ended June 30, 2008. Interest reversals related to non-performing loans contributed to the decline, along with interest rate cuts from the Federal Reserve. For the three months ended June 30, 2008, average securities available for sale were \$118.3 million compared to \$99.7 million for the same period of 2007.

The average cost of funds decreased 92 basis points to 4.11% for the second quarter of 2008 compared to the same period in 2007, primarily due to decreases in the interest rates paid on certificates of deposits. Average time deposits for the second quarter of 2008 were \$557.9 million, compared to \$376.0 million for the same period of 2007, an increase of 48.4%. The average rate paid on time deposits decreased from 5.38% for the three months ended June 30, 2007 to 4.59% for the same period of 2008. While the Federal Reserve reduced the federal funds target rate beginning late 2007, average rates paid on these deposits typically lag these rate reductions due to the longer term of the accounts.

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The banking industry uses two ratios to measure relative profitability of net interest income. The net interest rate spread measures the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. The interest rate spread eliminates the impact of non-interest-bearing deposits and gives a direct perspective on the effect of market interest rate movements. The net interest margin is defined as net interest income as a percent of average total interest-earning assets and takes into account the positive impact of investing non interest-bearing deposits.

For the three months ended June 30, 2008 and 2007, the net interest spread was 2.04% and 3.29%, respectively, while the net interest margin was 2.36% and 3.83%, respectively. A number of factors contributed to the net interest spread and net interest margin compression from a year ago. Competition for deposits has increased and we have had to offer relatively higher rates to retain deposits. Additionally, the increasing level of non-performing loans has lowered loan yields. Finally, as interest rates have declined, we have experienced margin compression, due to our loan rates dropping more immediately than our deposits have repriced to the lower rates.

Net interest income for the six months ended June 30, 2008 was \$10.5 million, a decrease of \$296 thousand or 2.8% compared to the same period of 2007. The decrease in net interest income was primarily driven by the aforementioned cost of funds declining more slowly in relation to the reduction of yield on our loans, which was exacerbated by interest reversals related to non-performing loans.

Average loans for the first six months of 2008 were \$690.3 million, compared to \$407.4 million for the same period in 2007. The average yield on loans decreased from 9.52% for the six months ended June 30, 2007 to 7.05% for the six months ended June 30, 2008, a decline of 247 basis points. Interest reversals related to non-performing loans contributed to the decline, along with interest rate cuts from the Federal Reserve. For the six months ended June 30, 2008, average securities available for sale were \$114.0 million compared to \$98.3 million for the same period of 2007.

The average cost of funds decreased 67 basis points to 4.38% for the first six months of 2008 compared to the same period in 2007, primarily due to decreases in the interest rates paid on certificates of deposit. Average time deposits for the first six months of 2008 were \$567.7 million, compared to \$365.1 million for the same period of 2007, an increase of 55.5%. The average rate paid on time deposits decreased from 5.40% for the six months ended June 30, 2007 to 4.84% for the same period of 2008.

For the six months ended June 30, 2008 and 2007, the net interest spread was 2.15% and 3.39%, respectively, while the net interest margin was 2.52% and 3.90%, respectively. The compression in net interest spread and net interest margin on a year-to-date basis was caused by similar factors discussed surrounding the quarter-over-quarter decline.

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The following tables show the relationship between interest income and expense and the average balances of interest earning assets and interest bearing liabilities for the three and six months ended June 30, 2008 and 2007:

| (Dollars in thousands)(Unaudited)             | Three Months Ended |                    |                |                    |                    |                |
|---|--------------------|--------------------|----------------|--------------------|--------------------|----------------|
|   | June 30, 2008      |                    |                | June 30, 2007      |                    |                |
|   | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate |
| <b>ASSETS:</b>                                |                    |                    |                |                    |                    |                |
| Federal funds sold                            | \$ 22,376          | \$ 120             | 2.16%          | \$ 44,873          | \$ 584             | 5.15%          |
| Interest bearing deposits                     | 400                | 3                  | 3.02%          | 396                | 4                  | 4.01%          |
| Investment securities available for sale      |                    |                    |                |                    |                    |                |
| Taxable                                       | 94,653             | 1,178              | 4.98%          | 76,993             | 1,030              | 5.23%          |
| Nontaxable <sup>1</sup>                       | 23,608             | 232                | 6.05%          | 22,663             | 230                | 6.11%          |
| Loans   | 696,544            | 11,262             | 6.50%          | 420,540            | 10,005             | 9.44%          |
| Total interest earning assets                 | 837,581            | 12,795             | 6.14%          | 565,465            | 11,853             | 8.32%          |
| All other assets                              | 78,974             |                    |                | 18,731             |                    |                |
| Total assets                                  | \$ 916,555         |                    |                | \$ 584,196         |                    |                |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY:</b>   |                    |                    |                |                    |                    |                |
| Interest bearing demand deposits and savings  | \$ 148,576         | 922                | 2.50%          | \$ 100,189         | 892                | 3.53%          |
| Time  | 557,899            | 6,367              | 4.59%          | 375,977            | 5,100              | 5.38%          |
| Junior subordinated debt                      | 15,465             | 189                | 4.92%          | 15,465             | 286                | 7.34%          |
| Short-term borrowings                         | 30,267             | 208                | 2.76%          | 12,670             | 111                | 3.48%          |
| Long-term borrowings                          | 19,769             | 196                | 3.99%          |                    |                    |                |
| Total interest bearing liabilities            | 771,976            | 7,882              | 4.11%          | 504,301            | 6,389              | 5.03%          |
| Noninterest-bearing deposits                  | 49,611             |                    |                | 33,268             |                    |                |
| Other liabilities                             | 6,929              |                    |                | 3,825              |                    |                |
| Shareholders equity                           | 88,039             |                    |                | 42,802             |                    |                |
| Total liabilities and shareholders equity     | \$ 916,555         |                    |                | \$ 584,196         |                    |                |
| Net interest spread                           |                    |                    | 2.04%          |                    |                    | 3.29%          |
| Net interest margin on average earning assets |                    |                    | 2.36%          |                    |                    | 3.83%          |
| Net interest income                           |                    | \$ 4,913           |                |                    | \$ 5,464           |                |

1 Yield is on a tax-equivalent basis

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| (Dollars in thousands)(Unaudited)             | June 30, 2008      |                    |                | Six Months Ended<br>June 30, 2007 |                    |                |
|---|--------------------|--------------------|----------------|-----------------------------------|--------------------|----------------|
|   | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance                | Income/<br>Expense | Yield/<br>Rate |
| <b>ASSETS:</b>                                |                    |                    |                |                                   |                    |                |
| Federal funds sold                            | \$ 27,827          | \$ 381             | 2.75%          | \$ 45,031                         | \$ 1,165           | 5.22%          |
| Interest bearing deposits                     | 1,413              | 26                 | 3.70%          | 513                               | 8                  | 3.04%          |
| Investment securities available for sale      |                    |                    |                |                                   |                    |                |
| Taxable                                       | 90,262             | 2,256              | 5.00%          | 75,645                            | 2,048              | 5.41%          |
| Nontaxable <sup>1</sup>                       | 23,695             | 467                | 6.06%          | 22,698                            | 453                | 6.50%          |
| Loans   | 690,251            | 23,935             | 7.05%          | 407,437                           | 19,422             | 9.52%          |
| Total interest earning assets                 | 833,448            | 27,065             | 6.53%          | 551,324                           | 23,096             | 8.44%          |
| All other assets                              | 77,225             |                    |                | 17,401                            |                    |                |
| Total assets                                  | \$ 910,673         |                    |                | \$ 568,725                        |                    |                |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY:</b>   |                    |                    |                |                                   |                    |                |
| Interest bearing demand deposits and savings  | \$ 140,868         | 1,874              | 2.68%          | \$ 100,573                        | 1,788              | 3.58%          |
| Time  | 567,744            | 13,661             | 4.84%          | 365,122                           | 9,781              | 5.40%          |
| Junior subordinated debt                      | 15,465             | 439                | 5.71%          | 15,465                            | 574                | 7.49%          |
| Short-term borrowings                         | 27,507             | 415                | 3.03%          | 11,710                            | 205                | 3.53%          |
| Long-term borrowings                          | 11,857             | 224                | 3.80%          |                                   |                    |                |
| Total interest bearing liabilities            | 763,441            | 16,613             | 4.38%          | 492,870                           | 12,348             | 5.05%          |
| Noninterest-bearing deposits                  | 47,305             |                    |                | 32,633                            |                    |                |
| Other liabilities                             | 11,127             |                    |                | 2,219                             |                    |                |
| Shareholders equity                           | 88,800             |                    |                | 41,003                            |                    |                |
| Total liabilities and shareholders equity     | \$ 910,673         |                    |                | \$ 568,725                        |                    |                |
| Net interest spread                           |                    |                    | 2.15%          |                                   |                    | 3.39%          |
| Net interest margin on average earning assets |                    |                    | 2.52%          |                                   |                    | 3.90%          |
| Net interest income                           |                    | \$ 10,452          |                |                                   | \$ 10,748          |                |

<sup>1</sup> Yield is on a tax-equivalent basis

Nonaccrual loans and the interest income which was recorded on these loans, if any, are included in the yield calculation for loans in all periods reported. Loan fees totaled \$469.7 thousand and \$497.8 thousand for the three months ended June 30, 2008 and 2007, respectively, and are included with interest income on loans. Loan fees totaled \$1.1 million and \$1.0 million for the six months ended June 30, 2008 and 2007.

**Table of Contents*****Other Income and Other Expense***

For the three months ended June 30, 2008 and 2007, total noninterest income totaled \$280 thousand and \$327 thousand, respectively. There was a \$145 thousand decrease in gains on the sale of SBA loans and a \$134 thousand increase in gains on sales of securities available for sale. Other noninterest income was comprised primarily of service charge and fee income and declined \$36 thousand, or 25.5% from the second quarter of 2007.

For the six months ended June 30, 2008 and 2007, total noninterest income totaled \$495 thousand and \$817 thousand, respectively. The decrease was primarily due to a \$515 thousand, or 99.0% decrease in gains on the sale of SBA loans.

Total noninterest expense for the three months ended June 30, 2008 increased \$2.5 million, or 73.5% from 2007. The primary component of total noninterest expense was salary and employee benefits, which totaled \$2.7 million and \$2.1 million for the second quarter of 2008 and 2007, respectively. The \$0.6 million, or 28.2% increase in salary and employee benefits primarily resulted from additional employees due to the acquisition of Allied. We had 127 full time equivalent employees at June 30, 2008, compared to 97 full time equivalent employees at June 30, 2007. Other operating expenses increased \$1.5 million, or 261.8% from the three months ended June 30, 2007, primarily due to a \$1.1 million increase in provision for OREO losses and OREO expenses, as well as a \$140 thousand increase in FDIC premiums. Data processing and other expenses also increased in general, due to the acquisition of Allied.

For the six months ended June 30, 2008, total noninterest expense was \$11.1 million compared to \$6.7 million for the same period of 2007. The increase was primarily driven by a \$2.4 million, or 213.6% increase in other operating expenses. This increase was attributable to a \$1.0 million increase in provision for OREO losses, as well as approximately \$443 thousand in additional expenses related to carrying OREO. In addition, FDIC premiums increased \$294 thousand and data processing expenses increased \$243 thousand compared to the six months ended June 30, 2007. Salaries and employee benefits increased \$1.4 million, or 34.5% from the six months ended June 30, 2007 to the six months ended June 30, 2008, primarily due to the aforementioned increase in headcount.

The following table shows the components of noninterest expense for the three and six months ended June 30, 2008 and 2007:

| (Dollars in thousands)(Unaudited)     | Three months ended<br>June 30 |                 | Six months ended<br>June 30 |                 |
|---------------------------------------|-------------------------------|-----------------|-----------------------------|-----------------|
|                                       | 2008                          | 2007            | 2008                        | 2007            |
| Salaries and employee benefits        | \$ 2,731                      | \$ 2,131        | \$ 5,630                    | \$ 4,187        |
| Occupancy expenses                    | 646                           | 416             | 1,229                       | 839             |
| Advertising and marketing             | 177                           | 140             | 333                         | 273             |
| Legal and other professional services | 221                           | 128             | 449                         | 245             |
| FDIC premiums                         | 154                           | 14              | 322                         | 28              |
| Provision for OREO losses             | 821                           | 25              | 1,069                       | 25              |
| OREO expenses                         | 368                           | 34              | 504                         | 61              |
| Amortization of intangibles           | 71                            |                 | 142                         |                 |
| Data processing and technology        | 283                           | 194             | 626                         | 383             |
| Other expenses                        | 431                           | 321             | 818                         | 613             |
| <b>Total noninterest expense</b>      | <b>\$ 5,903</b>               | <b>\$ 3,403</b> | <b>\$ 11,122</b>            | <b>\$ 6,654</b> |



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### ***Income Taxes***

We had a tax benefit of \$872 thousand for the second quarter of 2008, compared to a provision for income taxes of \$732 thousand for the three months ended June 30, 2007. Effective tax rates for the periods were (41.9) % and 34.6%, respectively. For the six months ended June 30, 2008, our tax benefit totaled \$1.5 million, compared to tax expense of \$1.4 million for the six months ended June 30, 2007, resulting in effective tax rates of (42.0)% and 34.6%, respectively.

### **Liquidity**

We must maintain, on a daily basis, sufficient funds to cover the withdrawals from depositors' accounts and to supply new borrowers with funds. To meet these obligations, we keep cash on hand, maintain account balances with our correspondent banks, and purchase and sell federal funds and other short-term investments. Asset and liability maturities are monitored in an attempt to match these to meet liquidity needs. We seek to monitor our liquidity to meet regulatory requirements and local funding requirements. We believe the current level of liquidity is adequate to meet current needs, and we are constantly monitoring it in an effort to improve our position. Maintaining an adequate level of liquidity is a top priority of management.

Our primary sources of liquidity are a stable base of deposits, scheduled repayments on loans, and interest and maturities of investments. All securities have been classified as available for sale, which means they are carried at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of other comprehensive income. If necessary, we have the ability to sell a portion of our unpledged investment securities to manage interest sensitivity gap or liquidity. During the second quarter of 2008, we successfully reduced our level of pledged securities from \$76.2 million at March 31, 2008 to \$58.0 million at June 30, 2008. Cash and due from banks and federal funds sold may also be utilized to meet liquidity needs.

At June 30, 2008 and December 31, 2007, we had arrangements with a correspondent and commercial banks for short term unsecured advances up to \$30.5 million.

Our cash flows are composed of three classifications: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities. Cash and due from banks decreased \$10.9 million from December 31, 2007, to a total of \$8.2 million at June 30, 2008. Cash used in investing activities totaled \$48.9 million for the six months ended June 30, 2008, primarily due to purchases of securities available for sale, and the funding of loans, as well as for the cash portion of the purchase of Allied. Cash provided by financing activities totaled \$45.3 million for the six months ended June, 2008, primarily due to proceeds from short-term borrowings and long-term debt.

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The table below contains a summary of our contractual obligations as of June 30, 2008:

| (Dollars in thousands)(Unaudited)  | 1 year<br>or less | 1-3 years  | 3-5 years | After<br>5 years | Total      |
|------------------------------------|-------------------|------------|-----------|------------------|------------|
| Deposits having no stated maturity | \$ 192,169        | \$         | \$        | \$               | \$ 192,169 |
| Junior subordinated debt           |                   | 5,155      | 10,310    |                  | 15,465     |
| Certificates of deposit            | 445,485           | 110,561    | 15,814    | 101              | 571,961    |
| Short-term borrowings              | 31,789            |            |           |                  | 31,789     |
| Long-term debt                     |                   | 10,000     |           | 10,000           | 20,000     |
| Leases                             | 858               | 1,496      | 1,384     | 1,291            | 5,029      |
|                                    | \$ 670,301        | \$ 127,212 | \$ 27,508 | \$ 11,392        | \$ 836,413 |

**Capital Resources**

We are subject to various regulatory capital requirements administered by our respective federal banking regulators. 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 adequacy guidelines and the regulatory framework for prompt corrective action, both the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's respective capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as such terms are defined in the regulations. Management believes, as of June 30, 2008, that the Company and the Bank meet all capital adequacy requirements to which each is subject.

As of June 30, 2008, the most recent regulatory notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. There are no conditions or events since that notification that management believes have changed the Bank's category.

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At June 30, 2008, our capital ratios were sufficient for us to be considered well capitalized based on regulatory minimum capital requirements. The minimum capital requirements and the actual capital ratios on a consolidated and bank-only basis are as follows:

| (Unaudited)                             | Tier 1<br>Leverage | Tier 1<br>Risk-based | Total<br>Risk-based |
|---|--------------------|----------------------|---------------------|
| Minimum required                        | 4.00%              | 4.00%                | 8.00%               |
| Minimum required to be well capitalized | 5.00%              | 6.00%                | 10.00%              |
| Actual ratios at June 30, 2008          |                    |                      |                     |
| The Buckhead Community Bank             | 7.63%              | 8.37%                | 10.87%              |
| Consolidated                            | 7.68%              | 8.43%                | 10.92%              |

**Off-Balance-Sheet Items**

Our financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of business. These off-balance-sheet financial instruments include commitments to extend credit and standby letters of credit. These financial instruments are included in the financial statements when funds are distributed or the instruments become payable. We use the same credit policies in making commitments as we do for on-balance sheet instruments. Our exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit, standby letters of credit and credit card commitments is represented by the contractual amount of those instruments.

The table below contains a summary of our commitments as of June 30, 2008 and December 31, 2007.

| (Dollars in thousands)(Unaudited) | June 30<br>2008 | December 31<br>2007 |
|-----------------------------------|-----------------|---------------------|
| Commitments to extend credit      | \$ 126,205      | \$ 158,997          |
| Standby letters of credit         | 10,204          | 7,681               |
|                                   | \$ 136,409      | \$ 166,678          |

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

***Interest Rate Sensitivity Management***

The absolute level and volatility of interest rates can have a significant impact on the Company's profitability. The objective of interest rate risk management is to identify and manage the sensitivity of net interest income to changing interest rates, in order to achieve the Company's overall financial goals. Based on economic conditions, asset quality and various other considerations, management establishes tolerance ranges for interest rate sensitivity and manages within these ranges.

The Company's net interest income and the fair value of its financial instruments are influenced by changes in the level of interest rates. We manage our exposure to fluctuations in interest rates through policies established by the asset/liability committee of the board of directors. The asset/liability committee meets periodically and has responsibility for approving asset/liability management policies, formulating and implementing strategies to improve balance sheet positioning and/or earnings and reviewing the Company's interest rate sensitivity.

One of the tools management utilizes to estimate the sensitivity of net interest revenue to changes in interest rates is an interest rate simulation model. Such estimates are based upon a number of assumptions for each scenario, including the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments. The simulation model measures the potential change in net interest revenue over a twelve-month period under six interest rate scenarios. The first scenario assumes rates remain flat over the next twelve months and is the scenario that all others are compared to in order to measure the change in net interest income. The second scenario is a most likely scenario that projects the most likely change in rates over the next twelve months based on the slope of the yield curve. The Company models ramp scenarios that assume gradual increases and decreases of 300 basis points each over the next twelve months. At June 30, 2008, our simulation model indicated that a 300 basis point increase in rates over the next twelve months would cause an approximate 21.9% increase in net interest income and a 300 basis point decrease in rates over the next twelve months would cause an approximate 19.32% decrease in net interest income. At December 31, 2007, our simulation model indicated that a 300 basis point increase in rates over the next twelve months would cause an approximate 16.43% increase in net interest income and a 300 basis point decrease in rates over the next twelve months would cause an approximate 12.63% decrease in net interest income.

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames within which the interest-earning assets and interest-bearing liabilities are subject to change in interest rates either at replacement, repricing or maturity during the life of the instruments. Interest rate sensitivity management focuses on the maturity structure of assets and liabilities and their repricing characteristics during periods of changes in market interest rates. Effective interest rate sensitivity management seeks to ensure that both assets and liabilities respond to changes in interest rates within an acceptable timeframe, thereby minimizing the impact of interest rate changes on net interest revenue. Interest rate sensitivity is measured as the difference between the volumes of assets and liabilities in the Company's current portfolio that are subject to repricing at various time horizons: immediate; one to three months; four to twelve months; one to five years; over five years, and on a cumulative basis. The differences are known as interest sensitivity gaps.

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The following table shows interest sensitivity gaps for these different intervals.

| (Dollars in thousands)(Unaudited)                                    | Interest Sensitivity by Month<br>As of June 30, 2008 |                |                |                |               | Total          |
|--|--|----------------|----------------|----------------|---------------|----------------|
|  | Immediate  | 1 to 3         | 4 to 12        | 13 to 60       | Over 60       |                |
| <b>Interest-earning assets:</b>                                      |  |                |                |                |               |                |
| Federal funds sold   | \$ 7,309   |                |                |                |               | 7,309          |
| Interest Bearing due from accounts                                   | 274  |                |                |                |               | 274            |
| Investment securities available for sale                             |  | 9,450          | 8,140          | 37,593         | 59,781        | 114,964        |
| Loans  |  | 577,516        | 58,732         | 47,341         | 24,992        | 708,581        |
| <b>Total earning assets</b>  | <b>7,583</b>   | <b>586,966</b> | <b>66,872</b>  | <b>84,934</b>  | <b>84,773</b> | <b>831,128</b> |
| <b>Interest-bearing liabilities:</b>                                 |  |                |                |                |               |                |
| Non-interest bearing deposits  |  | 1,554          | 4,662          | 24,864         | 18,548        | 49,628         |
| Interest bearing deposits (NOW)                                      |  | 1,629          | 4,887          | 26,010         |               | 32,526         |
| Savings deposits (includes MMkt)                                     |  | 106,321        | 585            | 3,109          |               | 110,015        |
| Time deposits  |  | 151,648        | 293,288        | 126,463        | 562           | 571,961        |
| Short-term borrowings  | 31,789   |                |                |                |               | 31,789         |
| Long-term debt   |  |                |                | 10,000         | 10,000        | 20,000         |
| Junior subordinated debt   |  |                |                | 15,465         |               | 15,465         |
| <b>Total interest-bearing liabilities</b>                            | <b>31,789</b>  | <b>261,152</b> | <b>303,422</b> | <b>205,911</b> | <b>29,110</b> | <b>831,384</b> |
| Interest sensitivity gap   | (24,206)   | 325,814        | (236,550)      | (120,977)      | 55,663        |                |
| Cumulative interest-sensitivity gap                                  | \$ (24,206)  | 301,608        | 65,058         | (55,919)       | (256)         |                |
| Ratio of cumulative interest-sensitivity gap to total earning assets | -2.91%   | 36.29%         | 7.83%          | -6.73%         | -0.03%        |                |

As demonstrated in the preceding table, 71.7% of interest-bearing liabilities will reprice within twelve months compared with 79.6% of interest-earning assets, however such changes may not be proportionate with changes in market rates within each balance sheet category. In addition, the Company may have some discretion in the extent and timing of deposit repricing depending upon the competitive pressures in the markets in which it operates. Changes in the mix of earning assets or supporting liabilities can either increase or decrease the net interest margin without affecting interest rate sensitivity. The interest rate spread between an asset and its supporting liability can vary significantly even when the timing of repricing for both the asset and the liability remains the same, due to the two instruments repricing according to different indices.

Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities that are not reflected in the interest rate sensitivity gap analysis. These prepayments may have significant impact on the net interest margin. Because of these limitations, an interest sensitivity gap analysis alone generally does not provide an accurate assessment of exposure to changes in interest rates.

**Table of Contents****Impact of Inflation and Changing Prices**

The effect of relative purchasing power over time due to inflation has not been taken into effect in our financial statements. Rather, the statements have been prepared on a historical cost basis in accordance with generally accepted accounting principles in the United States.

Since most of the assets and liabilities of a financial institution are monetary in nature, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. Interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude.

The table below summarizes the return on average assets, return on average equity, and average equity to average assets for the three and six months ended June 30, 2008 and 2007:

| (Unaudited)                      | Three Months Ended<br>June 30 |        | Six Months Ended<br>June 30 |        |
|----------------------------------|-------------------------------|--------|-----------------------------|--------|
|                                  | 2008                          | 2007   | 2008                        | 2007   |
| Return on average assets         | -0.53%                        | 0.95%  | -0.47%                      | 0.96%  |
| Return on average equity         | -5.52%                        | 12.94% | -4.82%                      | 13.37% |
| Average equity to average assets | 9.61%                         | 7.33%  | 9.75%                       | 7.21%  |

**ITEM 4T. Controls and Procedures**

As of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have evaluated the effectiveness of our disclosure controls and procedures ( Disclosure Controls ). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act ), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Our management, including the CEO and CFO, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our CEO and CFO have concluded that our Disclosure Controls are effective at a reasonable assurance level.

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There have been no changes in our internal controls over financial reporting during our second fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

The Company and its subsidiaries are subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of these pending claims and legal proceedings will not have a material adverse effect on the Company's results of operations.

### **ITEM 1A. Risk Factors**

*Weakness in the economy and in the real estate market, including specific weakness within our geographic footprint, has adversely affected us and may continue to adversely affect us.*

If the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations decline, or continue to decline, this could continue to result in, among other things, a deterioration in credit quality or a reduced demand for credit, including a resultant adverse effect on our loan portfolio and allowance for loan and lease losses. Declines in the U.S. economy and the real estate market contributed to our increasing provisions for loan losses in the fourth quarter of 2007 and through the second quarter of 2008, and our expectation for future loan losses and loss provisions for the remainder of 2008 and 2009. These factors could result in loan loss provisions in excess of charge-offs, delinquencies and/or greater charge-offs in future periods, which may adversely affect our financial condition and results of operations. In addition, deterioration of the U.S. economy may adversely impact our traditional banking business. Economic declines may be accompanied by a decrease in demand for consumer or commercial credit and declining real estate and other asset values. Declining real estate and other asset values may reduce the ability of borrowers to use such equity to support borrowings. Delinquencies, foreclosures and losses generally increase during economic slowdowns or recessions. Additionally, our servicing costs, collection costs and credit losses may also increase in periods of economic slowdown or recessions. The impact of recent events relating to subprime mortgages resulting in a substantial housing recession has not been limited to those directly involved in the real estate construction industry (such as builders and developers). Rather, it has impacted a number of related businesses such as building materials suppliers, equipment leasing firms, and real estate attorneys, among others. All of these affected businesses have banking relationships and when their businesses suffer from recession, the banking relationship suffers as well.

*The impact of the current economic downturn on the performance of other financial institutions in our primary market area, actions taken by our competitors to address the current economic downturn, and the public perception of and confidence in the economy generally, and the banking industry specifically, could negatively impact our performance and operations.*

All financial institutions are subject to the same risks resulting from a weakening economy such as increased charge-offs and levels of past due loans and nonperforming assets. As troubled institutions in our market area continue to dispose of problem assets, the already excess inventory of residential homes and lots will continue to negatively impact home values and increase the time it takes us or our borrowers to sell existing inventory. The perception that troubled banking institutions (and smaller banking institutions that are not in trouble) are risky institutions for purposes of regulatory compliance or

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safeguarding deposits may cause depositors nonetheless to move their funds to larger institutions. If our depositors should move their funds based on events happening at other financial institutions, our operating results would suffer.

### ***Future impairment losses could be required on the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) mortgage-backed securities that the Company owns.***

As of June 30, 2008, FNMA and FHLMC mortgage-backed securities represented approximately \$46 million or 40% of the total amortized cost of the Company's portfolio of investment securities and \$45 million or 40% of the fair value of the Company's portfolio of investment securities. Recently, FNMA and FHLMC have announced significant losses related to their respective business activities, which are primarily mortgage related. Both of these government-sponsored entities raised substantial new equity capital through the issuance of additional preferred stock in late 2007, which the Company believes shows investors' confidence in the issuers' strength, long-term viability and ability to fund dividends. The Company believes it is too soon as of June 30, 2008, to conclude whether the unrealized losses are other-than-temporary in nature and further believes as of June 30, 2008, that the market fluctuations that precipitated the decrease in values in late 2007 and the first two quarters of 2008 will reverse over time. If the market values of the Company's FNMA and FHLMC mortgage-backed investment securities do not demonstrate a clear pattern of substantial recovery in the near future, the Company would be required to recognize impairment losses.

The Company establishes fair value estimates of securities available-for-sale in accordance with generally accepted accounting principles. The Company's estimates can change from reporting period to reporting period and it cannot provide any assurance that the fair value estimates of the FNMA and FHLMC mortgage-backed securities would be the realizable value in the event of a sale of the securities.

A number of factors could cause the Company to conclude in one or more future reporting periods that any difference between the fair value and the amortized cost of one or more of the FNMA and FHLMC mortgage-backed securities that it owns constitutes an other-than-temporary impairment. These factors include, but are not limited to, an increase in the severity of the unrealized loss on a particular security, an increase in the length of time unrealized losses continue without an improvement in value, a change in the Company's intent or ability to hold the security for a period of time sufficient to allow for the forecasted recovery, or changes in market conditions or industry or issuer specific factors that would render it unable to forecast a full recovery in value, including adverse developments concerning the financial condition of FNMA or FHLMC.

### ***Other Risks***

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described above and in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.



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

The Company made no repurchases of its common stock during the quarter ended June 30, 2008.

**ITEM 3. Defaults upon Senior Securities**

None.

**Table of Contents****ITEM 4. Submission of Matters to a Vote of Security Holders**

The shareholders of the Buckhead Community Bancorp, Inc. took the following actions at the Annual Meeting of Shareholders held May 27, 2008:

Elected the following individuals as directors of the Company:

| <b>Directors</b>           | <b>For</b> | <b>Withheld/Abstain</b> |
|----------------------------|------------|-------------------------|
| Hugh C. Aldredge           | 4,742,298  | 3,480                   |
| David B. Allman            | 4,742,298  | 3,480                   |
| Leo Benatar                | 4,742,298  | 3,480                   |
| Marvin Cosgray             | 4,742,298  | 3,480                   |
| Louis J. Douglass, III     | 4,742,298  | 3,480                   |
| Julian LeCraw, Sr.         | 4,742,298  | 3,480                   |
| R. Charles Loudermilk, Sr. | 4,742,298  | 3,480                   |
| John D. Margeson           | 4,742,298  | 3,480                   |
| Larry P. Martindale        | 4,742,298  | 3,480                   |
| Mark C. Pope, III          | 4,742,298  | 3,480                   |
| William T. Towles          | 4,742,298  | 3,480                   |
| Jackson P. Turner          | 4,742,298  | 3,480                   |
| Andrew K. Walker           | 4,742,298  | 3,480                   |

Approved the First Amendment to the Company's Articles of Incorporation, which provides for increases to the number of our authorized shares of common stock and special stock to 20,000,000 and 2,000,000, respectively

| <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker Non-Votes</b> |
|------------|----------------|----------------|-------------------------|
| 4,606,440  | 44,222         | 95,116         | 0                       |

Approved the Buckhead Community Bancorp, Inc. 2008 Long-Term Incentive Plan to replace the Stock Incentive Plan currently maintained by the Company, which will expire on June 22, 2009.

| <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker Non-Votes</b> |
|------------|----------------|----------------|-------------------------|
| 4,677,030  | 31,459         | 37,289         | 0                       |

Ratified the appointment of Mauldin and Jenkins, LLC as independent public accountants for the Company's current fiscal year

| <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker Non-Votes</b> |
|------------|----------------|----------------|-------------------------|
| 4,742,974  | 1,200          | 1,604          | 0                       |

**ITEM 5. Other Information**

None.

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**ITEM 6. Exhibits**

|                  |  |
|------------------|--|
| Exhibit No. 10.1 | Buckhead Community Bancorp, Inc. 2008 Long-term Incentive Plan   |
| Exhibit No. 31.1 | Chief Executive Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)   |
| Exhibit No. 31.2 | Chief Financial Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)   |
| Exhibit No. 32.1 | Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit No. 32.2 | Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**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.

Buckhead Community Bancorp, Inc.

(Registrant)

DATE: August 13, 2008

BY: /s/ Marvin Cosgray  
Marvin Cosgray  
President and Chief Executive Officer

DATE: August 13, 2008

BY: /s/ Dawn Kinard  
Dawn Kinard  
Chief Financial Officer