BANK OF SOUTH CAROLINA CORP
Form 10QSB
August 01, 2007

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2007

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file number: 0-27702
Bank of South Carolina Corporation
(Exact name of small business issuer as specified in its charter)

South Carolina	57-1021355
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

256 Meeting Street, Charleston, SC 29401
(Address of principal executive offices)
(843) 724-1500
(Issuer s Telephone Number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

As of June 30, 2007 there were 3,948,838 Common Shares outstanding.

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

Transitional Small Business Disclosure Format (Check one):

Yes o No þ

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Report on Form 10-QSB
for quarter ended
June 30, 2007

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PART I ITEM 1 FINANCIAL STATEMENTS
BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	(Unaudited) June 30, 2007	(Audited) December 31,2006
Assets:		
Cash and due from banks	$ 11,284,703	$ 9,747,621
Interest bearing deposits in other banks	8,050	7,990
Federal funds sold	14,474,139	26,857,657
Investment securities available for sale	42,020,086	40,897,855
Mortgage loans to be sold	3,225,320	3,960,728
Loans	161,888,533	158,596,560
Allowance for loan losses	(1,334,455)	(1,294,994)
Net loans	160,554,078	157,301,566
Premises and equipment, net	2,560,865	2,662,086
Accrued interest receivable	1,453,047	1,474,703
Other assets	871,315	562,534
Total assets	$ 236,451,603	$ 243,472,740
Liabilities and Shareholders Equity:		
Deposits:		
Non-interest bearing demand	$ 55,061,485	$ 58,835,554
Interest bearing demand	52,187,385	48,557,628
Money market accounts	52,460,706	56,179,204
Certificates of deposit $100,000 and over	25,132,760	22,281,984
Other time deposits	15,602,646	14,092,859
Other savings deposits	9,415,508	15,369,672
Total deposits	209,860,490	215,316,901
Short-term borrowings	871,501	2,712,683
Accrued interest payable and other liabilities	1,364,947	1,802,725
Total liabilities	212,096,938	219,832,309
Common Stock No par value; 12,000,000 shares authorized; issued 4,148,339 shares at June 30, 2007 and 4,129,409 at December 31, 2006; outstanding 3,948,838 shares at June 30, 2007 and 3,929,908 at December 31, 2006		
Additional paid in capital	22,910,965	22,719,918
Retained earnings	3,407,495	2,592,719
Treasury stock 199,501 shares at June 30, 2007 and December 31, 2006	(1,692,964)	(1,692,964)
Accumulated other comprehensive (loss) income, net of income taxes	(270,831)	20,758

Total shareholders equity	24,354,665	23,640,431
Total liabilities and shareholders equity	$ 236,451,603	$ 243,472,740

See accompanying notes to consolidated financial statements

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30,	
	2007	2006
Interest and fee income		
Interest and fees on loans	$ 3,580,597	$ 3,285,108
Interest and dividends on investment securities	494,953	461,650
Other interest income	154,970	288,620
Total interest and fee income	4,230,520	4,035,378
Interest expense		
Interest on deposits	1,299,290	1,153,696
Interest on short-term borrowings	10,769	8,591
Total interest expense	1,310,059	1,162,287
Net interest income	2,920,461	2,873,091
Provision for loan losses	20,000	60,000
Net interest income after provision for loan losses	2,900,461	2,813,091
Other income		
Service charges, fees and commissions	219,396	223,007
Mortgage banking income	127,975	178,457
Loss on sale of securities		(22,950)
Other non-interest income	7,213	7,719
Total other income	354,584	386,233
Other expense		
Salaries and employee benefits	1,041,443	973,623
Net occupancy expense	337,007	296,332
Other operating expenses	402,620	395,387
Total other expense	1,781,070	1,665,342
Income before income tax expense	1,473,975	1,533,982
Income tax expense	513,664	523,148
Net income	$ 960,311	$ 1,010,834

Basic earnings per share	$	.24	$	.26
Diluted earnings per share	$	.24	$	.25
Weighted average shares outstanding				
Basic		3,939,685		3,893,576
Diluted		3,965,466		3,978,899

See accompanying notes to consolidated financial statements

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Six Months Ended June 30,	
	2007	2006
Interest and fee income		
Interest and fees on loans	$ 7,062,529	$ 6,386,283
Interest and dividends on investment securities	972,624	857,149
Other interest income	482,472	431,622
Total interest and fee income	8,517,625	7,675,054
Interest expense		
Interest on deposits	2,659,809	2,107,586
Interest on short-term borrowings	19,117	14,176
Total interest expense	2,678,926	2,121,762
Net interest income	5,838,699	5,553,292
Provision for loan losses	40,000	120,000
Net interest income after provision for loan losses	5,798,699	5,433,292
Other income		
Service charges, fees and commissions	428,313	440,941
Mortgage banking income	315,405	290,261
Loss on sale of securities		(22,950)
Other non-interest income	13,795	13,688
Total other income	757,513	721,940
Other expense		
Salaries and employee benefits	2,086,544	1,935,391
Net occupancy expense	644,178	594,089
Other operating expenses	761,809	776,373
Total other expense	3,492,531	3,305,853
Income before income tax expense	3,063,681	2,849,379
Income tax expense	1,066,904	973,109
Net income	$ 1,996,777	$ 1,876,270

Basic earnings per share	$	.51	$	.48
Diluted earnings per share	$	.50	$	.47
Weighted average shares outstanding				
Basic		3,934,824		3,879,419
Diluted		3,964,405		3,961,842

See accompanying notes to consolidated financial statements

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(UNAUDITED)
FOR SIX MONTHS JUNE 30, 2007 AND 2006

	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total
December 31, 2005	$	$ 22,077,627	$ 1,173,050	$ (1,692,964)	$ (51,919)	$ 21,505,794
Comprehensive income:						
Net income			1,876,270			1,876,270
Net unrealized loss on securities (net of tax benefit of $233,981)					(437,479)	(437,479)
Comprehensive income						1,438,791
Exercise of stock options		514,149				514,149
Stock-based compensation expense		18,459				18,459
Cash paid on fractional shares 25% stock dividend			(3,913)			(3,913)
Cash dividends ($0.29 per common share)			(1,012,417)			(1,012,417)
June 30, 2006	$	$ 22,610,235	$ 2,032,990	$ (1,692,964)	$ (489,398)	$ 22,460,863
December 31, 2006	$	$ 22,719,918	$ 2,592,719	$ (1,692,964)	$ 20,758	$ 23,640,431
Comprehensive income:						
Net income			1,996,777			1,996,777
Net unrealized loss on securities (net of tax benefit of $171,251)					(291,589)	(291,589)
Total comprehensive income						1,705,188
Exercise of stock options		168,856				168,856
Stock-based compensation expense		22,191				22,191
			(1,182,001)			(1,182,001)

Cash dividends ($0.30 per common share)						
June 30, 2007	$	$ 22,910,965	$ 3,407,495	$ (1,692,964)	$ (270,831)	$ 24,354,665

See accompanying notes to consolidated financial statements.

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flows from operating activities:		
Net income	$ 1,996,777	$ 1,876,270
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation	123,331	115,320
Loss on sale of securities		22,950
Provision for loan losses	40,000	120,000
Stock-based compensation expense	22,191	18,459
Net accretion of unearned discounts on investments	(46,444)	(174,214)
Origination of mortgage loans held for sale	(33,210,068)	(30,352,954)
Proceeds from sale of mortgage loans held for sale	33,945,476	28,082,666
Increase in accrued interest receivable and other assets	(115,874)	(808,611)
(Decrease) increase in accrued interest payable and other liabilities	(126,414)	39,155
Net cash provided (used) by operating activities	2,628,975	(1,060,959)
Cash flows from investing activities:		
Purchase of investment securities available for sale	(1,853,627)	(27,266,181)
Maturities and sales of investment securities available for sale	315,000	27,277,950
Net increase in loans	(3,292,512)	(568,645)
Purchase of premises and equipment	(22,110)	(24,191)
Net cash used by investing activities	(4,853,249)	(581,067)
Cash flows from financing activities:		
Net (decrease) increase in deposit accounts	(5,456,411)	12,228,878
Net decrease in short-term borrowings	(1,841,182)	(1,825,482)
Dividends paid	(1,493,365)	(927,679)
Fractional shares paid		(3,913)
Stock options exercised	168,856	514,149
Net cash (used) provided by financing activities	(8,622,102)	9,985,953
Net (decrease) increase in cash and cash equivalents	(10,846,376)	8,343,927
Cash and cash equivalents, beginning of period	36,613,268	20,272,566
Cash and cash equivalents, end of period	$ 25,766,892	$ 28,616,493

Supplemental disclosure of cash flow data:		
Cash paid during the period for:		
Interest	$ 2,682,855	$ 2,009,484
Income taxes	$ 1,014,825	$ 1,015,998
Supplemental disclosure for non-cash investing and financing activity:		
Change in dividends payable	$ (311,364)	$ 84,738
Change in unrealized loss on available for sale securities	$ (291,589)	$ (437,479)

See accompanying notes to consolidated financial statements.

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BANK OF SOUTH CAROLINA CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2007

NOTE 1: Basis of Presentation

The Bank of South Carolina (the Bank) began operations on February 26, 1987 as a state chartered bank and later became a subsidiary of Bank of South Carolina Corporation (the Company) a South Carolina corporation, in a reorganization effective on April 17, 1995. The Bank currently has four locations, two in Charleston, South Carolina, one in Summerville, South Carolina and one in Mt. Pleasant, South Carolina. The consolidated financial statements in this report are unaudited, except for the December 31, 2006 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the three and six months ended June 30, 2007, are not necessarily indicative of the results which may be expected for the entire year.

The preparation of the consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America (GAAP) which requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of income and expense during the reporting period. Actual results could differ from these estimates and assumptions.

NOTE 2: Investment Securities

The Company accounts for its investment securities in accordance with Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities . Investment securities are classified as Held to Maturity , Trading and Available for Sale . Currently the Company has only investments classified as Available for Sale . These securities are carried at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders equity (net of estimated tax effects). Unrealized losses on securities due to fluctuations in fair value are recognized when it is determined that an other than temporary decline in value has occurred. Realized gains or losses on the sale of investments are based on the specific identification method, trade date basis.

NOTE 3: Stock Based Compensation

The Company has an Incentive Stock Option Plan which was approved in 1998. Under the 1998 Incentive Stock Option Plan, options are periodically granted to employees at a price not less than the fair market value of the shares at the date of the grant. Employees become 20% vested after five years and then vest 20% each year until fully vested. The right to exercise each such 20% of the options is cumulative and will not expire until the tenth anniversary of the date of the grant. At June 30, 2007, 26,041 shares of common stock are reserved to be granted under the 1998 Incentive Stock Option Plan from the original 272,250 shares

There were options for 10,000 shares granted during the six months ended June 30, 2007 and 32,500 shares granted during the six months ended June 30, 2006. Fair values were estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for the 2006 grant: dividend yield of 3.58%; historical volatility of 29.98%; risk-free interest rate of 4.36%; and expected life of the options of 10 years. The following assumptions were used for the 10,000 shares granted in 2007: dividend yield of 2.75%; historical volatility of 25.68%; risk-free interest rate of 4.70% for 5,000 shares granted in January and 5.16% for 5,000 shares granted in June. For purposes of the calculation, compensation expense is recognized on a straight-line basis over the vesting period.

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The following is a summary of the activity under the Incentive Stock Options Plan for the three and six months ending June 30, 2007

Three Months Ended June 30, 2007	Options	Weighted Average Exercise Price
Balance at April 1, 2007	159,770	$ 10.72
Granted	5,000	15.51
Exercised	(18,930)	8.92
Cancelled		
Balance at June 30, 2007	145,840	$ 11.12

Six Months Ended June 30, 2007	Options	Weighted Average Exercise Price
Balance at January 1, 2007	160,094	$ 10.49
Granted	5,000	15.99
Granted	5,000	15.51
Exercised	(18,930)	8.92
Cancelled	(5,324)	8.92
Balance at June 30, 2007	145,840	$ 11.12
Options exercisable at June 30, 2007	8,709	$ 8.92

The following is a summary of the activity under the Incentive Stock Options Plan for the three and six months ending June 30, 2006

Three Months Ended June 30, 2006	Options	Weighted Average Exercise Price
Balance at April 1, 2006	197,895	$ 9.09
Granted	32,500	16.62
Exercised	(55,122)	9.33
Cancelled		
Balance at June 30, 2006	175,273	$ 10.41

Six Months Ended June 30, 2006	Options	Weighted Average Exercise Price
Balance at January 1, 2006	197,895	$ 9.09
Granted	32,500	16.62
Exercised	(55,122)	9.33
Cancelled		

Balance at June 30, 2006	175,273	$	10.41
Options exercisable at June 30, 2006	634	$	8.92

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NOTE 4: Shareholders Equity

A regular quarterly cash dividend of $.16 per share was declared on June 21, 2007 for shareholders of record at July 2, 2007, payable July 31, 2007. Income per common share for the three and six months ended June 30, 2007 and for the three and six months ended June 30, 2006 was calculated as follows:

	FOR THE THREE MONTHS ENDED JUNE 30, 2007		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	$ 960,311		
Basic income available to common shareholders	$ 960,311	3,939,685	$ .24
Effect of dilutive options		25,781	
Diluted income available to common shareholders	$ 960,311	3,965,466	$ .24

	FOR THE SIX MONTHS ENDED JUNE 30, 2007		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	$ 1,996,777		
Basic income available to common shareholders	$ 1,996,777	3,934,824	$ .51
Effect of dilutive options		29,581	
Diluted income available to common shareholders	$ 1,996,777	3,964,405	$ .50

	FOR THE THREE MONTHS ENDED JUNE 30, 2006		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	$ 1,010,834		

Basic income available to Common shareholders	$ 1,010,834	3,893,576	$ .26
Effect of dilutive options		85,323	
Diluted income available to common shareholders	$ 1,010,834	3,978,899	$ .25

	FOR THE SIX MONTHS ENDED JUNE 30, 2006		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	$ 1,876,270		
Basic income available to common shareholders	$ 1,876,270	3,879,419	$ .48
Effect of dilutive options		82,423	
Diluted income available to common shareholders	$ 1,876,270	3,961,842	$ .47

NOTE 5: Comprehensive Income

The Company applies the provisions of SFAS No. 130, *Reporting Comprehensive Income,* which establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income consists of net income and net unrealized gains or losses on securities and is presented in the consolidated statements of shareholders equity and comprehensive income.

Total comprehensive income is $637,018 and $647,855, respectively for the three months ended June 30, 2007 and 2006, and $1,705,188 and $1,438,791, respectively for the six months ended June 30, 2007 and 2006.

ITEM 2
MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Bank of South Carolina Corporation (the Company) is a financial institution holding company headquartered in Charleston, South Carolina, with branch operations in Summerville, South Carolina, Mt. Pleasant, South Carolina and the West Ashley community of Charleston, South Carolina. It offers a broad range of financial services through its wholly-owned subsidiary, The Bank of South Carolina (the Bank). The Bank is a state-chartered commercial bank which operates principally in the Charleston, Dorchester and Berkeley, counties of South Carolina.

The Company s significant accounting policies are discussed in Note 1 to the Consolidated Financial Statements for the year ended December 31, 2006. Of the significant accounting policies, the Company considers its policies regarding the allowance for loan losses to be its most subjective accounting policy due to the significant degree of management judgment. For additional discussion concerning the Company s allowance for loan losses and related matters, see Provision for Loan Losses.

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BALANCE SHEET
LOANS

The Company focuses its lending activities on small and middle market businesses, professionals and individuals in its geographic markets. At June 30, 2007 outstanding loans (less deferred loan fees) totaled $161,888,533 which equaled 77.14% of total deposits and 68.47% of total assets. The major components of the loan portfolio were commercial loans and commercial real estate totaling 31.38% and 47.58%, respectively of total loans. Substantially all loans were to borrowers located in the Company s market areas in the counties of Charleston, Dorchester and Berkley in South Carolina. The breakdown of total loans by type and the respective percentage of total loans are as follows:

	June 30,		**December 31,**
	2007	2006	2006
Commercial loans	$ 50,824,805	$ 49,708,129	$ 52,603,319
Commercial real estate	77,045,363	77,936,459	76,295,205
Residential mortgage	15,741,512	14,259,216	14,430,196
Consumer loans	5,365,370	4,223,999	4,377,353
Personal banklines	12,664,540	10,305,910	10,719,387
Other	302,841	238,105	246,775
Total	$ 161,944,431	$ 156,671,818	$ 158,672,235
Deferred loan fees (net)	(55,898)	(93,822)	(75,675)
Allowance for loan losses	(1,334,455)	(1,138,189)	(1,294,994)
Loans, net	$ 160,554,078	$ 155,439,807	$ 157,301,566

	June 30,		**December 31,**
Percentage of Loans	2007	2006	2006
Commercial loans	31.38%	31.73%	33.15%
Commercial real estate	47.58%	49.74%	48.08%
Residential mortgage	9.72%	9.10%	9.09%
Consumer loans	3.31%	2.70%	2.76%
Personal banklines	7.82%	6.58%	6.76%
Other	0.19%	0.15%	0.16%
Total	100.00%	100.00%	100.00%

Total loans increased $5,272,613 or 3.37% to $161,944,431 at June 30, 2007 from $156,671,818 at June 30, 2006 and increased $3,272,196 or 2.06% from $158,672,235 at December 31, 2006. The increase in loans between June 2006 and June 2007 is primarily due to an increase in consumer loans of 27.02%, personal banklines of 22.89% and other loans of 27.19%.

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INVESTMENT SECURITIES AVAILABLE FOR SALE

The Company uses the investment securities portfolio for several purposes. It serves as a vehicle to manage interest rate and prepayment risk, to generate interest and dividend income from investment of funds, to provide liquidity to meet funding requirements, and to provide collateral for pledges on public funds. Investments are classified into three categories (1) Held to Maturity (2) Trading and (3) Available for Sale. All securities were classified as Available for Sale for the six months ended June 30, 2007 and June 30, 2006. Management believes that maintaining its securities in the Available for Sale category provides greater flexibility in the management of the overall investment portfolio. The average yield on investments at June 30, 2007 was 4.64% compared to 4.70% at June 30, 2006. The carrying values of the investments available for sale at June 30, 2007 and 2006 are as follows:

INVESTMENT PORTFOLIO

	2007	2006
US Treasury Bonds	5,975,584	5,961,627
US Treasury Notes	5,884,932	5,854,722
Federal Agency Securities	3,000,000	3,000,000
Government-Sponsored Enterprises	20,832,166	20,764,553
Municipal Securities	6,757,295	4,497,195
	$ 42,449,977	$ 40,078,097

	2007	2006
US Treasury Bonds	14.08%	14.88%
US Treasury Notes	13.86%	14.61%
Federal Agency Securities	7.07%	7.49%
Government-Sponsored Enterprises	49.07%	51.81%
Municipal Securities	15.92%	11.22%
	100.00%	100.00%

DEPOSITS

Deposits remain the Company s primary source of funding for loans and investments. Average interest bearing deposits provided funding for 68.65% of average earning assets for the six months ended June 30, 2007, and 68.36% for the six months ended June 30, 2006. The Bank encounters strong competition from other financial institutions as well as consumer and commercial finance companies, insurance companies and brokerage firms located in the primary service area of the Bank. However, the percentage of funding provided by deposits has remained stable, and accordingly, the Company has not had to rely on other sources. The breakdown of total deposits by type and the respective percentage of total deposits are as follows:

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	June 30, 2007	June 30, 2006	December 31, 2006
Non-interest bearing demand	$ 55,061,485	$ 55,790,192	$ 58,835,554
Interest bearing demand	$ 52,187,385	$ 49,866,638	$ 48,557,628
Money market accounts	$ 52,460,706	$ 58,540,905	$ 56,179,204
Certificates of deposit $100,000 and over	$ 25,132,760	$ 20,668,283	$ 22,281,984
Other time deposits	$ 15,602,646	$ 13,422,087	$ 14,092,859
Other savings deposits	$ 9,415,508	$ 11,788,087	$ 15,369,672
Total Deposits	$ 209,860,490	$ 210,076,192	$ 215,316,901

Percentage of Deposits	June 30, 2007	June 30, 2006	December 31, 2006
Non-interest bearing demand	26.24%	26.56%	27.32%
Interest bearing demand	24.87%	23.74%	22.55%
Money Market accounts	25.00%	27.86%	26.09%
Certificates of deposit $100,000 and over	11.97%	9.84%	10.35%
Other time deposits	7.43%	6.39%	6.55%
Other savings deposits	4.49%	5.61%	7.14%
Total Deposits	100.00%	100.00%	100.00%

Total deposits decreased $215,702 or .10% to $209,860,490 at June 30, 2007 from $210,076,192 at June 30, 2006 and decreased $5,456,411 or 2.53% from $215,316,901 at December 31, 2006. Total non-interest bearing demand deposits, money market accounts and other savings deposits decreased 1.31%, 10.39% and 20.13%, respectively, from June 30, 2006 to June 30, 2007 and 6.41%, 6.62%, and 38.74%, respectively, from December 31, 2006 to June 30, 2007. The decrease was offset by an increase in interest bearing demand deposits, certificate of deposits $100,000 and over and other time deposits of 4.65%, 21.60% and 16.25%, respectively and 7.48%, 12.79% and 10.71%, respectively, for the same period.

SHORT-TERM BORROWINGS

The Bank has a demand note through the US Treasury, Tax and Loan system with the Federal Reserve Bank of Richmond. The Bank may borrow up to $2,800,000 under the arrangement at an interest rate set by the Federal Reserve. The note is secured by Government Sponsored Enterprise Securities with a market value of $3,453,950 at June 30, 2007. The amount outstanding under the note totaled $871,501 and $218,768 at June 30, 2007 and 2006, respectively.

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Comparison of Three Months Ended June 30, 2007 to Three Months Ended June 30, 2006

The Company s results of operations depend primarily on the level of its net interest income, its non-interest income and its operating expenses. Net interest income depends upon the volumes, rates and mix associated with interest earning assets and interest bearing liabilities which result in the net interest spread. Net income decreased $50,523 or 5.00% to $960,311, or basic and diluted earnings per share of $.24 for the three months ended June 30, 2007, from $1,010,834, or basic and diluted earnings per share of $.26 and $.25, respectively, for the three months ended June 30, 2006.

Net Interest Income

Net interest income increased $47,370 or 1.65% to $2,920,461 for the three months ended June 30, 2007, from $2,873,091 for the three months ended June 30, 2006. Total interest and fee income increased $195,142 or 4.84% for the three months ended June 30, 2007, to $4,230,520 from $4,035,378 for the three months ended June 30, 2006. This increase is due to an increase in interest and fees on loans and an increase in interest and dividends on investment securities offset by a decrease in interest on federal funds sold. Total interest and fees on loans increased $295,489 or 8.99% to $3,580,597 for the three months ended June 30, 2007, compared to $3,285,108 for the three months ended June 30, 2006. Interest and dividends on investment securities increased $33,303 or 7.21% to $494,953 for the three months ended June 30, 2007 from $461,650 for the three months ended June 30, 2006. Other interest income decreased $133,650 or 46.31% to $154,970 for the three months ended June 30, 2007 from $288,620 for the three months ended June 30, 2006. This decrease is due to a decrease in the average balance of federal funds sold from $23,721,388 for the three months ended June 30, 2006, to $12,017,658 for the three months ended June 30, 2007. Average interest earning assets increased from $221.4 million for the three months ended June 30, 2006, to $223.0 million for the three months ended June 30, 2007. The yield on interest earning assets increased 30 basis points between periods to 7.69% for the three months ended June 30, 2007, compared to 7.39% for the same period in 2006. This increase is primarily due to the increase in the yield on average loans of 22 basis points and an increase of 30 basis points in the yield on federal funds sold.

Total interest expense increased $147,772 or 12.71% to $1,310,059 for the three months ended June 30, 2007, from $1,162,287 for the three months ended June 30, 2006. The increase in interest expense is primarily due to an increase in average cost of deposits. Interest on deposits for the three months ended June 30, 2007, was $1,299,290 compared to $1,153,696 for the three months ended June 30, 2006, an increase of $145,594 or 12.62%. Total interest bearing deposits averaged approximately $153.1 million for the three months ended June 30, 2007, as compared to $151.4 million for the three months ended June 30, 2006. The average cost of interest bearing deposits was 3.44% and 3.09% for the three months ended June 30, 2007 and 2006, respectively, an increase of 35 basis points.

Provision for Loan Losses

The provision for loan losses is based on management s and the Loan Committee s review and evaluation of the loan portfolio and general economic conditions on a monthly basis and by the Board of Directors on a quarterly basis. Management s review and evaluation of the allowance for loan losses is based on a historical review of the loan portfolio performance, analysis of individual loans, and additional risk factors that affect the quality and ultimately the collectibility of the loan portfolio. These risk factors include: loan and credit administration risk, economic conditions, portfolio risk, loan concentration risk and off balance sheet risk which were added to the loan loss model during the first quarter of 2006. Loans are charged off when, in the opinion of management, they are deemed to be uncollectible. Recognized losses are charged against the allowance and subsequent recoveries are added to the allowance.

The allowance for loan losses is subject to periodic evaluation by various regulatory authorities and may be subject to adjustment based upon information that is available to them at the time of their examination.

All loan relationships are reviewed and classified in accordance with the Company s loan policy. The Company s classifications are generally based on regulatory definitions of classified assets for other loans especially mentioned, substandard loans, doubtful loans and loss loans. The Company annually reviews its overall Loan Policy.

The allowance for loan losses consists of an estimated reserve for classified loans and an estimated reserve for unclassified loans. Classified loans are assigned a loss estimate in the allowance for loan loss model based on their risk grade. The loss estimate is based on regulatory guidelines which the Company believes is an appropriate measure of the estimated loss on its classified loans. The loss estimates for classified loans is 5% for other loans especially mentioned and 15% for substandard loans. The loss estimates for doubtful and loss loans are 50% and 100%, respectively. Loans on the Company s watch list have a loss estimate of 1.5%. Unclassified loans are assigned a loss ratio in the allowance for loan loss model based on the Company s average historical loss experience for the previous five years, adjusted quarterly. The Company believes the five year historical loss ratio is a reasonable estimate of the existing losses in the unclassified loan portfolio. In addition, the reserve includes unclassified past due loans greater than 30 days at 2.5%. During the quarter ending June 30, 2006, the Company reviewed its allowance for loan loss model and made changes to better reflect the risk in the portfolio. The changes included adding additional risk factors to the model. Loan and credit administration risks include collateral documentation risk, insurance risk and maintenance of borrower s financial information risk. Economic conditions, international, national and local, have an impact on the Bank and the Bank s borrowers. Because the economic conditions are often macroeconomic in nature and cannot be controlled by the bank, a risk factor of .0625% has been added to the model for this risk. Portfolio risks include portfolio growth and trends as well as over margined real estate lending risk. Risk factors of .055%, .075%, and .0575%, respectively, were added to the model for each of the loan and credit administration risk. From time to time the Bank extends credit beyond our normal collateral advance percentages in our real estate lending. An excessive level of this lending practice may result in additional examiner scrutiny, competitive disadvantages, and potential losses if the collateral becomes acquired by the Bank. Risk factors of .0625% and .25% have been added to the model for portfolio growth and trends and over margined real estate lending risks, respectively. The concentration risk factors include loan concentration and geographic concentration. As of June 30, 2007, there were only five Standard Industrial Code groups that comprised more than three percent of our total loans outstanding. The five Standard Industrial Code groups are Finance, Insurance and Real-Estate, Service, Consumer, Retail Trade, and Construction. The market area of the Bank is located along the coast and also located on an earthquake fault, increasing the chances of a natural disaster which would impact the Bank and the Bank s borrowers. Risk factors of .06% and .0625%, respectively, were added to the model for each of the concentration risks. Off balance sheet risk includes off balance sheet items that are unfunded amounts under existing approved lines of credit, letters of credit, Automated Clearing House activity and potential liability for recourse in the mortgage loans we sold to investors. A risk factor of .025% has been added to the model for off balance sheet risk.

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Based on the evaluation described above, the Company recorded a provision for loan losses of $20,000 for the three months ended June 30, 2007, compared to $60,000 for the three months ended June 30, 2007. The historical loss ratio used at June 30, 2007 was .066% compared to .112% at June 30, 2006 and was based on a five-year historical average. The Company believes that the five-year historical average is representative of the loss cycle of the portfolio. Classified assets were $2.3 million at June 30, 2007 compared to $1.2 million at June 30, 2006.

During the quarter ended June 30, 2007, charge-offs of $2,427 were recorded. Recoveries of $2,395 were recorded to the allowance for loan losses during the quarter ended June 30, 2007, resulting in an allowance for loan losses of $1,334,455 or .82% of total loans at June 30, 2007, compared to $1,294,994 or .82% of total loans at December 31, 2006 and $1,138,189 or .73% or total loans at June 30, 2006.

The Bank had impaired loans totaling $764,225 as of June 30, 2007, compared to $14,451 as of June 30, 2006. The impaired loans include non-accrual loans with balances at June 30, 2007 and 2006 of $752,620 and $14,451 respectively. The Bank had one restructured loan at June 30, 2007, totaling $11,605 and one restructured loan included in the non accrual loans totaling $270 at June 30, 2006. Management does not know of any loans, which will not meet their contractual obligations that are not otherwise discussed herein.

The accrual of interest is generally discontinued on loans, which become 90 days past due as to principal or interest. The accrual of interest on some loans, however, may continue even though they are 90 days past due if the loans are well secured or in the process of collection and management deems it appropriate. If non-accrual loans decrease their past due status to less than 30 days for a period of six months, they are reviewed individually by management to determine if they should be returned to accrual status. There was one loan over 90 days past due still accruing interest as of June 30, 2007 and no loans over 90 days past due still accruing interest as of June 30, 2006.

Net charge-offs were $32 for the three months ended June 30, 2007 as compared to net recoveries of $4,458 for the three months ended June 30, 2006. Uncertainty in the economic outlook still exists, making charge-off levels in future periods less predictable; however, loss exposure in the portfolio is identified, reserved and closely monitored to ensure that changes are promptly addressed in the analysis of reserve adequacy.

The Company had $133,119 unallocated reserves at June 30, 2007 related to other inherent risk in the portfolio compared to unallocated reserves of $13,963 at June 30, 2006. The increase in unallocated reserves between periods is primarily due to an increase in substandard loans from $1,092,311 at June 30, 2006 to $2,073,810 at June 30, 2007.

Management believes the allowance for loan losses at June 30, 2007, is adequate to cover probable losses in the loan portfolio; however, assessing the adequacy of the allowance is a process that requires considerable judgment. Management s judgments are based on numerous assumptions about current events which it believes to be reasonable, but which may or may not be valid. Thus there can be no assurance that loan losses in future periods will not exceed the current allowance amount or that future increases in the allowance will not be required. No assurance can be given that management s ongoing evaluation of the loan portfolio in light of changing economic conditions and other relevant circumstances will not require significant future additions to the allowance, thus adversely affecting the operating results of the Company.

The local real estate market has had a reduction in sales and an increase in days on market but no material decline in prices after four years of significant price appreciation.

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Other Income

Other income for the three months ended June 30, 2007, decreased $31,649 or 8.19% to $354,584 from $386,233 for the three months ended June 30, 2006. This decrease is primarily due to a decrease in mortgage banking income of $50,482 or 28.29% to $127,975 for the three months ended June 30, 2007 as compared to $178,457 for the three months ended June 30, 2006. During the three months ended June 30, 2006, there was a sale of an investment security which resulted in a loss of $22,950, and no sales of securities during the three months ended June 30, 2007.

Other Expense

Bank overhead increased $115,728 or 6.95% to $1,781,070 for the three months ended June 30, 2007, from $1,665,342 for the three months ended June 30, 2006. Salaries and employee benefits increased $67,820 or 6.97% to $1,041,443 from $973,623 for the three months ended June 30, 2007 and 2006 respectively. This increase was due to the increase in salaries and employee benefits as a result of annual merit increases. Net occupancy expense increased $40,675 or 13.73% to $337,007 from $296,332 for the three months ended June 30, 2007 and 2006, respectively. This increase was primarily due to an increase of $16,020 or 129.67% in insurance as well as an increase in janitorial expenses and maintenance contracts of 71.18% and 11.64%, respectively.

Income Tax Expense

For the three months ended June 30, 2007, the Company s effective tax rate was 34.85% compared to 34.10% during the three months ended June 30, 2006.

Comparison of Six Months Ended June 30, 2007 to Six Months Ended June 30, 2006

Net interest income is the Company s primary source of revenue. Net interest income is the difference between the interest earned on assets, including loan fees and interest on investment securities, and the interest incurred for the liabilities to support such assets. The net interest margin measures how effectively the Company manages the difference between the yield on earning assets and the rate incurred on funds used to support those assets. Net income increased $120,507 or 6.42% to $1,996,777 or basic earnings per share of $.51 and diluted earnings per share of $.50 for the six months ended June 30, 2007 from $1,876,270 or basic earnings per share of $.48 and diluted earnings per share of $.47 for the six months ended June 30, 2006.

Net Interest Income

Net interest income increased $285,407 or 5.14% to $5,838,699 for the six months ended June 30, 2007, from $5,553,292 for the six months ended June 30, 2006. Total interest and fee income increased $842,571 or 10.98%, for the six months ended June 30, 2007, to $8,517,625 from $7,675,054 for the six months ended June 30, 2006. Total interest and fees on loans increased $676,246, or 10.59% to $7,062,529 for the six months ended June 30, 2007, from $6,386,283 for the six months ended June 30, 2006. Interest and dividends on investment securities increased $115,475 or 13.47% to $972,624 for the six months ended June 30, 2007, from $857,149 for the same period in 2006. Loans averaged $166.8 million for the six months ended June 30, 2007, an increase of $8.5 million or 5.37% from $158.3 for the six months ended June 30, 2006. This increase in average loans primarily led to an increase in the average earnings assets from $215.0 million to $227.2 million for the six months ended June 30, 2007. The yield on average earning assets increased 36 basis points to 7.56% from 7.20% for the six months ended June 30, 2007 and 2006, respectively. Average investments for the six months ended June 30, 2007 were $41.8 million compared to $38.2 million for the six months ended June 30, 2006, with an increase in the yield from 4.53% to 4.70% or 17 basis points.

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Total interest expense increased $557,164 or 26.26% to $2,678,926 for the six months ended June 30, 2007, from $2,121,762 for the six months ended June 30, 2006. The increase in interest expense is primarily due to an increase in average deposits and the average cost of deposits. Interest on deposits for the six months ended June 30, 2007, was $2,659,809 compared to $2,107,586 for the six months ended June 30, 2006, an increase of $552,223 or 26.20%. Total interest bearing deposits averaged approximately $157.2 million for the six months ended June 30, 2007, as compared to $146.6 million for the six months ended June 30, 2006. The average cost of interest bearing deposits was 3.41% and 2.90% for the six months ended June 30, 2007 and 2006, respectively, an increase of 51 basis points.

Provision for Loan Losses

The provision for loan loss for the six months ended June 30, 2007 was $40,000 compared to $120,000 for the six months ended June 30, 2006. During the six months ended June 30, 2007, charge-offs $4,690 and recoveries of $4,152 were recorded to the allowance for loan losses resulting in an allowance for loan losses of $1,334,455 or .82% of total loans at June 30, 2007, compared to $1,294,994 or .82% of total loans at December 31, 2006 and $1,138,189 or .73% or total loans at June 30, 2006.

Net charge-offs were $538 for the six months ended June 30, 2007, as compared to net recoveries of $1,014 for the six months ended June 30, 2006. Loss exposure in the portfolio is identified, reserved and closely monitored to ensure that changes are promptly addressed in the analysis of the reserve.

Other Income

Other income for the six months ended June 30, 2007, increased $35,573 or 4.93% to $757,513 from $721,940 for the six months ended June 30, 2006. This increase was primarily due to an increase in mortgage banking income of $25,144 or 8.66% to $315,405 from $290,261 for the six months ended June 30, 2007 and 2006, respectively. This increase was offset by a decrease in service charges, fees and commissions of $12,628 or 2.86% to $428,313 from $440,941 for the six months ended June 30, 2007 and 2006, respectively. This decrease resulted from a decrease in overdraft fees of $6,265 or 3.79% from $165,407 for the six months ended June 30, 2006 to $159,142 for the six months ended June 30, 2007.

Other Expense

Bank overhead increased $186,678 or 5.65% to $3,492,531 for the six months ended June 30, 2007, from $3,305,853 for the six months ended June 30, 2006. This increase was primarily due to an increase in both salaries and employee benefits and net occupancy expense. Salaries and employee benefits increased $151,153 or 7.81% to $2,086,544 for the six months ended June 30, 2007 from $1,935,391 for the six months ended June 30, 2006, as a result of annual merit increases. Total occupancy expense increased $50,089 or 8.43% to $644,178 for the six months ended June 30, 2007. This increase was primarily due to an increase in insurance of $22,762 or 107.63%.

Income Tax Expense

For the six months ended June 30, 2007, the Company s effective tax rate was 34.82% compared to 34.15% during the six months ended June 30, 2007.

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Off Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used by the Company for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customer s requests for funding.

The Company s off-balance sheet arrangements consist principally of commitments to extend credit described below. At June 30, 2007 and 2006, the Company had no interests in non-consolidated special purpose entities.

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 amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management s credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, negotiable instruments, inventory, property, plant and equipment, and real estate. Commitments to extend credit, including unused lines of credit, amounted to $42,240,790 and $49,733,120 at June 30, 2007 and 2006 respectively.

Standby letters of credit represent an obligation of the Company to a third party contingent upon the failure of the Company s customer to perform under the terms of an underlying contract with the third party or obligates the Company to guarantee or stand as surety for the benefit of the third party. The underlying contract may entail either financial or nonfinancial obligations and may involve such things as the shipment of goods, performance of a contract, or repayment of an obligation. Under the terms of a standby letter, generally drafts will be drawn only when the underlying event fails to occur as intended. The Company can seek recovery of the amounts paid from the borrower. The majority of these standby letters of credit are unsecured. Commitments under standby letters of credit are usually for one year or less. At June 30, 2007, and 2006, the Company has recorded no liability for the current carrying amount of the obligation to perform as a guarantor; as such amounts are not considered material. The maximum potential amount of undiscounted future payments related to standby letters of credit at June 2007 and 2006 was $441,252 and $430,402 respectively.

The Company originates certain fixed rate residential loans and commits these loans for sale. The commitments to originate fixed rate residential loans and the sale commitments are freestanding derivative instruments. The fair value of the commitments to originate fixed rate conforming loans was not significant at June 30, 2007. The Company has forward sales commitments, totaling $3.2 million at June 30, 2007, to sell loans held for sale of $3.2 million. The fair value of these commitments was not significant at June 30, 2007. The Company has no embedded derivative instruments requiring separate accounting treatment.

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Liquidity

The Company must maintain an adequate liquidity position in order to respond to the short-term demand for funds caused by withdrawals from deposit accounts, extensions of credit and for the payment of operating expenses. Primary liquid assets of the Company are cash and due from banks, federal funds sold, investments available for sale, other short-term investments and mortgage loans held for sale. The Company s primary liquid assets accounted for 30.03% and 31.42% of total assets at June 30, 2007 and 2006, respectively. Proper liquidity management is crucial to ensure that the Company is able to take advantage of new business opportunities as well as meet the credit needs of its existing customers. Investment securities are an important tool in the Company s liquidity management. Securities classified as available for sale may be sold in response to changes in interest rates and liquidity needs. All of the securities presently owned by the Bank are classified as available for sale. At June 30, 2007, the Bank had unused short-term lines of credit totaling approximately $15,500,000 (which are withdrawable at the lender s option). Additional sources of funds available to the Bank for additional liquidity needs include borrowing on a short-term basis from the Federal Reserve System, increasing deposits by raising interest rates paid and selling mortgage loans for sale.

The Company s core deposits consist of non-interest bearing accounts, NOW accounts, money market accounts, time deposits and savings accounts. The Company closely monitors its reliance on certificates of deposit greater than $100,000. The Company s management believes its liquidity sources are adequate to meet its operating needs and does not know of any trends, events or uncertainties that may result in a significant adverse effect on the Company s liquidity position. At June 30, 2007 and 2006, the Bank s liquidity ratio was 25.02% and 26.58%, respectively.

Capital Resources

The capital needs of the Company have been met to date through the $10,600,000 in capital raised in the Bank s initial offering, the retention of earnings less dividends paid and the exercise of stock options for total shareholders equity at June 30, 2007, of $24,354,665. The rate of asset growth since the Bank s inception has not negatively impacted this capital base. The risk-based capital guidelines for financial institutions are designed to highlight differences in risk profiles among financial institutions and to account for off balance sheet risk. The guidelines established require a risk based capital ratio of 8% for bank holding companies and banks. The risk based capital ratio at June 30, 2007, for the Bank is 12.92% and at June 30, 2006 was 12.37%. The Company s management does not know of any trends, events or uncertainties that may result in the Company s capital resources materially increasing or decreasing.

The Company and the Bank are 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 material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company s and the Bank s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and to average assets. Management believes, as of June 30, 2007, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

At June 30, 2007 and 2006, the Company and the Bank are categorized as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Company and the Bank must maintain minimum total risk based, Tier 1 risk based and Tier 1 leverage ratios of 10%, 6% and 5%, respectively, and to be categorized as adequately capitalized, the Company and the Bank must maintain minimum total risk based, Tier 1 risk based and Tier 1 leverage ratios of 8%, 4% and 4%, respectively. There are no current conditions or events that management believes would change the Company s or the Bank s category.

Accounting and Reporting Changes

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. This Statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company does not believe that the adoption of SFAS No. 155 will have a material impact on its financial position, results of operations or cash flows.

In June 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140. This Statement amends FASB No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose its subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity s exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. An entity should adopt SFAS No. 156 as of the beginning of its first fiscal year that begins after September 15, 2006. The Company does not believe the adoption of SFAS No. 156 will have a material impact on its financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes . FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprises financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the effects of FIN 48.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company s financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date the date at which the benefit obligation and plan assets are measured is required to be the company s fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company is currently analyzing the effects of SFAS 158 but does not expect that its implementation will have a significant impact on the Company s financial conditions or results of operations.

In September, 2006, The FASB ratified the consensus reached by the FASB s Emerging Issues Task Force (EITF) relating to EITF 06-4 Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements . EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with FASB Statement of Financial Accounting Standards (SFAS) No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions", or Accounting Principles Board (APB) Opinion No. 12, Omnibus Opinion 1967". EITF 06-4 is effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial position, results of operations or cash flows.

On September 13, 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company s balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that upon adoption it will have no impact on the reported results of operations or financial conditions.

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. This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement (1) applies to all entities, (2) specifies certain election dates, (3) can be applied on an instrument-by-instrument basis with some exceptions, (4) is irrevocable, and (5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the Company on January 1, 2008. Earlier adoption is permitted in 2007 if the Company also elects to apply the provisions of SFAS 157, Fair Value Measurement. The Company is currently analyzing the fair value option provided under SFAS 159.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Effect of Inflation and Changing Prices

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

Unlike most other industries, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution s performance than does the effect of inflation.

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ITEM 3
CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures and internal controls and procedures for financial reporting

An evaluation was carried out under the supervision and with the participation of Bank of South Carolina Corporation s management, including its Principal Executive Officer and the Executive Vice President and Treasurer, of the effectiveness of Bank of South Carolina Corporation s disclosure controls and procedures as of June 30, 2007. Based on that evaluation, Bank of South Carolina Corporation s management, including the Chief Executive Officer and Executive Vice President and Treasurer, has concluded that Bank of South Carolina Corporation s disclosure controls and procedures are effective. During the period ending June 30, 2007, there was no change in Bank of South Carolina Corporation s internal control over financial reporting that has materially affected or is reasonably likely to materially affect, Bank of South Carolina Corporation s internal control over financial reporting.

The Company established a Disclosure Committee on December 20, 2002. The committee is made up of the President and Chief Executive Officer, Executive Vice President and Treasurer, Executive Vice President, Senior Vice President (Operations), Vice President (Audit Compliance Officer), Accounting Officer and Assistant Vice President (Credit Department). This Committee meets quarterly to review the 10QSB and the 10KSB, to assure that the financial statements, Securities and Exchange Commission filings and all public releases are free of any material misstatements and correctly reflect the financial position, results of operations and cash flows of the Company. This Committee also assures that the Company is in compliance with the Sarbanes-Oxley Act.

The Disclosure Committee establishes a calendar each year to assure that all filings are reviewed and filed in a proper manner. The calendar includes the dates of the Disclosure Committee meetings, the dates that the 10QSB and the 10KSB are sent to our independent accountants and to our independent counsel for review as well as the date for the Audit Committee of the Board of Directors to review the reports.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company and its subsidiary from time to time are involved as plaintiff or defendant in various legal actions incident to its business. These actions are not believed to be material either individually or collectively to the consolidated financial condition of the Company or its subsidiary.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

On Tuesday April 10, 2007, the shareholders elected Linda J. Bradley-McKee, PHD., CPA, C. Ronald Coward, Graham M. Eubank, Jr., T. Dean Harton, Fleetwood S. Hassell, Glen B. Haynes, DVM, William L. Hiott, Jr., Katherine M. Huger, Richard W. Hutson, Jr., Charles G. Lane, Hugh C. Lane, Jr., Louise J. Maybank, Alan I. Nussbaum, MD, Edmund Rhett, Jr., MD, Malcolm M. Rhodes, MD, Thomas C. Stevenson, III, and Steve D. Swanson, to serve on the Board of Directors until the Company s 2008 annual meeting.

On Tuesday April 10, 2007, the shareholders approved an increase in authorized shares from 6,000,000 to 12,000,000.

On Tuesday April 10, 2007, the shareholders ratified the appointment of Elliott Davis, LLC, as independent certified public accountants for 2007.

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Item 5. Other Information

None.

Item 6. Exhibits

1. The Consolidated Financial Statements are included in this Form 10-QSB and listed on pages as indicated.

		Page
(1)	Consolidated Balance Sheets	3
(2)	Consolidated Statements of Operations for the three months ended June 30, 2007 and 2006	4
(3)	Consolidated Statements of Operations for the six months ended June 30, 2007 and 2006	5
(4)	Consolidated Statements of Shareholders Equity and Comprehensive Income	6
(4)	Consolidated Statements of Cash Flows	7
(5)	Notes to Consolidated Financial Statements	8-11

2. Exhibits

2.0	Plan of Reorganization (Filed with 1995 10-KSB)
3.0	Articles of Incorporation of the Registrant (Filed with 1995 10-KSB)
3.1	By-laws of the Registrant (Filed with 1995 10-KSB)
4.0	2007 Proxy Statement (Filed with 2007 10-KSB)
10.0	Lease Agreement for 256 Meeting Street (Filed with 1995 10-KSB)
10.1	Sublease Agreement for Parking Facilities at 256 Meeting Street (Filed with 1995 10-KSB)
10.2	Lease Agreement for 100 N. Main Street, Summerville, SC (Filed with 1995 10-KSB)
10.3	Lease Agreement for 1337 Chuck Dawley Blvd., Mt. Pleasant, SC (Filed with 1995 10-KSB)
31.1	Certification of Principal Executive Officer pursuant to 15 U.S.C. 78m(a) or 78 o(d) (Section 302 of the Sarbanes-Oxley Act of 2002)
31.2	Certification of Principal Financial Officer Pursuant to 15 U.S.C. 78m(a) or 78 o(d) (Section 302 of the Sarbanes-Oxley Act of 2002)
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)
32.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BANK OF SOUTH CAROLINA CORPORATION

August 1, 2007

BY: /s/ Hugh C. Lane, Jr.
Hugh C. Lane, Jr.
President and Chief Executive Officer

BY: /s/ William L. Hiott, Jr.
William L. Hiott, Jr.
Executive Vice President & Treasurer