

McGladrey & Pullen

Certified Public Accountants

Colonial American Bank

Financial Statements
December 31, 2009

Colonial American Bank

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McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

To the Board of Directors
Colonial American Bank
Horsham, Pennsylvania

We have audited the accompanying balance sheets of Colonial American Bank as of December 31, 2009 and 2008, and the related statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Colonial American Bank as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Bank will continue as a going concern. As discussed in Note 17 to the financial statements, the Bank has incurred losses from operations totaling approximately \$6.4 million during its first three years of operations. Unless the Bank can obtain additional capital during 2010, it likely will cease to be considered "well-capitalized" for regulatory purposes. Failure to meet regulatory capital requirements exposes the Bank to regulatory sanctions that may include restrictions on operations and growth, mandatory asset dispositions and seizure. This raises substantial doubt about the Bank's ability to continue as a going concern. Management's plans in regard to these matters are described in Note 18. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

McGladrey & Pullen, LLP

Blue Bell, Pennsylvania
February 19, 2010

Colonial American Bank

Balance Sheets

December 31, 2009 and 2008

(Amounts in Thousands, Except Share Data)

	2009	2008
Assets		
Cash and due from banks	\$ 161	\$ 264
Interest-bearing deposits with other banks	132	13
Cash and cash equivalents	<u>293</u>	<u>277</u>
Investment securities held-to-maturity, at amortized cost, fair value of \$1,007 in 2009	1,003	-
Investment securities available-for-sale, at fair value, amortized cost of \$3,000 in 2009 and \$7,999 in 2008	2,970	8,015
Loans receivable, net of allowance for loan losses of \$225 in 2009 and \$210 in 2008	19,344	19,242
Bank premises and equipment, net	293	485
Other real estate owned (OREO)	75	-
Accrued interest receivable and other assets	780	940
Total assets	<u>\$ 24,758</u>	<u>\$ 28,959</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	\$ 724	\$ 698
Interest-bearing	21,656	24,299
Total deposits	<u>22,380</u>	<u>24,997</u>
Short-term borrowings	-	800
Accrued interest payable and other accrued liabilities	205	360
Total liabilities	<u>22,585</u>	<u>26,157</u>
Commitments and Contingencies (Notes 8, 16, 17 and 18)		
Shareholders' Equity		
Non-cumulative perpetual preferred stock, \$1 par value, 2,500,000 shares authorized;		
Series A - 5% for five years, 9% thereafter, \$1,000 liquidation preference, 574 shares issued and outstanding in 2009	1	-
Series B - 9%, \$1,000 liquidation preference, 29 shares issued and outstanding in 2009	-	-
Common stock, \$1 par value, 7,500,000 shares authorized;		
751,079 shares issued and outstanding	751	751
Additional paid-in-capital	7,838	7,286
Accumulated deficit	(6,387)	(5,251)
Accumulated other comprehensive income (loss)	(30)	16
Total shareholders' equity	<u>2,173</u>	<u>2,802</u>
Total liabilities and shareholders' equity	<u>\$ 24,758</u>	<u>\$ 28,959</u>

See Notes to Financial Statements.

Colonial American Bank

Statements of Operations

Years Ended December 31, 2009 and 2008

(Amounts in Thousands, Except Share Data)

	2009	2008
Interest and Dividend Income		
Interest and fees on loans	\$ 1,372	\$ 1,163
Interest and dividends on securities	310	905
Interest on deposits with other banks	1	27
Total interest and dividend income	<u>1,683</u>	<u>2,095</u>
Interest Expense		
Interest on deposits	755	905
Interest on borrowings	1	215
Total interest expense	<u>756</u>	<u>1,120</u>
Net interest income	927	975
Provision for Loan Losses	143	125
Net interest income after provision for loan losses	<u>784</u>	<u>850</u>
Noninterest Income (Loss)		
Service fees	76	34
Gain (loss) on sale of securities available-for-sale	29	(56)
Gain on sale of loans held-for-sale	9	18
Other	8	1
Total noninterest income (loss)	<u>122</u>	<u>(3)</u>
Noninterest Expense		
Compensation and benefits, net	719	1,200
Occupancy and data processing	614	629
Professional services	433	407
Other operating expenses	272	387
Total noninterest expenses	<u>2,038</u>	<u>2,623</u>
Loss Before Income Taxes	(1,132)	(1,776)
Income Taxes	-	-
Net loss	(1,132)	(1,776)
Preferred stock dividends and discount accretion	(29)	-
Net loss attributable to common shareholders	<u>\$ (1,161)</u>	<u>\$ (1,776)</u>
Net loss per common share		
Basic and diluted	<u>\$ (1.55)</u>	<u>\$ (2.36)</u>
Weighted average shares outstanding		
Basic and diluted	<u>751,079</u>	<u>751,079</u>

See Notes to Financial Statements.

Colonial American Bank

Statements of Shareholders' Equity
 Years Ended December 31, 2009 and 2008
 (Amounts in Thousands)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2007	\$ -	\$ 751	\$ 7,286	\$ (3,475)	\$ 26	\$ 4,588
Comprehensive loss:						
Net loss - 2008	-	-	-	(1,776)	-	(1,776)
Change in unrealized loss on securities available-for-sale, net of reclassification adjustment of \$(56)	-	-	-	-	(10)	(10)
Total comprehensive loss						(1,786)
Balance, December 31, 2008	-	751	7,286	(5,251)	16	2,802
Net proceeds from issuance of preferred stock to US Treasury	1	-	573	-	-	574
Accretion of preferred stock discount	-	-	4	(4)	-	-
Dividends on preferred stock	-	-	(25)	-	-	(25)
Comprehensive loss:						
Net loss - 2009	-	-	-	(1,132)	-	(1,132)
Change in unrealized loss on securities available-for-sale, net of reclassification adjustment of \$29	-	-	-	-	(46)	(46)
Total comprehensive loss						(1,178)
Balance, December 31, 2009	\$ 1	\$ 751	\$ 7,838	\$ (6,387)	\$ (30)	\$ 2,173

See Notes to Financial Statements.

Colonial American Bank

Statements of Cash Flows

Year Ended December 31, 2009 and 2008

(Amounts in Thousands)

	2009	2008
Cash Flows from Operating Activities		
Net loss	\$ (1,132)	\$ (1,776)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	195	189
Provision for loan losses	143	125
(Gain) loss on sale of investment securities available for sale	(29)	56
Gain on sale of loans held-for-sale	(9)	(18)
Net amortization/accretion of discounts/premiums on securities	97	-
Originations of loans held-for-sale	(7,219)	(1,472)
Proceeds from sales of loans held-for-sale	7,228	1,490
Changes in operating assets and liabilities:		
Decrease (increase) in accrued interest receivable and other assets	160	(609)
(Decrease) increase in accrued interest payable and other accrued liabilities	(160)	85
Net cash used in operating activities	(726)	(1,930)
Cash Flows from Investing Activities		
Investment securities available for sale		
Purchases	(11,057)	(15,499)
Sales	5,516	14,943
Maturities	10,500	-
Investment securities held to maturity		
Purchases	(1,031)	-
Maturities	-	1,500
Net increase in loans	(320)	(10,529)
Purchases of premises and equipment	(3)	(24)
Net cash provided by (used in) investing activities	3,605	(9,609)
Cash Flows from Financing Activities		
Net proceeds from issuance of preferred stock	574	-
Cash dividends on preferred stock	(20)	-
Net (decrease) increase in interest-bearing deposits	(2,643)	8,622
Net increase in noninterest-bearing deposits	26	193
Net (decrease) increase in short-term borrowings	(800)	800
Net cash (used in) provided by financing activities	(2,863)	9,615
Increase (decrease) in cash and cash equivalents	16	(1,924)
Cash and cash equivalents, beginning	277	2,201
Cash and cash equivalents, ending	\$ 293	\$ 277
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest	\$ 787	\$ 1,095
Dividends	\$ 20	-
Non-cash transfer from loans receivable to OREO	\$ 75	-

See Notes to Financial Statements.

Colonial American Bank

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Nature of Operations: Colonial American Bank (the "Bank") is a state chartered bank, which was incorporated on September 1, 2006 under the laws of the Commonwealth of Pennsylvania. The Bank commenced operations on February 9, 2007. The Bank is chartered by the Pennsylvania Department of Banking and insured by the Federal Deposit Insurance Corporation. The Bank maintains its principal and only branch office in Horsham, Pennsylvania and provides financial services primarily to Montgomery County and the surrounding counties of the Greater Delaware Valley. During 2009 the Bank closed its principal office in West Conshohocken. No penalties were incurred relating to the closure of the Bank's West Conshohocken location.

The accounting and financial reporting policies of the Bank conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The policies that materially affect the determination of financial position, results of operations and cash flows are summarized below.

Accounting Standards Codification (ASC): On July 1, 2009, the Financial Accounting Standards Board (FASB) officially launched the *FASB Accounting Standards Codification*[™] (ASC), which has become the single official source of authoritative, nongovernmental U.S. Generally Accepted Accounting Principles (GAAP), superseding all prior FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF), and related literature. The Codification is effective for interim and annual periods ending on or after September 15, 2009. Accordingly, the Bank's accounting policies, which are consistent with prior periods and detailed below are now in accordance with ASC and no longer contain references to Statements on Financial Accounting Standards (SFAS), or related literature.

Use of Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand, interest bearing deposits with other banks, and federal funds sold, all of which mature within ninety days.

Investment Securities: Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss), net of the related income tax effect. The Bank does not hold trading securities.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) whether the Bank intends to sell the security, or it is more likely than not that the Bank will be required to sell the security before recovery of the cost basis, which may be maturity. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Bank holds investments in the common stocks of Federal Home Loan Bank of Pittsburgh (FHLB) and Atlantic Central Bankers Bank (ACBB). These investments in restricted stock are carried at cost and are included in Other Assets. FHLB stock has no quoted market value and is subject to redemption restrictions. Management reviews for impairment based on the ultimate recoverability of the cost basis in the stock.

Note 1. Summary of Significant Accounting Policies (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

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

Loans Held for Sale: These loans are carried at the lower of cost or fair value. Gains or losses on loan sales are recorded in non-interest income and direct origination costs and fees are deferred at origination and recognized in non-interest income as part of the gain or loss upon sale of the loan. There were no loans held for sale as of December 31, 2009 or 2008.

Concentration of Credit Risk: The Bank's loans are generally to diversified customers in the Greater Delaware Valley area. Generally, loans are collateralized by real estate assets of the borrower and are expected to be repaid from the cash flow of the borrower or proceeds from the sale of selected assets of the borrower.

Allowance for Loan Losses: The allowance for loan losses is established as losses are estimated to occur through a provision for loan losses. Loans that are determined to be uncollectible are charged against the allowance account, and subsequent recoveries, if any, are credited to the allowance. When evaluating the adequacy of the allowance, an assessment of the loan portfolio will typically include changes in the composition and volume of the loan portfolio, overall portfolio quality and past loss experience, review of specific problem loans, current economic conditions which may affect borrowers' ability to repay, and other factors which may warrant current recognition. Such periodic assessments may, in management's judgment, require the Bank to recognize additions or reductions to the allowance.

Various regulatory agencies periodically review the adequacy of the Bank's allowance for loan losses as an integral part of their examination process. Such agencies may require the Bank to recognize additions or reductions to the allowance based on their evaluation of information available to them at the time of their examination. It is reasonably possible that the above factors may change significantly and, therefore, affect management's determination of the allowance for loan losses in the near term.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off experience and expected losses given the Bank's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not reflected in the historical loss or risk rating data.

Note 1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued): A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial loans using either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

Bank Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method and charged to expense over the estimated useful lives of the assets. Leasehold improvements are amortized to expense over the shorter of the term of the respective lease or the estimated useful life of the improvements with terms generally ranging from five to thirty years. The estimated useful lives for calculating depreciation and amortization on furniture and equipment are between three and seven years.

Other Real Estate Owned (OREO): OREO is comprised of property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure and loans classified as in-substance foreclosure. A loan is classified as in-substance foreclosure when the Bank has taken possession of the collateral regardless of whether formal foreclosure proceedings take place. Foreclosed assets initially are recorded at fair value, net of estimated selling costs, at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value less estimated costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other expenses.

Income Taxes: Deferred federal and state tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial statement and tax bases of existing assets and liabilities. The effect of a change in the tax rate on deferred taxes is recognized in the period of the enactment date. Deferred tax assets are reduced by a valuation allowance, when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more likely-than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

Note 1. Summary of Significant Accounting Policies (Continued)

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Earnings (Loss) Per Common Share: Basic earnings (loss) per common share are computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share considers common stock equivalents (when dilutive) outstanding during the period such as options and warrants outstanding. In computing diluted earnings (loss) per share for 2009 and 2008, options and warrants to purchase an aggregate of 338,715 shares of common stock were excluded from the computation because the effect of these instruments would be antidilutive.

Stock-Based Compensation: The Bank accounts for its stock based compensation plans under the provisions of ASC Topic 718, *Compensation – Stock Compensation*, which requires recognizing expense for options granted equal to the grant-date fair value of the unvested amounts over their remaining vesting period. Excess tax benefits arising from increases in the value of equity instruments issued under stock-based payment arrangements are treated as cash inflows from financing activities.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains or losses on securities available for sale which are also recognized as a separate component of shareholders' equity.

Recent Accounting Pronouncements:

Accounting for Uncertainty in Income Taxes in accordance with ASC Topic 740 became effective for the Bank on January 1, 2009. This standard guidance the application of accounting for income taxes by defining the criteria that an individual tax position must meet in order for the position to be recognized within the financial statements and provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition for tax positions.

The Bank presently recognizes income tax positions based on management's estimate of whether it is reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying ASC Topic 450, *Accounting for Contingencies*. Adoption of this authoritative accounting guidance did not have a material impact on the Bank's financial position and results of operations. The Bank did not recognize or accrue any interest or penalties related to the income tax during the year ended December 31, 2009. The Bank does not have an accrual for uncertain tax positions as of December 31, 2009, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2007 and thereafter are subject to future examination by tax authorities.

Fair value of non-financial assets and liabilities: Effective January 1, 2009, the Bank measures non-recurring nonfinancial assets and liabilities recognized or disclosed at fair value and has included these disclosures at Note 3. Accordingly, the fair value of OREO is included as of December 31, 2009.

Note 1. Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued):

Business Combinations: This new authoritative accounting guidance (ASC Topic 805) is a revision of previous business combinations guidance. It requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. It applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 and became effective for the Bank on January 1, 2009. No transactions have occurred through December 31, 2009 warranting application of this guidance.

Subsequent Events: The Bank adopted the requirements of ASC 855-10-05 relating to subsequent events effective December 31, 2009. This guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued (*i.e.*, complete in a form and format that complies with GAAP and approved for issuance). It does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. There are two types of subsequent events to be evaluated:

Recognized subsequent events - An entity must recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.

Non-recognized subsequent events - An entity must not recognize subsequent events that provide evidence about conditions that did *not* exist at the date of the balance sheet but that arose after the balance sheet date but before financial statements are issued or are available to be issued. Some non-recognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity must disclose the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

The guidance also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date - that is, whether that date represents the date the financial statements were issued or were available to be issued. Accordingly, management has evaluated subsequent events through February 19, 2010, the date the financial statements are available to be issued and has determined that no recognized or non-recognized subsequent events warranted inclusion or disclosure in the financial statements as of December 31, 2009.

FASB ASC Topic 320, *Investments – Debt and Equity Securities*. New authoritative accounting guidance under ASC Topic 320, *Investments – Debt and Equity Securities*, (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under ASC Topic 320, declines in the fair value of held-to-maturity and available-for-sale debt securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. The Bank adopted the provisions of the new authoritative accounting guidance under ASC Topic 320 during 2009. Adoption of the new guidance did not significantly impact the Bank's financial statements.

Note 1. Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued):

FASB ASC Topic 860, *Transfers and Servicing*. New authoritative accounting guidance under ASC Topic 860, *Transfers and Servicing*, amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a “qualifying special-purpose entity” and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 will be effective January 1, 2010 and is not expected to have a significant impact on the Bank’s financial statements.

Note 2. Cash and Due from Banks

The Bank maintains various deposit accounts with other banks to meet normal funds transaction requirements, to satisfy minimum deposit requirements, and to compensate other banks for certain correspondent services. The Federal Deposit Insurance Corporation insures these accounts up to \$250,000 per account through December 31, 2013. Management is responsible for assessing the credit risk of its correspondent banks. The withdrawal or usage restrictions of these balances did not have a significant impact on the operations of the Bank as of December 31, 2009 or 2008.

Note 3. Fair Value Measurements

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the *Fair Value Measurements and Disclosures* topic of FASB ASC, the fair value of a financial instrument 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. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. In accordance with this guidance, the Bank groups its assets and liabilities carried at fair value in three levels as follows:

Colonial American Bank

Notes to Financial Statements

Note 3. Fair Value Measurements (Continued)

Level 1

- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain US Treasury and US Government and agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in markets that are not active.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes US Government and agency mortgage-backed securities, corporate debt securities, derivative contracts and loans held for sale.

Level 3 Inputs

- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following is a description of the valuation methodologies used for instruments measured at fair value:

Fair Value on a Recurring Basis:

Securities Available for Sale: The fair value of available for sale securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

(Amounts in Thousands)	Level 1	Level 2	Level 3	Total
<u>December 31, 2009</u>				
Financial assets:				
Securities available for sale	\$ -	\$ 2,970	\$ -	\$ 2,970
<u>December 31, 2008</u>				
Financial assets:				
Securities available for sale	\$ -	\$ 8,015	\$ -	\$ 8,015

Fair Value on a Non-Recurring Basis: Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities measured at fair value on a non-recurring basis.

Colonial American Bank

Notes to Financial Statements

Note 3. Fair Value Measurements (Continued)

Impaired loans, which are measured for impairment using the loan's observable market price or the fair value of the collateral for collateral-dependent loans had a carrying amount of \$270,000 with a valuation allowance of \$-0-, resulting in no additional provisions for the year ended December 31, 2009. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. The valuation allowance for impaired loans is included in the allowance for loan losses in the balance sheets.

OREO is carried at fair value, indicated by a current appraisal, adjusted for reasonable disposition costs. The appraised value may be discounted based on management's review and changes in market conditions (Level 3 inputs).

(Amounts in Thousands)	Level 1	Level 2	Level 3	Total	Total Fair Value Loss During the Year
<u>December 31, 2009</u>					
Impaired loans	\$ -	\$ -	\$ 270	\$ 270	\$ -
OREO	\$ -	\$ -	\$ 75	\$ 75	\$ -
<u>December 31, 2008</u>					
Impaired loans	\$ -	\$ -	\$ 590	\$ 590	\$ 6

Colonial American Bank

Notes to Financial Statements

Note 4. Investment Securities

The amortized cost and estimated fair value of securities at December 31, 2009 and 2008, summarized by contractual maturities, are shown below (Amounts in Thousands).

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. Government agencies				
Due within one year	\$ -	\$ -	\$ -	\$ -
Due within one year through five years	1,500	-	-	1,500
Due within five years through ten years	-	-	-	-
Due after ten years	1,500	-	30	1,470
Total available-for-sale	\$ 3,000	\$ -	\$ 30	\$ 2,970
Held-to-maturity:				
Corporate Bonds				
Due within one year	\$ 1,003	\$ 4	\$ -	\$ 1,007
Due within one year through five years	-	-	-	-
Due within five years through ten years	-	-	-	-
Due after ten years	-	-	-	-
Total held-to-maturity	\$ 1,003	\$ 4	\$ -	\$ 1,007
2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. Government agencies				
Due within one year	\$ -	\$ -	\$ -	\$ -
Due within one year through five years	-	-	-	-
Due within five years through ten years	-	-	-	-
Due after ten years	7,999	16	-	8,015
Total available-for-sale	\$ 7,999	\$ 16	\$ -	\$ 8,015

There were no investment securities held-to-maturity as of December 31, 2008.

Securities of \$1.5 million and \$4.7 million were pledged against borrowings from the Federal Home Loan Bank at December 31, 2009 and 2008, respectively.

For the years ended December 31, 2009 and 2008, proceeds from sales of securities available-for-sale amounted to \$5.5 million and \$14.9 million, respectively. Gross realized gains were \$29,000 and gross realized losses were \$56,000 for the years ended December 31, 2009 and 2008, respectively.

Colonial American Bank

Notes to Financial Statements

Note 4. Investment Securities (Continued)

Securities available-for-sale are stated at fair value with an adjustment to shareholders' equity for unrealized gains and losses. There was one security at December 31, 2009 in an unrealized loss position, which was for a period less than twelve months. The unrealized loss on this investment in a U.S. Government sponsored entity was caused by movement in interest rates. Because the Bank does not intend to sell the investment and it is not more likely than not that the Bank will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider this investment to be other-than-temporarily impaired at December 31, 2009. There were no securities in an unrealized loss position at December 31, 2008.

Note 5. Loans

The composition of loans at December 31, 2009 and 2008 follows:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Residential mortgages	\$ 10,327	\$ 10,144
Home equity line of credit	1,105	1,176
Commercial real estate	6,309	5,595
Construction	1,655	2,333
Consumer	148	148
Total loans	<u>19,544</u>	<u>19,396</u>
Less:		
Allowance for loan losses	(225)	(210)
Net deferred loan costs	25	56
Net loans	<u>\$ 19,344</u>	<u>\$ 19,242</u>

Note 6. Loans and Deposits to Related Parties

Loans to related parties (executive officers and directors) were as follows during 2009 and 2008:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Balance, beginning of period	\$ 169	\$ -
Advances	-	345
Less: repayments	169	176
Balance, December 31	<u>\$ -</u>	<u>\$ 169</u>

At December 31, 2009 and 2008, deposits from related parties totaled approximately \$350,000 and \$550,000, respectively.

Colonial American Bank

Notes to Financial Statements

Note 7. Allowance for Loan Losses

An analysis of the allowance for loan losses is as follows:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Balance, beginning of period	\$ 210	\$ 85
Provision for loan losses	143	125
Charge-offs	(128)	-
Recoveries	-	-
Balance, December 31	<u>\$ 225</u>	<u>\$ 210</u>

At December 31, 2009 the Bank had one impaired loan totaling \$270,000 with no specific reserves. At December 31, 2008 the Bank had one impaired loan totaling \$590,000 with \$6,000 in specific reserves. Impaired loans include those on non-accrual. There was no interest recognized on a cash basis on non-accrual loans as of December 31, 2009 or December 31, 2008. Loans on non-accrual at December 31, 2009 and 2008 were \$270,000 and \$112,000, respectively.

Note 8. Bank Premises and Equipment

A summary of the cost and accumulated depreciation of bank premises and equipment as of December 31, 2009 and 2008 is as follows:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Leasehold improvements	\$ 297	\$ 294
Furniture and equipment	511	511
	<u>808</u>	<u>805</u>
Less: accumulated depreciation and amortization	515	320
Bank premises and equipment	<u>\$ 293</u>	<u>\$ 485</u>

The Bank has a five-year operating lease agreement for its main office, which commenced on March 1, 2006 and for its branch office, which commenced on March 1, 2007. The Bank has the option to extend the lease agreements for additional five-year periods.

During the first quarter of 2009, the Bank entered into a sublease agreement for its West Conshohocken location. The term of the sublease expires on March 31, 2011, concurrently with the expiration of the master lease.

Colonial American Bank

Notes to Financial Statements

Note 8. Bank Premises and Equipment (Continued)

At December 31, 2009, the required future minimum rental payments are as follows:

Years Ending December 31,	Rent Obligation	Rent from Sublease	Net Rent Obligation
	(Amounts in Thousands)		
2010	\$ 154	\$ 88	\$ 66
2011	59	22	37
2012	40	-	40
2013	40	-	40
2014	40	-	40
Total minimum lease payments	<u>\$ 333</u>	<u>\$ 110</u>	<u>\$ 223</u>

Rent expense of approximately \$109,000 and \$169,000 is reflected in the statements of operations for the years ended December 31, 2009 and 2009, respectively.

No penalties were incurred relating to the closure of the Bank's West Conshohocken location.

Note 9. Deposits

Deposits at December 31, 2009 and 2008 consisted of the following:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Demand deposits, noninterest-bearing	\$ 724	\$ 698
Demand deposits, interest-bearing	1,120	5,798
Savings deposits	12,664	5,535
Time deposits of \$100,000 or more	2,626	5,064
Other time deposits	5,246	7,902
Total deposits	<u>\$ 22,380</u>	<u>\$ 24,997</u>

Scheduled maturities of certificates of deposit at December 31, 2009:

Years Ending December 31,	(Amounts in Thousands)
2010	\$ 4,597
2011	27
2012	2,972
2013	177
2014	99
	<u>\$ 7,872</u>

Colonial American Bank

Notes to Financial Statements

Note 10. Borrowings

At December 31, 2009 the Bank had no outstanding borrowings. The Bank maintains a \$5.0 million line of credit with the Federal Home Loan Bank of Pittsburgh. At December 31, 2008, the Bank had an \$800,000 loan with the Federal Home Loan Bank of Pittsburgh. The loan was on the line of credit with the Federal Home Loan Bank of Pittsburgh and carried a variable rate of interest. The rate at December 31, 2008 was 0.64%.

Note 11. Income Taxes

The Bank, during its pre-opening period and subsequent to commencement of banking operations, has incurred cumulative net losses which has caused there to be no provision for income taxes, net deferred taxes and income taxes payable as of and for the years ended December 31, 2009 and 2008 because of related valuation allowances.

The components of net deferred taxes at December 31, 2009 and 2008 are as follows:

	2009	2008
	(Amounts in Thousands)	(Amounts in Thousands)
Deferred tax assets:		
Organizational costs	\$ 368	\$ 398
Net operating loss carryforwards	1,523	1,055
Premises and equipment	70	49
Stock option expense	246	246
Allowance for loan losses	48	61
Unrealized loss on securities available for sale	10	-
Other	5	1
	<u>2,270</u>	<u>1,810</u>
Valuation allowance	(2,261)	(1,786)
Total deferred tax assets, net of valuation allowance	9	24
Deferred tax liabilities:		
Deferred loan costs	9	19
Unrealized gain on securities available for sale	-	5
	<u>9</u>	<u>24</u>
Net deferred taxes	<u>\$ -</u>	<u>\$ -</u>

The Bank has net operating loss carryforwards available for federal income tax purposes of approximately \$4.5 million, which begin to expire in years 2027 through 2029.

Note 12. Regulatory Matters

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

Colonial American Bank

Notes to Financial Statements

Note 12. Regulatory Matters (Continued)

Capital Ratios (Continued): Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2009 and 2008, that the Bank met all capital adequacy requirements to which it is subject.

De novo banks (those insured seven years or less), such as the Bank, are required to maintain Tier I capital to average assets (leverage) ratios of at least 8% during this period. As of December 31, 2009 and 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action.

The Bank's actual capital amounts and ratios are presented in the following table (Dollars in Thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009:						
Total Risk Based Capital (to Risk Weighted Assets)	\$ 2,428	12.8%	\$ 1,522	8.0%	\$ 1,902	10.0%
Tier I Capital (to Risk Weighted Assets)	2,203	11.6%	760	4.0%	1,141	6.0%
Tier I Capital (to Average Assets)	2,203	8.2%	1,070	4.0%	1,338	5.0%
As of December 31, 2008:						
Total Risk Based Capital (to Risk Weighted Assets)	\$ 2,996	15.7%	\$ 1,531	8.0%	\$ 1,914	10.0%
Tier I Capital (to Risk Weighted Assets)	2,786	14.6%	766	4.0%	1,148	6.0%
Tier I Capital (to Average Assets)	2,786	8.1%	1,383	4.0%	1,729	5.0%

Banking regulations limit the amount of dividends that may be paid without prior regulatory agency approval. Since the Bank's deposits are insured by the FDIC, no dividends may be paid if the Bank is in default on any assessment due the FDIC. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

Note 13. Employee Benefit Plans

The Bank has a 401(k) Plan whereby substantially all employees participate in the Plan. Employees may contribute up to 15 percent of their compensation subject to certain limits based on federal tax laws. The Bank makes matching contributions equal to 50 percent of the first 7 percent of an employee's compensation contributed to the Plan. Matching contributions vest to the employee equally over a five-year period. For the years ended December 31, 2009 and 2008, expense attributable to the Plan amounted to \$14,000 and \$22,000, respectively.

Note 14. Shareholders' Equity

Stock Warrants: In connection with the initial offering, each shareholder was also granted one stock purchase warrant for every five shares of common stock purchased. Each warrant was issued at a price of \$12.50 and expires on March 23, 2012. There were 150,215 warrants outstanding and exercisable at December 31, 2009 and 2008.

Stock Options: Upon the closing of the initial offering, on March 23, 2007, the Bank issued transferable stock options exercisable over a 10-year period to certain organizers and initial subscribers to purchase a total of 188,500 shares of common stock at the initial offering price of \$10.00 per share. These options were granted in consideration of their efforts in connection with the formation and the organization of the Bank. Of these grants, 96,000 options were issued to related parties including directors and officers of the Bank. The options were granted on March 23, 2007, were exercisable on March 23, 2008 and all expense related to the grant was recognized as of the grant date for past services. Consequently, there is no unrecognized stock option expense as of December 31, 2009 and 2008.

Employee and Director Stock Compensation Plan: The Bank's Board of Directors has approved the 2008 Colonial American Stock Compensation Plan (the "Plan") that will have a term of 10 years. Pursuant to the Plan, 15% of the common stock shares that were issued in the initial offering, or 112,662, are reserved for future issuance. To grant incentive stock options under the Plan, the shareholders must approve the Plan. On December 30, 2008 the shareholders approved the Plan. As of December 31, 2009 and 2008, there were no awards under the Plan.

Preferred Stock: On October 3, 2008 Congress passed the Emergency Economic Stabilization Act of 2008 ("EESA"), which provides the U.S. Secretary of the Treasury with broad authority to implement certain actions to help restore stability and liquidity to the U.S. markets. One of the provisions resulting from the Act was the Treasury Capital Purchase Program ("CPP") which provides direct equity investment of preferred stock by the U.S. Treasury in qualified financial institutions. This program is voluntary and requires an institution to comply with several restrictions and provisions, including limits on executive compensation, stock redemptions, and declaration of dividends. The CPP provides for a minimum investment of 1 percent of Risk-Weighted-Assets, with a maximum investment of the lesser of 3 percent of Risk-Weighted Assets or \$25 Billion. The non-cumulative perpetual preferred stock, Series A has a dividend rate of 5 percent per year until the fifth anniversary of the Treasury investment and a dividend of 9 percent, thereafter. The CPP also requires the Treasury to receive warrants for fixed rate non-cumulative perpetual preferred stock, Series B with liquidation value equal to 5 percent of the capital invested by the Treasury. The exercise price of the warrants was \$1.00. The Series B preferred stock has a dividend rate of 9 percent per year.

On March 27, 2009, the Bank received an investment in preferred stock of \$574,000. On the same date the warrants for the non-cumulative perpetual preferred stock, Series B were exercised. The proceeds for the preferred stock were allocated between the Series A and Series B preferred stock based on their relative fair value, using a discount rate of 12%. The original net discount is being accreted over the expected term of five years using the effective interest method. The Bank has recorded dividends in the approximate amount of \$25,000 through December 31, 2009. In accordance with state law, because the Bank is in an accumulated deficit position, the preferred stock dividends are declared from additional paid-in capital. All dividend amounts billed by the US Treasury through December 31, 2009 have been paid. The two preferred stock series qualify for and are accounted for as equity securities and included in the Bank's Tier I Capital on the date of receipt.

Note 14. Shareholders' Equity (Continued)

Preferred Stock (Continued): Provisions introduced by the American Recovery and Reinvestment Act of 2009 indicate that once the Bank notifies Treasury that it would like to redeem the CPP preferred stock, the Treasury must permit the Bank to do so subject to consultation with the Bank's federal regulator. The Bank will be subject to existing supervisory procedures for approving redemption requests for capital instruments. The federal regulator will weigh the Bank's desire to redeem the preferred stock against the contribution of Treasury capital to the Bank's overall soundness, capital adequacy and ability to lend, including confirming that the Bank has a comprehensive internal capital assessment process.

Note 15. Other Related Party Transactions

The Bank has an agreement to purchase, at its discretion, loans from a mortgage banking entity, Colonial Mortgage Service Company of America, which is 100% owned by the Bank's Chief Executive Officer, for which the mortgage banking entity receives a broker fee. Such fees totaled zero for the years ended December 31, 2009 and 2008, respectively. Total loans purchased for the years ended December 31, 2009 and 2008 from Colonial Mortgage Service Company of America were zero and \$255,000, respectively.

Note 16. Commitments and Contingencies

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of these instruments reflect the extent of the Bank's involvement in these particular classes of financial instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties. As of December 31, 2009 and 2008, commitments to extend credit amounted to approximately \$551,000 and \$877,000, respectively.

Note 17. Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that Colonial American Bank will continue as a going concern. Colonial American Bank has suffered recurring losses through December 31, 2009 of approximately \$6.4 million and, although it is considered well-capitalized as of December 31, 2009, it will not remain well-capitalized during 2010 without additional capital. These conditions raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Bank be unable to continue as a going concern. Management's plans in regard to these matters are to increase its capital by obtaining an investor or an acquirer as described in Note 18.

Note 18. Signing of Securities Purchase Agreement

On December 24, 2009 the Bank executed a Securities Purchase Agreement (the "Agreement") with a group of investors unrelated to Colonial American Bank to purchase \$6.0 million of newly issued common stock of Colonial American Bank directly from the Bank. The Agreement is subject to certain terms and conditions as outlined in the Agreement, and subject to regulatory approvals. After completion of the transaction, the investors will own approximately 89% of the outstanding common stock of the Bank.