

TRINITY BANK, N.A.

Financial Statements

December 31, 2004 and 2003

(With Independent Auditors' Report Thereon)

Independent Auditors' Report

The Board of Directors
Trinity Bank, N.A.

We have audited the accompanying balance sheet of Trinity Bank, N.A. as of December 31, 2004 and the related statements of operations, changes in stockholders' equity, and cash flows for the year ended December 31, 2004. 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 audit. The financial statements of Trinity Bank, N.A. as of December 31, 2003 were audited by other auditors whose report dated January 20, 2004 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 audit provides 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 Trinity Bank, N.A. as of December 31, 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Payne Falkner Smith & Jones, P.C.

March 14, 2005

TRINITY BANK, N.A.

Balance Sheet

December 31, 2004 and 2003

(in thousands)

	<u>2004</u>	<u>2003</u>
<u>ASSETS</u>		
Cash and due from banks	\$ 2,600	\$ 1,451
Federal funds sold	<u>605</u>	<u>2,110</u>
Total cash and cash equivalents	3,205	3,561
Interest bearing deposits at other banks	7,467	9,304
Securities available for sale	8,923	3,980
Securities held to maturity	7,984	6,986
Loans:		
Gross loans	27,922	12,094
Allowance for loan losses	<u>(253)</u>	<u>(106)</u>
Net loans	27,669	11,988
Bank furniture, fixtures and leasehold improvements	2,040	1,778
Other assets	<u>691</u>	<u>580</u>
	<u>\$ 57,979</u>	<u>\$ 38,177</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Deposits:		
Noninterest bearing	\$ 12,171	\$ 7,371
Interest bearing	<u>35,973</u>	<u>20,672</u>
Total deposits	48,144	28,043
Other liabilities	43	34
Commitments and contingencies	-	-
Stockholders' equity:		
Common stock	5,516	5,516
Additional paid-in capital	5,516	5,516
Accumulated deficit	(1,216)	(939)
Accumulated other comprehensive (loss) income	<u>(24)</u>	<u>7</u>
Total stockholders' equity	<u>9,792</u>	<u>10,100</u>
	<u>\$ 57,979</u>	<u>\$ 38,177</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statement of Operations

For the Years Ended December 31, 2004 and December 31, 2003

(in thousands, except for share amounts)

	<u>2004</u>	<u>2003</u>
Interest income:		
Interest and fees on loans	\$ 1,030	\$ 201
Interest and dividends on securities	519	107
Interest on federal funds sold	14	81
Interest on other investments	<u>183</u>	<u>17</u>
Total interest income	1,746	406
Interest on deposit accounts	<u>462</u>	<u>146</u>
Net interest income	1,284	260
Provision for loan losses	<u>147</u>	<u>106</u>
Net interest income (loss) after provision	<u>1,137</u>	<u>154</u>
Noninterest income:		
Service charges on deposit accounts	54	10
Other	<u>203</u>	<u>27</u>
Total noninterest income	<u>257</u>	<u>37</u>
Noninterest expense:		
Salaries and employee benefits	1,005	531
Occupancy, furniture and equipment	306	133
Professional fees	70	61
Other	<u>290</u>	<u>110</u>
Total noninterest expense	<u>1,671</u>	<u>835</u>
Net loss from operations	(277)	(644)
Pre-opening costs	<u>-</u>	<u>(274)</u>
Net loss	<u>\$ (277)</u>	<u>\$ (918)</u>
Net loss per weighted average share	<u>\$ (0.25)</u>	<u>\$ (0.83)</u>
Weighted average shares outstanding	<u>1,103,307</u>	<u>1,103,307</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statement of Changes in Stockholders' Equity

For the Years Ended December 31, 2004 and December 31, 2003

(in thousands, except for share amounts)

	Common Stock \$5 par value 1,295,373 shares <u>Authorized</u>		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Comprehensive Loss	Total
	Shares	Amount					
Balance at January 1, 2003	-	\$ -	\$ -	\$ (21)	\$ -		\$ (21)
Sale of common stock	1,103,307	5,516	5,516	-	-		11,032
Comprehensive loss:							
Net loss	-	-	-	(918)	-	\$ (918)	(918)
Other comprehensive income:							
Unrealized holding gains arising during the period	-	-	-	-	7	<u>7</u>	7
Total comprehensive loss						<u>\$ (911)</u>	
Balance at December 31, 2003	<u>1,103,307</u>	<u>5,516</u>	<u>5,516</u>	<u>(939)</u>	<u>7</u>		<u>10,100</u>
Comprehensive loss:							
Net loss	-	-	-	(277)	-	\$ (277)	(277)
Other comprehensive loss:							
Unrealized holding losses arising during the period	-	-	-	-	(31)	<u>(31)</u>	(31)
Total comprehensive loss						<u>\$ (308)</u>	
Balance at December 31, 2004	<u><u>1,103,307</u></u>	<u><u>\$ 5,516</u></u>	<u><u>\$ 5,516</u></u>	<u><u>\$ (1,216)</u></u>	<u><u>\$ (24)</u></u>		<u><u>\$ 9,792</u></u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statement of Cash Flows

For the Years Ended December 31, 2004 and December 31, 2003

(in thousands)

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Net loss	\$ (277)	\$ (918)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation	178	74
Provision for loan losses	147	106
Accretion	(20)	(2)
Increase in other assets	(94)	(575)
Increase (decrease) in other liabilities	<u>9</u>	<u>(6)</u>
Net cash used by operating activities	<u>(57)</u>	<u>(1,321)</u>
Cash flows from investing activities:		
Purchases of securities available for sale	(16,973)	(4,967)
Purchases of securities held to maturity	(3,994)	(6,986)
Proceeds from sales of securities available for sale	11,998	-
Proceeds from maturities of securities held to maturity	3,000	1,000
Net decrease (increase) in interest bearing deposits in other banks	1,837	(9,304)
Net increase in loans	(15,828)	(12,095)
Purchases of premises and equipment	<u>(440)</u>	<u>(1,853)</u>
Net cash used by investing activities	<u>(20,400)</u>	<u>(34,205)</u>
Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	18,147	24,239
Net increase in certificates of deposit	1,954	3,806
Proceeds from sale of common stock	<u>-</u>	<u>11,032</u>
Net cash provided by financing activities	<u>20,101</u>	<u>39,077</u>
Net (decrease) increase in cash and cash equivalents	(356)	3,551
Cash and cash equivalents at beginning of period	<u>3,561</u>	<u>10</u>
Cash and cash equivalents at end of period	<u>\$ 3,205</u>	<u>\$ 3,561</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Notes to Financial Statements

December 31, 2004 and 2003

1. Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies used by Trinity Bank, N.A. (Bank) in the preparation of its financial statements. These accounting policies conform to generally accepted accounting principles and practices generally followed within the banking industry. A description of the more significant of these policies follows.

Business

The Bank, a national bank located in Fort Worth, Texas, began operations on May 28, 2003. The Bank provides a full range of banking services to individual and corporate customers and is subject to competition from other local, regional, and national financial institutions. The Bank is also subject to the regulations of certain federal agencies and undergoes periodic examinations by those regulatory authorities.

For the period from August 1, 2002 (date of inception) to May 28, 2003, the Bank was in a pre-opening stage, engaging in preparation of applications for regulatory approvals, raising of capital, financial planning, systems development, acquisition of equipment and facilities, and recruiting activities. On May 9, 2003, the Bank completed an offering of 1,103,307 shares of common stock (\$5 par value) at a price of \$10 per share. The gross and net proceeds from the offering totaled \$11,033,070.

The summary of the significant accounting policies of the Bank is presented to assist in understanding the Bank's financial statements. The financial statements and notes are the representation of the Bank's management, who are responsible for their integrity and objectivity.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the 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 valuation of other real estate owned. While management uses available information to recognize losses on loans and other real estate owned, future provisions may be necessary based on changes in local economic conditions. In addition, banking regulators, as an integral part of their examination process, periodically review the Bank's allowance for loan and other real estate losses. They may require the Bank to record additional provisions for losses based on their judgment about information available to them at the time of their examination.

A significant portion of the Bank's loans are secured by real estate and related assets located in local markets. Accordingly, the ultimate collectibility of this portion of the Bank's loan portfolio is susceptible to changes in local market conditions.

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Cash and Cash Equivalents

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, other short-term investments and federal funds sold. All highly liquid investments with an initial maturity of less than ninety days are considered to be cash equivalents.

Securities

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 or trading, including equity securities with readily determinable fair values, 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.

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 estimating other-than-temporary impairment losses, management considers (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) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans

The Bank grants commercial, real estate, agricultural, and consumer loans to customers. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally 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. Fees associated with originating loans to the extent they exceed the direct loan origination costs are generally deferred and recognized over the life of the loan as an adjustment of yield.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. 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.

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Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as 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 loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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 and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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, unless such loans are the subject of a restructuring agreement.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into or intends to enter into in the future commitments to extend credit, including commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Bank Premises and Equipment

Land is carried at cost. Bank premises and furniture and equipment are carried at cost, less accumulated depreciation and amortization computed using the straight-line method.

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Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Income Taxes

Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Advertising

Advertising consists of the Bank's advertising in its local market area. Advertising is expensed as incurred. Advertising expense was approximately \$9,000 and \$4,000 for the years ended December 31, 2004 and 2003, respectively.

Fair Values of Financial Instruments

The following methods and assumptions were used by the Bank in estimating the fair values of financial instruments as disclosed herein:

Cash and short-term instruments

The carrying amounts of cash and short-term instruments approximate their fair value.

Securities

Fair values for securities excluding restricted equity securities, are based on quoted market prices. The carrying values of restricted equity securities approximate fair values.

Loans

For variable-rate loans that repriced frequently and have no significant changes in credit risk, fair values are based on carrying values. Fair values for commercial real estate, mortgage, consumer and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed term money market accounts and certificates of deposit (CD's) approximate their fair values at the reporting date. Fair values for fixed-rate CD's are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

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Other borrowings

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest

The carrying amounts of accrued interest approximate their fair values.

Off-balance sheet instruments

Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counter parties' credit standings.

Stock Based Compensation

The Bank applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations, in accounting for its stock-based compensation plans. Under Opinion 25, compensation cost is measured as the excess, if any, of the market price of the Bank's stock at the date of the grant above the amount an employee must pay to acquire the stock. No compensation expense is recognized when the exercise price is equal to the market value of the stock on the day of the grant. The Financial Accounting Standards Board (FASB) published SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) on January 1, 1996 which encourages but does not require, companies to recognize compensation expense for grants of stock, stock options and other equity instruments to employees based on fair value accounting rules. Companies that do not adopt the fair value rules will continue to apply the existing rules, but are required to disclose pro forma net income or loss under the new method.

The following table reflects charges calculated under SFAS No. 123 for the stock options and warrants of approximately \$15,000 and \$8,000 for the years ended December 31, 2004 and 2003, respectively.

	<u>2004</u>	<u>2003</u>
Net loss:		
As reported	\$ <u>(277)</u>	\$ <u>(918)</u>
Proforma	\$ <u>(292)</u>	\$ <u>(926)</u>
Net income (loss) per share:		
As reported:		
Basic	(0.25)	(0.83)
Diluted	(0.26)	(0.83)
Proforma:		
Basic	(0.25)	(0.84)
Diluted	(0.26)	(0.84)

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Earnings Per Share

Earnings per share is computed in accordance with FAS No. 128, "Earnings Per Share," which requires dual presentation of basic and fully diluted earnings per share (EPS) for entities with complex capital structures. Basic EPS is based on net income divided by the weighted-average number of shares outstanding during the period. Diluted EPS includes the dilutive effect of potential common stock using the treasury stock method only if the effect on earnings per share is dilutive.

Earnings per common share are computed by dividing net income by the weighted-average number of shares outstanding for the year. The weighted-average number of common shares outstanding for basic and diluted earnings per share computations was 1,103,307 for the years ended December 31, 2004 and 2003, respectively. For the years ended December 31, 2003, all shares issued upon formation of the Bank were considered outstanding from the beginning of the period.

The Bank reported a loss for the years ended December 31, 2004 and 2003. Accordingly, the dilutive effect of stock options and warrants is not considered in the net loss per share calculations for these periods.

2. Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), which establishes guidance for determining when an entity should consolidate another entity that meets the definition of a variable interest entity. FIN 46 requires a variable interest entity to be consolidated by a company if that company will absorb a majority of the expected losses, will receive a majority of the expected residual returns, or both. Transferors to qualified special-purpose entities ("QSPEs") and certain other interests in a QSPE are not subject to the requirements of FIN 46. On December 17, 2003, the FASB revised FIN 46 (FIN 46R) and deferred the effective date of FIN 46 to no later than the end of the first reporting period that ends after March 15, 2004, however, for special-purpose entities the Bank would be required to apply FIN 46 as of June 30, 2003. The Interpretation had no effect on the Bank's financial statements.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Postretirement Benefits*. This Statement requires additional disclosures about the assets, obligations and cash flows of defined benefit pension and postretirement plans, as well as the expense recorded for such plans. The majority of the provisions of this Statement are effective for financial statements with fiscal years ending after December 15, 2003. This Statement had no effect on the Bank's financial statements.

In December, 2004, the FASB issued a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. This Statement supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. The provisions of this statement are effective for nonpublic entities as of the beginning of the first annual reporting period that begins after December 15, 2005. Management anticipates this Statement will not have a significant effect on the Bank's financial statements.

In December 2004, the FASB issued SFAS 153, *Exchanges of Nonmonetary Assets*—an amendment of APB Opinion No. 29. The guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The provisions of this statement are effective for non monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Management anticipates this Statement will have no effect on the Bank's financial statements.

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3. Statement of Cash Flows

The Bank reports on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, loans made to customers and principal collections on those loans.

The Bank uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information for the years ended December 31, 2004 and 2003 is presented as follows (in thousands):

	<u>2004</u>	<u>2003</u>
Cash transactions:		
Interest income received	\$ <u>1,636</u>	\$ <u>261</u>
Interest expense paid	\$ <u>427</u>	\$ <u>154</u>
Income taxes paid	\$ <u>-</u>	\$ <u>-</u>
Noncash transactions:		
Net unrealized (depreciation) appreciation on securities available for sale	\$ <u>(48)</u>	\$ <u>11</u>

4. Debt and Equity Securities

Debt and equity securities have been classified as available for sale in the consolidated balance sheet according to management's intent. The carrying amount of securities and their approximate fair values at December 31, 2004 and 2003 are as follows (in thousands):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities Classified as Available for Sale</u>				
December 31, 2004:				
U.S. Government Agency obligations	\$ <u>8,960</u>	\$ <u>12</u>	\$ <u>49</u>	\$ <u>8,923</u>
December 31, 2003:				
U.S. Government Agency obligations	\$ <u>3,969</u>	\$ <u>11</u>	\$ <u>-</u>	\$ <u>3,980</u>
<u>Securities Classified as Held to Maturity</u>				
December 31, 2004:				
U.S. Government Agency obligations	\$ <u>7,984</u>	\$ <u>8</u>	\$ <u>33</u>	\$ <u>7,959</u>
December 31, 2003:				
U.S. Government Agency obligations	\$ <u>6,986</u>	\$ <u>20</u>	\$ <u>5</u>	\$ <u>7,001</u>

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The scheduled maturities of debt securities at December 31, 2004 are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Securities Available for Sale</u>		<u>Securities Held to Maturity</u>	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ -	\$ -	\$ -	\$ -
Due from one year to five years	7,965	7,939	3,991	3,984
Due from five years to ten years	995	984	3,993	3,975
Due after ten years	-	-	-	-
	<u>\$ 8,960</u>	<u>\$ 8,923</u>	<u>\$ 7,984</u>	<u>\$ 7,959</u>

Proceeds from the sales of investment securities available for sale during 2004 were approximately \$11,998,000. No gains or losses were realized on these sales. There were no sales of securities available for sale during 2003.

At December 31, 2004 there was \$1,000,000 of securities classified as held to maturity which were pledged as collateral for purposes required or permitted by law. There were no securities at December 31, 2003 which were pledged as collateral for purposes required or permitted by law.

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2004 are summarized as follows (in thousands):

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>Securities Available for Sale</u>						
U.S. Government Agency obligations	<u>\$ 6,923</u>	<u>\$ 49</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,923</u>	<u>\$ 49</u>
<u>Securities Held to Maturity</u>						
U.S. Government Agency obligations	<u>\$ 5,962</u>	<u>\$ 33</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,962</u>	<u>\$ 33</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (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) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. At December 31, 2004, certain securities have unrealized losses with aggregate depreciation from the Bank's amortized cost basis. These unrealized losses are generally due to changes in interest rates. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available for sale, no declines are deemed to be other than temporary.

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5. Loans and Allowance for Loan Losses

Loans at December 31, 2004 and 2003 consisted of the following (in thousands):

	<u>2004</u>	<u>2003</u>
Commercial	\$ 12,741	\$ 5,924
Real estate	12,038	4,847
Consumer	1,395	919
Interim	<u>1,748</u>	<u>404</u>
	27,922	12,094
Allowance for loan losses	<u>(253)</u>	<u>(106)</u>
	<u>\$ 27,669</u>	<u>\$ 11,988</u>

At December 31, 2004 and 2003, there were no loans which were contractually delinquent over ninety days that were continuing to accrue interest.

At December 31, 2004 and 2003, there were no loans considered as impaired which should have been recognized in conformity with FAS No. 114 as amended by FAS No. 118. No interest income on impaired loans was recognized for cash payments during the years ended December 31, 2004 and 2003.

An analysis of the allowance for loan losses for the years ended December 31, 2004 and 2003 is as follows (in thousands):

	<u>2004</u>	<u>2003</u>
Balance at January 1,	\$ 106	\$ -
Provision charged to earnings	147	106
Loans charged to the allowance account	-	-
Recoveries of loans previously charged off	<u>-</u>	<u>-</u>
Balance at December 31,	<u>\$ 253</u>	<u>\$ 106</u>

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6. Bank Furniture, Fixtures and Leasehold Improvements

Bank premises and equipment at December 31, 2004 and 2003 consisted of the following (in thousands):

	<u>2004</u>	<u>2003</u>
Land	\$ 297	\$ 297
Building and improvements	952	755
Furniture, fixtures and equipment	949	689
Autos	94	62
Construction in progress	<u>-</u>	<u>49</u>
	2,292	1,852
Accumulated depreciation	<u>(252)</u>	<u>(74)</u>
	<u>\$ 2,040</u>	<u>\$ 1,778</u>

The land and buildings used by the Bank were purchased while the Bank was in organization by one of the organizers. Subsequent to obtaining the Bank's charter, the land and buildings were deeded to the Bank and the organizer was reimbursed at the organizers' cost plus interest as specified in the agreement. This amount was included in the reimbursement made to the organizer detailed in Note 12.

7. Deposits

Deposits at December 31, 2004 and 2003 are summarized as follows (in thousands):

	<u>2004</u>		<u>2003</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Noninterest bearing demand				
accounts	\$ 12,171	25.3	\$ 7,371	26.3
Interest bearing demand				
accounts	6,991	14.5	4,715	16.9
Limited access money market accounts	23,224	48.2	12,153	43.3
Certificates of deposit,				
\$100,000 and greater	4,353	9.1	3,065	10.9
Certificates of deposit, less				
than \$100,000	<u>1,405</u>	<u>2.9</u>	<u>739</u>	<u>2.6</u>
	<u>\$ 48,144</u>	<u>100.00</u>	<u>\$ 28,043</u>	<u>100.00</u>

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At December 31, 2004, certificates of deposit accounts distributed by rate are as follows (in thousands):

	<u>2004</u>
Certificates of deposit:	
1.00% to 1.99%	\$ 1,530
2.00% to 2.99%	<u>4,228</u>
	<u>\$ 5,758</u>

At December 31, 2004, scheduled maturities of certificates of deposit accounts are as follows (in thousands):

Less than one year	\$ 5,757
One to three years	1
Over three years	<u>-</u>
	<u>\$ 5,758</u>

8. Income Taxes

The provision for income taxes for the year ended December 31, 2004 and 2003 consisted of the following (in thousands):

	<u>2004</u>	<u>2003</u>
Income tax benefit:		
Current	\$ -	\$ -
Deferred	<u>-</u>	<u>-</u>
Income tax benefit	<u>\$ -</u>	<u>\$ -</u>

A reconciliation of the expected tax benefit based on the federal statutory rate of 34% to the actual benefit for federal income taxes is as follows (in thousands):

	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>
Tax benefit based on statutory rate	\$ 94	34.0	\$ 312	34.0
Net non-deductible expenses	(3)	(1.1)	(1)	(0.1)
Effect of valuation allowance	<u>(91)</u>	<u>(32.9)</u>	<u>(311)</u>	<u>(33.9)</u>
	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>

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Deferred income taxes reflect the net tax effects of temporary differences between the recorded amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Bank's deferred tax assets and liabilities as of December 31, 2004 and 2003 are as follows (in thousands):

	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
Net operating loss carryforward	\$ 420	\$ 345
Pre-opening costs	59	80
Allowance for loan losses for book in excess of tax	75	26
Net unrealized depreciation on securities available for sale	13	-
Total deferred tax assets	<u>567</u>	<u>451</u>
Deferred tax liabilities:		
Premises and equipment basis for book in excess of tax	152	136
Net unrealized appreciation on securities available for sale	-	4
Total deferred tax liabilities	152	140
Net deferred tax asset before valuation allowance	415	311
Less valuation allowance	<u>(402)</u>	<u>(311)</u>
Deferred tax asset	<u>\$ 13</u>	<u>\$ -</u>

At December 31, 2004 and 2003, management believed that a valuation allowance was necessary in order to comply with the provisions of FAS 109, as discussed in Note 1.

As of December 31, 2004, the Bank has a net operating loss carryforward for income tax purposes of approximately \$1,236,000 that will expire if not utilized in 2023 and 2024.

9. Commitments and Contingencies

From time to time, the Bank may be involved in legal actions arising from normal business activities. There were no such legal actions or pending litigation at December 31, 2004 or 2003.

The Bank does not anticipate any material losses as a result of commitments and contingent liabilities.

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10. Financial Instruments

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. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2004 and 2003, the approximate amounts of these financial instruments were as follows (in thousands):

	<u>2004</u>	<u>2003</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 8,817	\$ 5,623
Standby letters of credit	<u>50</u>	<u>-</u>
	<u>\$ 8,867</u>	<u>\$ 5,623</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Management evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral and the nature of such collateral is essentially the same as that involved in making commitments to extend credit.

Although the maximum exposure to loss is the amount of such commitments, management currently anticipates no material losses from such activities.

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The estimated fair values of the Bank's financial instruments at December 31, 2004 and 2003 were as follows (in thousands):

	<u>2004</u>		<u>2003</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 3,205	\$ 3,205	\$ 3,561	\$ 3,561
Interest bearing deposits in other banks	7,467	7,467	9,304	9,304
Securities available for sale	8,923	8,923	3,980	3,980
Securities held to maturity	7,984	7,959	6,986	7,001
Loans	27,669	28,028	11,988	11,989
Accrued interest receivable	255	255	145	145
Financial liabilities:				
Deposits	48,144	48,141	28,043	28,043
Accrued interest payable	42	42	7	7
Off-balance sheet assets:				
Commitments to extend credit	-	-	-	-
Standby letters of credit	-	-	-	-

11. Significant Group Concentrations of Credit Risk

Most of the Bank's business activity is with customers located within Texas. Such customers are normally also depositors of the Bank.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

The contractual amounts of credit related financial instruments such as commitments to extend credit, credit card arrangements, and letters of credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

The nature of the Bank's business requires that it maintain amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses from such accounts.

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12. Related Party Transactions

In the ordinary course of business, the Bank has and expects to continue to have transactions, including borrowings, with its officers, directors and their affiliates. In the opinion of management, such transactions are on the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unaffiliated persons. At December 31, 2004 and 2003, the aggregate amounts of such loans were approximately \$5,650,000 and \$4,326,000, respectively. During 2004, approximately \$4,306,000 of new loans were made, and payments received were approximately \$2,982,000.

In addition, an officer of the Bank purchased participation in certain loans made by the bank that were in excess of the Bank's legal lending limit. The total related party loan participations outstanding at December 31, 2004 and 2003 were approximately \$1,052,000 and \$100,000, respectively.

During the organization period of the Bank, one of the organizers incurred costs that were reimbursed upon the receipt of the Bank charter from the Office of the Comptroller of the Currency. The total reimbursed to the organizer was approximately \$1,306,000 comprised of the following (in thousands):

	<u>Amount</u>
Land, buildings and improvements	\$ 1,002
Deposits and prepaid expenses	48
Preopening expenses and other	<u>256</u>
	<u>\$ 1,306</u>

13. Stock Warrants

At December 31, 2004 and 2003, a director and an officer had outstanding warrants to purchase up to 27,066 shares of the Bank's common stock for \$10 per share. The warrants expire May 28, 2013. The warrants were issued in conjunction with the registration statement filed by the Bank during the year ended December 31, 2003. The warrants were issued to the officer in lieu of compensation for the period prior to May 28, 2003 and to the director for providing office space, secretarial assistance, telephone, fax and other services during the development stage. The weighted average remaining contractual life of the warrants outstanding at December 31, 2004 was 8.42 years. All of the warrants outstanding were exercisable at December 31, 2004 and 2003.

The weighted-average value per share of warrants granted during the year ended December 31, 2003 was \$.76. The fair value of warrants granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: dividend yield of 0%; expected volatility of 0%; risk-free interest rate of 1.13%; and an expected life of 7 years.

14. Stock Options

The Bank has adopted the 2003 Stock Option Plan (Plan). The purpose of the plan is to encourage ownership of the Bank's common stock by key employees of the Bank and to provide increased incentive for key employees to render services and to exert maximum effort for the success of the Bank. The Plan is administered by the Board of Directors. Under the provisions of the Plan a total of 165,500 shares of common stock are available to be granted. The option price, vesting schedule and exercise period are determined for each grant by the Board of Directors. As of December 31, 2004, a total of 109,500 options were outstanding and 56,000 options were available for grant under the plan.

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A summary of option transactions and options outstanding during the years ended December 31, 2004 and 2003 is as follows:

	2004		2003	
	Number of		Number of	
	Shares Underlying <u>Options</u>	Average <u>Exercise Prices</u>	Shares Underlying <u>Options</u>	Average <u>Exercise Prices</u>
Outstanding at beginning of year	112,250	\$ 10.00	-	\$ -
Granted during the year	-	-	112,250	10.00
Expired or forfeited	(2,750)	10.00	-	-
Exercised during the year	-	-	-	-
Outstanding at the end of year	109,500	\$ 10.00	112,250	\$ 10.00
Exercisable at end of year	-		-	
Available for grant at end of year	56,000		53,250	

The weighted average remaining contractual life of the options outstanding at December 31, 2004 was 8.47 years. 95,250, 5,500 and 11,500 options were issued in May 2003, July 2003 and October 2003, respectively. In 2004, 2,750 shares were forfeited. All options carry an exercise price of \$10 with a contractual term of 10 years. None of the options are exercisable at December 2004. The options vest based on the performance of the Bank calculated by the return on equity. The number of options that will ultimately vest will depend on the Bank's performance.

The weighted-average value per share of options granted during the year ended December 31, 2003 was \$.76. The fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions; dividend yield of 0%; expected volatility of 0%; risk-free interest rate of 1.13%; and an expected life of 7 years.

15. Employee Benefit Plan

During the year ended December 31, 2003, the Bank adopted a 401(k) profit sharing plan to provide retirement benefits for employees. The plan covers all eligible employees. The Board of Directors determines the amount of discretionary contributions to the Plan and employees vest in those contributions over a six year period. There were no Bank contributions to the Plan for the years ended December 31, 2004 and 2003.

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16. Stockholders' Equity and Regulatory Matters

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval.

The Bank is subject to various regulatory capital requirements administered by 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 the Bank's assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) 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, 2004 and 2003, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2004 and 2003, the Bank's capital ratios exceeded those levels necessary to be categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum total risk based, Tier I risk based, and Tier I leverage ratios as set forth in the table. There are no conditions or events that have occurred since December 31, 2004, that management believes would change the Bank's category.

The Bank's actual capital amounts and ratios are presented in the following table as of December 31, 2004 and 2003 (in thousands):

	<u>Actual</u>		<u>To Be Adequately Capitalized Under Prompt Corrective Action Provisions</u>			<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>		
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>		<u>Amount</u>	<u>Ratio</u>	
As of December 31, 2004:								
Total capital (to risk weighted assets)	\$ 10,069	29.5%	≥ \$ 2,726	≥ 8.0%	≥	\$ 3,408	≥ 10.0%	
Tier I capital (to risk weighted assets)	\$ 9,816	28.8%	≥ \$ 1,363	≥ 4.0%	≥	\$ 2,045	≥ 6.0%	
Tier I capital (to average assets)	\$ 9,816	17.2%	≥ \$ 2,281	≥ 4.0%	≥	\$ 2,851	≥ 5.0%	
As of December 31, 2003:								
Total capital (to risk weighted assets)	\$ 10,206	61.1%	≥ \$ 1,337	≥ 8.0%	≥	\$ 1,672	≥ 10.0%	
Tier I capital (to risk weighted assets)	\$ 10,100	60.4%	≥ \$ 669	≥ 4.0%	≥	\$ 1,003	≥ 6.0%	
Tier I capital (to average assets)	\$ 10,100	26.4%	≥ \$ 1,529	≥ 4.0%	≥	\$ 1,911	≥ 5.0%	

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17. Pre-Opening Costs

As explained in Note 1, the Bank was in a pre-opening stage from August 1, 2002 to May 28, 2003 and incurred certain pre-opening costs. The pre-opening costs for 2003 consisted of the following (in thousands):

Salaries and employee benefits	\$	120
Legal and professional fees		78
Occupancy, furniture and fixtures		19
Interest		16
Licenses and permits		25
Other		<u>16</u>
	\$	<u>274</u>