

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

COMMISSION FILE NUMBER 1-5735

PROVIDENT COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its Charter)

Delaware
(State or other Jurisdiction of
Incorporation or Organization)

57-1001177
(I.R.S. Employer
Identification No.)

2700 Celanese Road, Rock Hill, South Carolina 29732
(Address of Principal Executive Offices)

(803)-325-9400
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes No

The Corporation had 1,790,599 shares, \$0.01 par value, of common stock issued and outstanding as of May 10, 2010.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

INDEX

| Part I. | <u>Financial Information</u> | <u>Page</u> |
|-----------------|--|--------------------|
| | Item 1. Financial Statements (unaudited) | |
| | Consolidated Balance Sheets as of March 31, 2010 and December 31, 2009 | 3 |
| | Consolidated Statements of Income (Loss) for the three months ended March 31, 2010 and 2009 | 4 |
| | Consolidated Statements of Cash Flows for the three months ended March 31, 2010 and 2009 | 5 |
| | Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss) for the three months ended March 31, 2010 and 2009 | 6 |
| | Notes to Consolidated Financial Statements | 7-15 |
| | Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 15-32 |
| | Item 3. Quantitative and Qualitative Disclosures about Market Risk | 32 |
| | Item 4T. Controls and Procedures | 32 |
| Part II. | <u>Other Information</u> | |
| | Item 1. Legal Proceedings | 32 |
| | Item 1A. Risk Factors | 32 |
| | Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 33 |
| | Item 3. Defaults Upon Senior Securities | 33 |
| | Item 4. Reserved | 33 |
| | Item 5. Other Information | 33 |
| | Item 6. Exhibits | 33 |
| | Signatures | 34 |

Part 1. Financial Information
PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
March 31, 2010 and December 31, 2009

| ASSETS | March 31, 2010 (Unaudited) | December 31, 2009 (Audited) |
|--|---|--|
| | (DOLLARS IN THOUSANDS) | |
| Cash and due from banks | \$ 4,427 | 5,103 |
| Interest earning balances with the Federal Reserve | 5,605 | 5,241 |
| Federal funds sold | 20,344 | 5,287 |
| Cash and cash equivalents | <u>30,376</u> | <u>15,631</u> |
| Investment and mortgage-backed securities | | |
| Held to maturity (market value of \$4,009,000 and \$3,976,000 at March 31, 2010 and December 31, 2009) | 3,934 | 3,934 |
| Available for sale | 127,143 | 147,816 |
| Total investment and mortgage-backed securities | <u>131,077</u> | <u>151,750</u> |
| Loans, net of unearned fees | 243,354 | 255,999 |
| Allowance for loan losses (ALL) | (5,433) | (5,579) |
| Loans, net of ALL | <u>237,921</u> | <u>250,420</u> |
| Real estate acquired through foreclosure | 6,441 | 5,917 |
| Office properties and equipment, net | 5,346 | 5,447 |
| Federal Home Loan Bank stock, at cost | 3,947 | 3,947 |
| Federal Reserve Bank stock, at cost | 832 | 832 |
| Accrued interest receivable | 1,863 | 2,238 |
| Cash surrender value of life insurance | 9,430 | 9,332 |
| Other assets | 11,298 | 11,489 |
| TOTAL ASSETS | \$ <u>438,531</u> | \$ <u>457,003</u> |
| LIABILITIES | | |
| Demand and savings deposits | \$ 163,557 | \$ 161,911 |
| Time deposits | 162,389 | 170,851 |
| Total deposits | <u>325,946</u> | <u>332,762</u> |
| Advances from the Federal Home Loan Bank | 59,500 | 64,500 |
| Securities sold under agreements to repurchase | 11,991 | 18,520 |
| Floating rate junior subordinated deferrable interest debentures | 12,372 | 12,372 |
| Accrued interest payable | 539 | 581 |
| Other liabilities | 2,323 | 2,147 |
| TOTAL LIABILITIES | <u>412,671</u> | <u>430,882</u> |
| Commitments and contingencies-Note 5 | | |
| SHAREHOLDERS' EQUITY | | |
| Serial preferred stock - \$0.01 par value | | |
| authorized - 500,000 shares | | |
| issued and outstanding - 9,266 | 9,246 | 9,245 |
| at March 31, 2010 and December 31, 2009, respectively | | |
| Common stock - \$0.01 par value, | | |
| authorized - 5,000,000 shares, | | |
| issued and outstanding - 1,790,599 shares at March 31, 2010 | 20 | 20 |
| and 1,790,599 at December 31, 2009 | | |
| Common stock warrants | 25 | 25 |
| Additional paid-in capital | 12,919 | 12,919 |
| Accumulated other comprehensive income (loss) | (1,135) | (972) |
| Retained earnings, substantially restricted | 11,085 | 11,184 |
| Treasury stock, at cost | (6,300) | (6,300) |
| TOTAL SHAREHOLDERS' EQUITY | <u>25,860</u> | <u>26,121</u> |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ <u>438,531</u> | \$ <u>457,003</u> |

See notes to consolidated financial statements.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
Three Months Ended March 31, 2010 and 2009 (unaudited)

| | Three Months Ended | |
|--|--|-------------------|
| | March 31, | March 31, |
| | 2010 | 2009 |
| | <small>(DOLLARS IN THOUSANDS EXCEPT PER SHARE)</small> | |
| Interest Income: | | |
| Loans | \$ 3,120 | \$ 3,596 |
| Deposits and federal funds sold | 6 | 8 |
| Interest and dividends on mortgage-backed securities | 429 | 895 |
| Interest and dividends on investment securities | 975 | 639 |
| Total interest income | 4,530 | 5,138 |
| Interest Expense: | | |
| Deposit accounts | 1,547 | 2,092 |
| Floating rate junior subordinated deferrable interest debentures | 118 | 151 |
| Advances from the FHLB and other borrowings | 744 | 784 |
| Total interest expense | 2,409 | 3,027 |
| Net Interest Income | 2,121 | 2,111 |
| Provision for loan losses | 896 | 2,700 |
| Net interest income (loss) after provision for loan losses | 1,225 | (589) |
| Non-Interest Income: | | |
| Fees for financial services | 662 | 673 |
| Other fees, net | 23 | 22 |
| Other-than-temporary-impairment write-down on securities | (303) | (309) |
| Net gain on sale of investments | 677 | 95 |
| Total non-interest income | 1,059 | 481 |
| Non-Interest Expense: | | |
| Compensation and employee benefits | 1,122 | 1,192 |
| Occupancy and equipment | 599 | 611 |
| Deposit insurance premiums | 144 | 56 |
| Professional services | 100 | 93 |
| Advertising and public relations | 13 | 30 |
| Loan operations | 93 | 110 |
| Intangible amortization | -- | 95 |
| Items processing | 77 | 89 |
| Telephone | 37 | 52 |
| Other | 154 | 188 |
| Total non-interest expense | 2,339 | 2,516 |
| Net loss before income taxes | (55) | (2,624) |
| Benefit for income taxes | (73) | (929) |
| Net income (loss) | \$ 18 | (1,695) |
| Accretion of preferred stock to redemption value and preferred dividends accrued | 119 | 25 |
| Net loss to common shareholders | (101) | \$ (1,720) |
| Net loss per common share (basic) | \$ (0.06) | \$ (0.96) |
| Net loss per common share (diluted) | \$ (0.06) | \$ (0.96) |
| Cash dividend per common share | \$ -- | \$ 0.03 |
| Weighted average number of common shares outstanding | | |
| Basic | 1,790,599 | 1,787,890 |
| Diluted | 1,790,599 | 1,787,890 |

See notes to consolidated financial statements.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Three Months Ended March 31, 2010 and 2009 (unaudited)

| | Three Months Ended | |
|---|---------------------------|------------------------|
| | March 31, | March 31, |
| | 2010 | 2009 |
| | (IN THOUSANDS) | |
| OPERATING ACTIVITIES: | | |
| Net income (loss) | \$18 | (\$1,695) |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | |
| Provision for loan losses | 896 | 2,700 |
| Amortization of intangibles | -- | 95 |
| Depreciation expense | 118 | 131 |
| Recognition of deferred income, net of costs | (65) | (108) |
| Deferral of fee income, net of costs | 56 | 73 |
| Other than temporary impairment charge on AFS securities | 303 | 309 |
| Gain on investment transactions | (677) | (95) |
| Gain on sale of assets acquired from foreclosed loans | -- | (2) |
| Changes in operating assets and liabilities: | | |
| Decrease in accrued interest receivable | 375 | 122 |
| Increase in cash surrender value of life insurance | (98) | (100) |
| Increase in other assets | (333) | (1,647) |
| Increase in other liabilities | 176 | 33 |
| Increase (decrease) in accrued interest payable | (42) | 44 |
| | <u>727</u> | <u>(140)</u> |
| Net cash (used) provided by operating activities | | |
| INVESTING ACTIVITIES: | | |
| Purchase of investment and mortgage-backed securities: | | |
| Available for sale | (40,598) | (54,278) |
| Held to maturity | -- | (504) |
| Proceeds from sale of investment and mortgage-backed securities available for sale | 26,495 | 5,123 |
| Proceeds from maturity of investment and mortgage-backed securities: | | |
| Available for sale | 27,848 | 18,251 |
| Held to maturity | -- | -- |
| Principal repayments on mortgage-backed securities: | | |
| Available for sale | 7,139 | 3,547 |
| Net decrease (increase) in loans | 11,582 | (2,716) |
| Purchase of FHLB/FRB stock | -- | (52) |
| Proceeds from sales of foreclosed assets, net of costs and improvements | 30 | 69 |
| Purchase of office properties and equipment | (17) | (62) |
| | <u>32,479</u> | <u>(30,622)</u> |
| Net cash (used) provided by investing activities | | |
| FINANCING ACTIVITIES: | | |
| Proceeds from the dividend reinvestment plan | -- | 8 |
| Proceeds from issuance of preferred stock | -- | 9,241 |
| Proceeds from issuance of warrants | -- | 25 |
| Dividends paid in cash | -- | (53) |
| Dividends paid on preferred stock | (116) | -- |
| Decrease in other borrowings | (11,529) | 26 |
| Increase (decrease) in deposit accounts | (6,816) | 24,775 |
| | <u>(18,461)</u> | <u>34,022</u> |
| Net cash (used) provided by financing activities | | |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 14,745 | 3,260 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 15,631 | 21,370 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | <u>\$30,376</u> | <u>\$24,630</u> |
| SUPPLEMENTAL DISCLOSURES: | | |
| Cash paid for: | | |
| Income taxes | \$18 | \$510 |
| Interest | 2,451 | 2,983 |
| Non-cash transactions: | | |
| Loans foreclosed | \$559 | \$499 |
| Unrealized gain (loss) on securities available for sale, net of income tax | (395) | 489 |
| See notes to consolidated financial statements. | | |

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
 Three Months Ended March 31, 2010 and 2009 (unaudited)

| | Preferred Stock | | Common Stock | | Warrants | Additional Paid-in Capital | Retained | Accumulated | Treasury Stock at Cost | Total Shareholders' Equity |
|--|-----------------|----------------|------------------|-------------|-------------|----------------------------------|--|---|---------------------------|----------------------------------|
| | Shares | Amount | Shares | Amount | | | Earnings, Substantially Restricted | Other Comprehensive Income (loss) | | |
| <i>(Dollars in Thousands, Except Share Data)</i> | | | | | | | | | | |
| BALANCE AT DECEMBER 31, 2008 | | | 1,787,092 | \$20 | | \$12,903 | \$18,997 | (\$1,696) | (\$6,300) | \$23,924 |
| Net income (loss) | | | | | | | (1,695) | | | (1,695) |
| Other comprehensive loss, net of tax on unrealized holding losses on securities available for sale arising during period | | | | | | | | 489 | | 489 |
| Less reclassification adjustment for gains and other than temporary investment charge in net loss | | | | | | | | (138) | | (138) |
| Comprehensive loss | | | | | | | | | | (1,344) |
| Dividend reinvestment plan contributions | | | 1,218 | | | 8 | | | | 8 |
| Issuance of preferred stock | 9,266 | 9,240 | | | | | | | | 9,240 |
| Issuance of common stock warrants | | | | | 25 | | | | | 25 |
| Accretion of Preferred Stock to redemption value | | 1 | | | | | (1) | | | -- |
| Cash dividend (\$.03 per share) | | | | | | | (52) | | | (52) |
| BALANCE AT MARCH 31, 2009 | 9,266 | \$9,241 | 1,788,310 | \$20 | \$25 | \$12,911 | \$17,249 | (\$1,345) | (\$6,300) | \$31,801 |
| BALANCE AT DECEMBER 31, 2009 | 9,266 | \$9,245 | 1,790,599 | \$20 | \$25 | \$12,919 | \$11,184 | (\$972) | (\$6,300) | \$26,121 |
| Net income (loss) | | | | | | | 18 | | | 18 |
| Other comprehensive loss, net of tax on unrealized holding losses on securities available for sale arising during period | | | | | | | | (395) | | (395) |
| Less reclassification adjustment for gains and other than temporary investment charge in net income | | | | | | | | 232 | | 232 |
| Comprehensive loss | | | | | | | | | | (145) |
| Accretion of Preferred Stock to redemption value | | 1 | | | | | (1) | | | -- |
| Preferred stock dividend | | | | | | | (116) | | | (116) |
| BALANCE AT MARCH 31, 2010 | 9,266 | \$9,246 | 1,790,599 | \$20 | \$25 | \$12,919 | \$11,085 | (\$1,135) | (\$6,300) | \$25,860 |

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Presentation of Consolidated Financial Statements

The accompanying unaudited consolidated financial statements of Provident Community Bancshares, Inc. (the "Corporation") were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of consolidated financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments which are, in the opinion of management, necessary for the fair presentation of the interim consolidated financial statements have been included. All such adjustments are of a normal and recurring nature. The results of operations for the three months ended March 31, 2010 are not necessarily indicative of the results which may be expected for the entire calendar year or for any other period. Certain amounts in the prior year's financial statements have been reclassified to conform to current year classifications. Subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet should be recognized at the balance sheet date. Subsequent events that provide evidence about conditions that arose after the balance sheet date but before financial statements are issued, or are available to be issued, are not required to be recognized.

Recently Issued Accounting Standards

The following is a summary of recent authoritative pronouncements that may affect accounting, reporting, and disclosure of financial information by the Corporation.

In January, 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in substance real estate or conveyances of oil and gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Corporation's financial statements.

In January 2010, fair value guidance was amended to require disclosures for significant amounts transferred in and out of Levels 1 and 2 and the reasons for such transfers and to require that gross amounts of purchases, sales, issuances and settlements be provided in the Level 3 reconciliation. The new disclosures are effective for the Corporation for the current quarter and have been reflected in the Fair Value footnote.

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 Corporation's financial position, results of operations or cash flows.

2. Income (Loss) Per Share

Basic income (loss) per common share amounts for the three months ended March 31, 2010 and 2009 were computed based on the weighted average number of common shares outstanding during the period. Diluted income (loss) per share adjusts for the dilutive effect of outstanding common stock options during the periods utilizing the treasury stock method. There were no common stock equivalents included in the diluted earnings (loss) per share calculation for the three months ended March 31, 2010 and 2009. Anti-dilutive common stock

equivalents that were excluded in the diluted earnings per share calculation for the three months ended March 31, 2010 and 2009 were 90,863 and 94,113, respectively.

3. Assets Pledged

Approximately \$76,547,000 and \$94,598,000 of debt securities at March 31, 2010 and December 31, 2009, respectively, were pledged by Provident Community Bank, N.A. (the "Bank") as collateral to secure deposits of the State of South Carolina, and Union, Laurens and York counties along with additional borrowings and repurchase agreements. The Bank pledges as collateral for Federal Home Loan Bank advances commercial and residential real estate mortgage loans under a collateral agreement with the Federal Home Loan Bank whereby the Bank maintains, free of other encumbrances, qualifying mortgages (as defined) with unpaid principal balances equal to, when discounted at 75% of the unpaid principal balances, 100% of total advances. As part of the total assets pledged, the Bank will also pledge securities to cover additional advances from the Federal Home Loan Bank that exceed the qualifying mortgages balance along with security repurchase lines with various brokerage houses.

4. Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures

On July 18, 2006, Provident Community Bancshares Capital Trust I ("Capital Trust I") was formed. The Corporation is the owner of all of the common securities of Capital Trust I. On July 21, 2006, Capital Trust I issued \$4,000,000 in the form of fixed/floating rate capital securities through a pooled trust preferred securities offering. The proceeds from this issuance, along with the Corporation's \$124,000 capital contribution for Capital Trust I's common securities, were used to acquire \$4,124,000 aggregate principal amount of the Corporation's floating rate junior subordinated deferrable interest debentures due October 1, 2036, which constitute the sole asset of Capital Trust I. The interest rate on the debentures and the capital securities is equal to 7.393% for the first five years. Thereafter, the interest rate is variable and adjustable quarterly at 1.74% over the three-month LIBOR. The debentures are subject to redemption at par at the option of the Corporation, subject to prior regulatory approval, in whole or in part on any interest payment date after October 1, 2011. The debentures are also subject to redemption prior to October 1, 2011 at up to 103.7% of par after the occurrence of certain events.

On November 28, 2006, Provident Community Bancshares Capital Trust ("Capital Trust II") was established. The Corporation is the owner of all of the common securities of the Trust. On December 15, 2006, the Trust issued \$8,000,000 in the form of floating rate capital securities through a pooled trust preferred securities offering. The proceeds of Capital Trust II were utilized for the redemption of Union Financial Bancshares Statutory Trust issued on December 18, 2001. The proceeds from this issuance, along with the Corporation's \$248,000 capital contribution for the Trust's common securities, were used to acquire \$8,247,000 aggregate principal amount of the Corporation's floating rate junior subordinated deferrable interest debentures due March 1, 2037, which constitute the sole asset of the Capital Trust II. The interest rate on the debentures and the capital securities is variable and adjustable quarterly at 1.74% over the three-month LIBOR. The debentures are subject to redemption at par at the option of the Corporation, subject to prior regulatory approval, in whole or in part on any interest payment date after March 1, 2012. The debentures are also subject to redemption prior to March 1, 2012 at 103.5% of par after the occurrence of certain events.

A summary of the Subordinated Deferrable Interest Debentures issued and outstanding follows:

| <u>Name</u> | <u>Amount Outstanding at March 31,</u> | | <u>Rate</u> | <u>Prepayment Option Date</u> | <u>Maturity</u> | <u>Distribution Payment Frequency</u> |
|--|--|---------------------|-------------|-----------------------------------|-----------------|---|
| | <u>2010</u> | <u>2009</u> | | | | |
| Provident Community Bancshares Capital Trust I | 4,000,000 | 4,000,000 | 7.39% | October 1, 2011 | October 1, 2036 | Quarterly |
| Provident Community Bancshares Capital Trust II | <u>8,000,000</u> | <u>8,000,000</u> | 1.99% | March 1, 2012 | March 1, 2037 | Quarterly |
| Total | <u>\$12,000,000</u> | <u>\$12,000,000</u> | | | | |

5. Contingencies and loan commitments

In the ordinary course of business, the Bank enters into financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These instruments expose the Bank to credit risk in excess of the amount recognized on 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 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. Total credit exposure at March 31, 2010 related to these items is summarized below:

| <u>Loan Commitments:</u> | <u>Contract Amount</u> |
|---|------------------------|
| Approved loan commitments | \$ 700,000 |
| Commitments to fund commercial and construction loans | 379,000 |
| Unused portions of loans and credit lines | <u>32,650,000</u> |
| Total loan commitments | <u>\$ 33,729,000</u> |

Loan 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. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counter party. Collateral held is primarily residential and commercial property. Commitments outstanding at March 31, 2010 consisted of fixed and adjustable rate loans at rates ranging from 5.5% to 7.5%. Commitments to originate loans generally expire within 30 to 60 days.

Commitments to fund loans, including credit lines (principally variable rate, consumer lines secured by real estate and overdraft protection) totaled approximately \$33,729,000 at March 31, 2010. Of these lines, the outstanding loan balances totaled approximately \$54,718,000.

6. Fair Value of Financial Instruments

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Effective January 1, 2008, the Corporation adopted FASB ASC 825-10-50 ("FASB Topic 820") Fair Value Measurements which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC 825-10-50 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent

to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair Value Hierarchy

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Valuation is based upon quoted prices in active markets for identical assets or liabilities.

Level 2 Valuation is based upon quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is based upon quoted prices for similar assets or liabilities; quoted prices in markets that are not active; and model-based techniques whose value is determined using pricing models, discounted cash flow methodologies and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available-for-Sale

Available-for-sale investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 may include asset-backed securities in less liquid markets.

Loans

The Corporation is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and the related impairment is charged against the allowance or a specific allowance is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Loans which are deemed to be impaired are primarily valued at the fair values of the underlying real estate collateral. Such fair values are obtained using collateral net liquidation value, market value of similar debt, enterprise value, and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of the expected repayment or collateral meet or exceed the recorded investment in such loans. The Corporation considers all non-accrual loans and troubled debt restructurings to be impaired. Therefore, at March 31, 2010, loans classified as impaired totaled \$26.1 million. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as

as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loans as nonrecurring Level 3.

Real Estate Acquired Through Foreclosure

Other real estate owned (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the OREO as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The following tables present the balances of assets measured at fair value on a recurring basis by level within the hierarchy as of March 31, 2010 and December 31, 2009 (In thousands).

| | March 31, <u>2010</u> | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|--------------------------|---|--|--|
| Investment securities: | | | | |
| U.S. Agency obligations | \$ 3 | 3 | | |
| Government Sponsored Enterprises | 82,188 | 82,188 | | |
| Municipal securities | 5,299 | | 5,299 | |
| Trust Preferred securities | <u>5,423</u> | | <u>2,536</u> | <u>2,887</u> |
| Total investment securities | <u>92,913</u> | <u>82,191</u> | <u>7,835</u> | <u>2,887</u> |
| Mortgage-backed and related securities..... | <u>34,230</u> | | <u>34,230</u> | |
| Total | <u>\$127,143</u> | <u>82,191</u> | <u>42,065</u> | <u>2,887</u> |

| | December 31, <u>2009</u> | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|-----------------------------|---|--|--|
| Investment securities: | | | | |
| U.S. Agency obligations | \$ 4 | 4 | | |
| Government Sponsored Enterprises | 78,471 | 78,471 | | |
| Municipal securities | 6,042 | | 6,042 | |
| Trust Preferred securities | <u>5,912</u> | | <u>2,802</u> | <u>3,110</u> |
| Total investment securities | <u>90,429</u> | <u>78,475</u> | <u>8,844</u> | <u>3,110</u> |
| Mortgage-backed and related securities..... | <u>57,387</u> | | <u>57,387</u> | |
| Total | <u>\$147,816</u> | <u>78,475</u> | <u>66,231</u> | <u>3,110</u> |

The following is a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended March 31, 2010.

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |
|--|--|
| | <u>Investment Securities Available-for-Sale</u> |
| Beginning balance at December 31, 2009 | \$3,110,000 |
| Transfers into Level 3 | -- |
| Gain/(Loss) for the year | (223,000) |
| Purchases, sales, issuances and settlements, net | <u>--</u> |
| Ending balance at March 31, 2010 | <u>\$2,887,000</u> |

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Corporation may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period and assumes all impaired loans have specific reserves or have been written down to fair value.

Assets measured at fair value on a nonrecurring basis at March 31, 2010 are as follows:

| | <u>Total</u> | <u>(Level 1)</u> | <u>(Level 2)</u> | <u>(Level 3)</u> |
|----------------------------|---------------------|------------------|---------------------|------------------|
| Impaired loans | \$21,875,000 | \$-- | \$21,875,000 | \$-- |
| Other real estate owned | <u>6,441,000</u> | -- | <u>6,441,000</u> | -- |
| Total assets at fair value | <u>\$28,316,000</u> | <u>\$--</u> | <u>\$28,316,000</u> | <u>\$--</u> |

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2009 are as follows:

| | <u>Total</u> | <u>(Level 1)</u> | <u>(Level 2)</u> | <u>(Level 3)</u> |
|----------------------------|---------------------|------------------|---------------------|------------------|
| Impaired loans | \$20,869,000 | \$-- | \$20,869,000 | \$-- |
| Other real estate owned | <u>5,917,000</u> | -- | <u>5,917,000</u> | -- |
| Total assets at fair value | <u>\$26,786,000</u> | <u>\$--</u> | <u>\$26,786,000</u> | <u>\$--</u> |

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

Cash and cash equivalents - The carrying amounts of cash and due from banks approximate their fair value.

Available for sale and held to maturity securities - Fair values for securities are based on quoted market prices. The carrying values of restricted equity securities approximate fair values. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Loans - The Corporation is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. The Corporation does not record loans at fair value on a recurring basis.

However, from time to time, a loan is considered impaired and the related impairment is charged against the allowance or a specific allowance is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Loans which are deemed to be impaired are primarily valued at the fair values of the underlying real estate collateral. Such fair values are obtained using collateral net liquidation value, market value of similar debt, enterprise value, and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of the expected repayment or collateral meet or exceed the recorded investment in such loans. The Corporation considers all non-accrual loans and troubled debt restructurings to be impaired.

Cash surrender value of life insurance - The carrying amounts of cash surrender values of life insurance approximate their fair value.

Deposit liabilities - 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 (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs 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.

Advances from the FHLB and other borrowings - The fair values of the Corporation's borrowings are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Securities sold under agreements to repurchase - The fair values of the Corporation's repurchase agreements are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest - The carrying amounts of accrued interest approximate their fair values.

Floating rate junior subordinated deferrable interest debentures - The fair values of the Corporation's floating rate debentures are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

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.

The estimated fair values of the Corporation's financial instruments were as follows at March 31, 2010 (in thousands):

| | March 31, 2010 | |
|---|----------------------------|-----------------------|
| | Carrying Amount | Fair Value |
| <u>Financial assets</u> | | |
| Cash and due from banks | \$30,376 | \$30,376 |
| Securities available for sale | 127,143 | 127,143 |
| Securities held to maturity | 3,934 | 4,009 |
| Federal Home Loan Bank stock, at cost | 3,947 | 3,947 |
| Federal Reserve Bank stock, at cost | 832 | 832 |
| Loans, net | 237,921 | 237,869 |
| Accrued interest receivable | 1,863 | 1,863 |
| Cash surrender value of life insurance | 9,430 | 9,430 |
| <u>Financial liabilities</u> | | |
| Deposits | \$325,946 | \$317,109 |
| Advances from FHLB and other borrowings | 59,500 | 62,145 |
| Securities sold under agreement to repurchase | 11,991 | 11,305 |
| Floating rate junior subordinated deferrable interest debentures .. | 12,372 | 11,231 |
| Accrued interest payable | 539 | 539 |
| <u>Off-balance-sheet assets (liabilities)</u> | | |
| Commitments to extend credit | (\$33,729) | (\$0) |

The estimated fair values of the Corporation's financial instruments were as follows at December 31, 2009 (in thousands):

| | December 31, 2009 | |
|---|----------------------------|-----------------------|
| | Carrying Amount | Fair Value |
| <u>Financial assets</u> | | |
| Cash and due from banks | \$15,631 | \$15,631 |
| Securities available for sale | 147,816 | 147,816 |
| Securities held to maturity | 3,934 | 3,976 |
| Federal Home Loan Bank stock, at cost | 3,947 | 3,947 |
| Federal Reserve Bank stock, at cost | 832 | 832 |
| Loans, net | 250,420 | 250,455 |
| Accrued interest receivable | 2,238 | 2,238 |
| Cash surrender value of life insurance | 9,332 | 9,332 |
| <u>Financial liabilities</u> | | |
| Deposits | \$332,762 | \$323,113 |
| Advances from FHLB and other borrowings | 64,500 | 67,457 |
| Securities sold under agreement to repurchase | 18,520 | 18,544 |
| Floating rate junior subordinated deferrable interest debentures .. | 12,372 | 10,758 |
| Accrued interest payable | 581 | 581 |
| <u>Off-balance-sheet assets (liabilities)</u> | | |
| Commitments to extend credit | (\$40,131) | (\$0) |

7. Preferred Stock

On March 13, 2009, as part of the United States Department of the Treasury's Capital Purchase Program, the Corporation issued 9,266 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, \$1,000 per share liquidation preference, and a warrant to purchase up to 178,880 shares of the Corporation's common stock for a period of ten years at an exercise price of \$7.77 per share, in exchange for \$9,266,000 in cash from

the United States Department of the Treasury. The proceeds, net of issuance costs consisting primarily of legal fees, were allocated between the preferred stock and the warrant on a pro rata basis, based upon the estimated market values of the preferred stock and the warrant. As a result, \$25,000 of the proceeds were allocated to the warrant, which increased additional paid-in-capital from common stock. The amount allocated to the warrant is considered a discount on the preferred stock and will be amortized using the level yield method over a five-year period through a charge to retained earnings. Such amortization will not reduce net income, but will reduce income available for common shares.

The preferred stock pays cumulative dividends of 5% per year for the first five years and 9% per year thereafter. The Corporation may redeem the preferred stock at its liquidation preference plus accrued and unpaid dividends at any time with the prior regulatory approval. The securities purchase agreement between the Corporation and the United States Department of the Treasury limits, for three years, the rate of dividend payments on the Corporation's common stock to the amount of its last quarterly cash dividend before participation in the program of \$0.03 per share unless an increase is approved by the Department of the Treasury, limits the Corporation's ability to repurchase its common stock for three years and subjects the Corporation to certain executive compensation limitations included in the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009.

7. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and no subsequent events have occurred requiring accrual or disclosure.

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

Critical Accounting Policies

The Corporation has adopted various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation of financial statements.

Certain accounting policies involve significant judgments and assumptions by management. Management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Corporation.

The Corporation believes the allowance for loan losses is a critical accounting policy that requires significant judgments and estimates used in the preparation of consolidated financial statements. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on the composition and size of the loan portfolio, overall portfolio quality, delinquency and charge-off levels, a review of specific problem loans, loss experience, economic conditions, and other factors related to the collectibility of the loan portfolio. A portion of the allowance is established by segregating the loans by residential mortgage, commercial and consumer and assigning allocation percentages based on historical loss

experience and delinquency trends. The applied allocation percentages are reevaluated at least annually to ensure their relevance in the current economic environment. Accordingly, increases in the size of the loan portfolio and the increased emphasis on commercial real estate and commercial business loans, which carry a higher degree of risk of default and, thus, a higher allocation percentage, increases the allowance. Additionally, a portion of the allowance is established based on the level of classified assets.

Although the Corporation believes that it uses the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, the Office of the Comptroller of the Currency, as an integral part of its examination process, will periodically review the Corporation's allowance for loan losses. Such agency may require the Corporation to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination.

Forward Looking Statements

Management's discussion and analysis of financial condition and results of operations and other portions of this Form 10-Q may contain certain "forward-looking statements" concerning the future operations, plans or strategies of the Corporation and the Bank. These forward-looking statements are generally identified by the use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. Management intends to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement for the express purpose of availing the Corporation of the protections of such safe harbor with respect to all forward-looking statements contained in this report. Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors which could effect actual results include interest rate trends, the general economic climate in the Corporation's and the Bank's market area and the country as a whole, the ability of the Corporation and the Bank to control costs and expenses, competitive products and pricing and the demand for such products, loan delinquency rates, the quality and composition of the loan and investment portfolios, changes in accounting principles and guidelines and changes in federal and state laws and regulations. The Corporation provides greater detail regarding some of these factors in its Form 10-K for the year ended December 31, 2009, including in the Risk Factors section of that report, and in its other SEC reports. These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements.

Except as required by applicable law or regulation, the Corporation does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward looking statements to reflect events or circumstances after the date of these statements or to reflect the occurrence of anticipated or unanticipated events.

Financial Condition

Assets

Total assets of the Corporation decreased \$18.5 million, or 4.0%, to \$438.5 million at March 31, 2010 from \$457.0 million at December 31, 2009. Investment securities at March 31, 2010 decreased 13.6% to \$131.1 million from \$151.8 million at December 31, 2009. Fed funds sold at March 31, 2010 increased \$15.1 million to \$20.3 million from \$5.3 million at December 31, 2009 as a result of sales and maturities of securities. Net

loans decreased \$12.5 million from December 31, 2009 to March 31, 2010, due primarily to a significant reduction in loan demand as a result of economic conditions currently present in South Carolina.

Investment and Mortgage-backed Securities

Included in our investment securities are 7 pooled trust preferred securities with an amortized cost of \$4.3 million and a fair value of \$2.9 million. An other than temporary investment charge of \$303,000 was recorded for the three-month period ended March 31, 2010 related to these trust preferred securities as a result of projected shortfalls of interest and principal payments in the cash flow analysis of the securities.

Held to Maturity-Securities classified as held to maturity consisted of the following (in thousands):

| | <u>March 31, 2010</u> | | <u>December 31, 2009</u> | |
|----------------------|-----------------------|-------------------|--------------------------|-------------------|
| | <u>Amortized Cost</u> | <u>Fair Value</u> | <u>Amortized Cost</u> | <u>Fair Value</u> |
| Municipal Securities | <u>\$3,934</u> | <u>\$4,009</u> | <u>\$3,934</u> | <u>\$3,976</u> |

Available for Sale-Securities classified as available for sale consisted of the following (in thousands):

| | <u>March 31, 2010</u> | | <u>December 31, 2009</u> | |
|-------------------------------------|-----------------------|-------------------|--------------------------|-------------------|
| | <u>Amortized Cost</u> | <u>Fair Value</u> | <u>Amortized Cost</u> | <u>Fair Value</u> |
| Investment Securities: | | | | |
| U.S. Agency Obligations | \$ 3 | \$ 3 | \$ 4 | \$ 4 |
| Government Sponsored Enterprises | 82,477 | 82,188 | 79,162 | 78,471 |
| Municipal Securities | 5,054 | 5,299 | 5,781 | 6,042 |
| Trust Preferred Securities | <u>8,285</u> | <u>5,423</u> | <u>8,570</u> | <u>5,912</u> |
| Total Investment Securities | <u>95,816</u> | <u>92,913</u> | <u>93,517</u> | <u>90,429</u> |
| Mortgage-backed Securities: | | | | |
| Fannie Mae | 18,367 | 19,052 | 35,561 | 36,723 |
| Ginnie Mae | 13,674 | 14,201 | 16,569 | 17,030 |
| Freddie Mac | 456 | 468 | 3,068 | 3,154 |
| Collateralized Mortgage Obligations | <u>572</u> | <u>509</u> | <u>597</u> | <u>480</u> |
| Total Mortgage-backed Securities | <u>33,067</u> | <u>34,230</u> | <u>55,795</u> | <u>57,387</u> |
| Total Available for Sale | <u>\$128,883</u> | <u>\$127,143</u> | <u>\$149,312</u> | <u>\$147,816</u> |

The Corporation 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 and FHLB borrowings. The average yield on investments at March 31, 2010 was 3.39% compared to 4.04% at December 31, 2009. The carrying values of the investment securities at March 31, 2010 and December 31, 2009 and percentage of each category to total investments are as follows:

| | As of March 31, 2010 | | | Fair Value |
|---|----------------------|----------------|-------------------|------------------|
| | Amortized Cost | Gross Gains | Unrealized Losses | |
| Investment Securities: | | | | |
| U.S. Agency Obligations | \$ 3 | \$ - | \$ -- | \$ 3 |
| Government Sponsored Enterprises | 82,477 | 166 | (455) | 82,188 |
| Municipal Securities | 5,054 | 245 | - | 5,299 |
| Trust Preferred Securities..... | 8,285 | - | (2,862) | 5,423 |
| Total Investment Securities..... | <u>95,819</u> | <u>411</u> | <u>(3,317)</u> | <u>92,913</u> |
| Mortgage-backed Securities: | | | | |
| Fannie Mae..... | 18,367 | 685 | - | 19,052 |
| Ginnie Mae..... | 13,674 | 527 | - | 14,201 |
| Freddie Mac | 456 | 12 | - | 468 |
| Collateralized Mortgage Obligations | <u>572</u> | <u>-</u> | <u>(63)</u> | <u>509</u> |
| Total Mortgage-backed Securities ... | <u>33,069</u> | <u>1,224</u> | <u>(63)</u> | <u>34,230</u> |
| Total available for sale..... | <u>\$128,888</u> | <u>\$1,635</u> | <u>(\$3,380)</u> | <u>\$127,143</u> |

Held to Maturity - Securities classified as held to maturity consisted of the following (in thousands):

| | As of December 31, 2009 | | | Fair Value |
|----------------------------|-------------------------|-------------|-------------------|----------------|
| | Amortized Cost | Gross Gains | Unrealized Losses | |
| Municipal Securities | <u>\$3,934</u> | <u>\$52</u> | <u>(\$10)</u> | <u>\$3,976</u> |

Available for Sale - Securities classified as available for sale consisted of the following (in thousands):

| | As of December 31, 2009 | | | Fair Value |
|---|-------------------------|-----------------|-------------------|------------------|
| | Amortized Cost | Gross Gains | Unrealized Losses | |
| Investment Securities: | | | | |
| U.S. Agency Obligations | \$ 4 | \$ -- | \$ -- | \$ 4 |
| Government Sponsored Enterprises | 79,162 | 217 | (908) | 78,471 |
| Municipal Securities | 5,781 | 261 | -- | 6,042 |
| Trust Preferred Securities..... | 8,570 | -- | (2,658) | 5,912 |
| Total Investment Securities..... | <u>93,517</u> | <u>478</u> | <u>(3,566)</u> | <u>90,429</u> |
| Mortgage-backed Securities: | | | | |
| Fannie Mae..... | 35,561 | 1,162 | -- | 36,723 |
| Ginnie Mae..... | 16,569 | 461 | -- | 17,030 |
| Freddie Mac | 3,068 | 86 | -- | 3,154 |
| Collateralized Mortgage Obligations | <u>597</u> | <u>--</u> | <u>(117)</u> | <u>480</u> |
| Total Mortgage-backed Securities ... | <u>55,795</u> | <u>1,709</u> | <u>(117)</u> | <u>57,387</u> |
| Total available for sale..... | <u>\$149,312</u> | <u>\$ 2,187</u> | <u>(\$3,683)</u> | <u>\$147,816</u> |

The maturities of securities at March 31, 2010 are as follows (in thousands):

| | Held to Maturity | | Available for Sale | |
|---|------------------|----------------|--------------------|------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less..... | \$ -- | \$ -- | \$ 11 | \$ 11 |
| Due after one year through five years... | -- | -- | 416 | 423 |
| Due after five years through ten years .. | -- | -- | 37,606 | 37,637 |
| Due after ten years | <u>3,934</u> | <u>4,009</u> | <u>90,855</u> | <u>89,072</u> |
| Total investment and mortgage-backed securities | <u>\$3,934</u> | <u>\$4,009</u> | <u>\$128,888</u> | <u>\$127,143</u> |

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2010 (in thousands).

| | Less than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|-------------------|-------------------|-------------------|-----------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| <u>Held to Maturity</u> | | | | | | |
| Municipal Securities | <u>\$ --</u> | <u>\$ --</u> | <u>\$497</u> | <u>\$6</u> | <u>\$497</u> | <u>\$6</u> |
| <u>Securities Available for Sale</u> | | | | | | |
| U.S. Agency Obligations..... | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Government Sponsored Enterprises | 47,481 | 455 | -- | -- | 47,481 | 455 |
| Municipal Securities | -- | -- | -- | -- | -- | -- |
| Trust Preferred Securities | -- | -- | 5,423 | 2,862 | 5,423 | 2,862 |
| Mortgage-backed Securities | -- | -- | 554 | 63 | 554 | 63 |
| Total | <u>\$47,481</u> | <u>\$455</u> | <u>\$5,977</u> | <u>\$2,925</u> | <u>\$53,458</u> | <u>\$3,380</u> |

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009 (in thousands).

| | Less than 12 Months | | 12 Months or More | | Total | |
|-------------------------|---------------------|-------------------|-------------------|-------------------|----------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| <u>Held to Maturity</u> | | | | | | |
| Municipal Securities | \$494 | \$9 | \$833 | \$1 | \$1,326 | \$10 |
| Total | <u>\$494</u> | <u>\$9</u> | <u>\$833</u> | <u>\$1</u> | <u>\$1,326</u> | <u>\$10</u> |

| | <u>Less than 12 Months</u> | | <u>12 Months or More</u> | | <u>Total</u> | |
|--|----------------------------|--------------------------|--------------------------|--------------------------|-------------------|--------------------------|
| | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| <u>Securities Available for Sale</u> | | | | | | |
| U.S. Agency Obligations..... | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Government Sponsored Enterprises | 41,040 | 908 | - | - | 41,040 | 908 |
| Municipal Securities | - | - | - | - | - | - |
| Trust Preferred Securities | - | - | 5,912 | 2,658 | 5,912 | 2,658 |
| Mortgage-backed Securities | -- | -- | 532 | 117 | 532 | 117 |
| Total | <u>\$41,040</u> | <u>\$908</u> | <u>\$6,444</u> | <u>\$2,775</u> | <u>\$47,484</u> | <u>\$3,683</u> |

Loans

Net loans decreased to \$237.9 million at March 31, 2010 compared to \$250.4 million at December 31, 2009. The decrease was due to a significant reduction in loan demand as a result of economic conditions currently present in South Carolina and more conservative underwriting standards. Consumer loans decreased \$2.4 million, or 4.5%, commercial loans decreased \$8.6 million, or 4.7%, and residential mortgage loans decreased \$1.7 million, or 8.6%, for the period ended March 31, 2010.

Loans receivable consisted of the following (in thousands):

| | <u>March 31,</u> <u>2010</u> | <u>December 31,</u> <u>2009</u> |
|--|---------------------------------|------------------------------------|
| Mortgage loans: | | |
| Fixed-rate residential | \$10,395 | \$10,675 |
| Adjustable-rate residential | 5,952 | 6,202 |
| Commercial real estate | 109,672 | 110,901 |
| Construction | <u>1,811</u> | <u>2,923</u> |
| Total mortgage loans | <u>127,830</u> | <u>130,701</u> |
| Commercial loans: | | |
| Commercial non-real estate | 28,831 | 34,429 |
| Commercial lines of credit | <u>37,301</u> | <u>39,096</u> |
| Total commercial loans | <u>66,132</u> | <u>73,525</u> |
| Consumer loans: | | |
| Home equity | 17,117 | 17,395 |
| Consumer and installment | 32,517 | 34,578 |
| Consumer lines of credit | <u>301</u> | <u>314</u> |
| Total consumer loans | <u>49,935</u> | <u>52,287</u> |
| Total loans | <u>243,902</u> | <u>256,513</u> |
| Less: | | |
| Undisbursed portion of interim construction loans | (379) | (320) |
| Unamortized loan discount | (296) | (309) |
| Allowance for loan losses | (5,433) | (5,579) |
| Net deferred loan origination costs | <u>127</u> | <u>115</u> |
| Total, net | <u>\$237,921</u> | <u>\$250,420</u> |
| Weighted-average interest rate of loans | 5.14% | 4.87% |

The following table sets forth information with respect to the Bank's non-performing assets at the dates indicated (dollars in thousands):

| | <u>March 31, 2010</u> | <u>December 31, 2009</u> |
|--|-----------------------|--------------------------|
| Non-accruing loans which are contractually past due 90 days or more: | | |
| Residential real estate | \$ 662 | \$ 649 |
| Commercial | 19,919 | 19,045 |
| Consumer | <u>1,294</u> | <u>1,175</u> |
| Total nonperforming loans | 21,875 | 20,869 |
| Real estate acquired through foreclosure and repossessed assets | <u>6,441</u> | <u>5,917</u> |
| Total nonperforming assets | <u>\$28,316</u> | <u>\$26,786</u> |
| Nonperforming loans to total loans | <u>8.96%</u> | <u>8.13%</u> |
| Nonperforming assets to total assets | <u>6.45%</u> | <u>5.86%</u> |
| Allowance for loan losses to total loans outstanding | <u>2.23%</u> | <u>2.18%</u> |
| Allowance for loan losses to Nonperforming loans | <u>24.84%</u> | <u>26.73%</u> |
| Allowance for loan losses | <u>\$5,433</u> | <u>\$5,579</u> |

Loans which management identifies as impaired generally will be non-performing loans. Non-performing assets increased \$1.5 million to \$28.3 million at March 31, 2010, or 6.45% of total assets, as compared to \$26.8 million or 5.86% of total assets, at December 31, 2009. Slow housing conditions have affected these borrowers' ability to sell the completed projects in a timely manner. These loans are currently being carried at management's best estimate of net realizable value, although no assurance can be given that no further losses will be incurred on these loans until the collateral has been acquired and liquidated or other arrangements can be made. Interest income that would have been recorded for the period ended March 31, 2010 had non-accruing loans been current in accordance with their original terms amounted to approximately \$325,000. There was no interest included in interest income on such loans for the period ended March 31, 2010. Management has allocated specific reserves to these and other non-performing assets that it believes will offset losses, if any, arising from less than full recovery of the loans from the supporting collateral. Specific reserves for non-performing loans are charged to the loan as a write-down after completion of the impairment analysis for all collateral dependent loans. These additional reserves are based on management's evaluation of a number of factors, including the estimated value of the collateral supporting each of these loans. Management believes that the combination of additional reserves and established impairment of these loans will be adequate to account for the current risk associated with these loans as of March 31, 2010. Management continues to evaluate and assess all nonperforming assets on a regular basis as part of its well-established loan monitoring and review process.

At March 31, 2010, criticized and classified loans totaled \$45.6 million, compared to \$51.4 million at December 31, 2009 and \$27.0 million at March 31, 2009. The reduction of \$4.0 million for criticized and classified loans from December 31, 2009 to March 31, 2010 was due to the payout of two commercial real estate loans. Our non-performing loans totaled \$21.9 million at March 31, 2010 compared to \$20.9 million at

December 31, 2009. Non-performing and impaired loans, net of specific reserves, totaled \$11.8 million at March 31, 2009 and \$12.5 million at December 31, 2008. While management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations. Such adjustments would be made in the relevant period and may be material to the financial statements.

Real estate acquired through foreclosure increased \$524,000 to \$6.4 million at March 31, 2010 from \$5.9 million at December 31, 2009, as a result of foreclosure on one commercial real estate property. Other real estate owned (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. The properties are being actively marketed and maintained with the primary objective of liquidating the collateral at a level which most accurately approximates fair market value and allows recovery of as much of the unpaid balance as possible upon the sale of the properties in a reasonable period of time. The carrying value of these assets are believed to be representative of their fair market value, although there can be no assurance that the ultimate proceeds from the sale of these assets will be equal to or greater than the carrying values.

Real estate acquired in settlement of loans through foreclosure is summarized as follows:

| | <u>March 31,</u> <u>2010</u> | <u>December 31</u> <u>2009</u> |
|---------------------------------------|---------------------------------|-----------------------------------|
| Balance at beginning of period | \$5,917 | \$667 |
| Foreclosures added during the period | 524 | 5,890 |
| Provision charged as a write-down ... | (0) | (640) |
| Balance at the end of period..... | <u>\$6,441</u> | <u>\$5,917</u> |

Other Assets

Cash surrender value of life insurance increased \$98,000, or 1.1%, to \$9.4 million at March 31, 2010 from \$9.3 million at December 31, 2009, due to accrued life insurance benefits.

Other assets decreased \$191,000, or 1.7%, to \$11.3 million at March 31, 2010 from \$11.5 million at December 31, 2009, due primarily to the amortization of prepaid FDIC premiums for the period.

Liabilities

Total liabilities decreased \$18.2 million to \$412.7 million at March 31, 2010 from \$430.9 million at December 31, 2009. Deposits decreased \$6.8 million, or 2.1%, to \$325.9 million at March 31, 2010 from \$332.8 million at December 31, 2009. The decrease was due to an \$8.5 million decrease in certificates of deposit, offset by a \$1.6 million increase in transaction accounts as a result of a special product promotion. The Corporation continues to target lower-cost demand deposit accounts through media advertising and special product promotions. FHLB advances decreased \$5.0 million to \$59.5 million at March 31, 2010 from \$64.5 million at December 31, 2009 due to the maturity of advances as additional advances were not needed due to the decrease in assets. Security agreements to repurchase decreased \$6.5 million to \$11.9 million at March 31, 2010 from \$18.5 million at December 31, 2009 due to the maturity of borrowings.

Deposit accounts were as follows (in thousands):

| <u>Account Type</u> | <u>March 31, 2010</u> | | | <u>December 31, 2009</u> | | |
|-----------------------------------|-----------------------|------------------|----------------|--------------------------|------------------|----------------|
| | <u>Rate</u> | <u>Balance</u> | <u>%</u> | <u>Rate</u> | <u>Balance</u> | <u>%</u> |
| NOW accounts: | | | | | | |
| Commercial non-interest-bearing | -- | \$18,965 | 5.82% | -- | \$18,015 | 5.42% |
| Non-commercial | 2.16% | 95,209 | 29.19% | 2.30% | 98,274 | 29.53% |
| Money market checking accounts | 1.31% | 27,091 | 8.31% | 1.57% | 32,239 | 9.69% |
| Regular savings | 0.58% | <u>22,292</u> | <u>6.84%</u> | <u>0.51%</u> | <u>13,383</u> | <u>4.02%</u> |
| Total demand and savings deposits | 1.60% | <u>163,557</u> | <u>50.16%</u> | 1.74% | <u>161,911</u> | <u>48.66%</u> |
| Time deposits: | | | | | | |
| Up to 3.00% | | 145,225 | 44.55% | | 135,064 | 40.59% |
| 3.01 %- 4.00% | | 3,851 | 1.18% | | 20,885 | 6.27% |
| 4.01 %- 5.00% | | 12,380 | 3.80% | | 13,744 | 4.13% |
| 5.01 %- 6.00% | | 933 | 0.31% | | 1,130 | 0.34% |
| 6.01 %- 7.00% | | -- | <u>0.00%</u> | | <u>28</u> | <u>0.01%</u> |
| Total time deposits | 2.02% | <u>162,389</u> | <u>49.84%</u> | 2.27% | <u>170,851</u> | <u>51.34%</u> |
| Total deposit accounts | 1.81% | <u>\$325,946</u> | <u>100.00%</u> | 2.02% | <u>\$332,762</u> | <u>100.00%</u> |

FHLB advances decreased \$5.0 million to \$59.5 million at March 31, 2010 from \$64.5 million at December 31, 2009. The maturity of the advances from the FHLB is as follows (in thousands):

| | <u>March 31, 2010</u> | | <u>December 31, 2009</u> | |
|--|-----------------------|---------------------|--------------------------|---------------------|
| | <u>Balance</u> | <u>Wtd Avg Rate</u> | <u>Balance</u> | <u>Wtd Avg Rate</u> |
| Contractual Maturity: | | | | |
| Within one year - fixed rate | \$-- | --% | \$5,000 | 4.93% |
| After one but within three years - fixed rate | -- | --% | -- | --% |
| After one but within three years - adjustable rate | 22,000 | 4.58% | 22,000 | 4.58% |
| Greater than five years - adjustable rate | <u>37,500</u> | 3.89% | <u>37,500</u> | 3.89% |
| Total advances | <u>\$59,500</u> | 4.14% | <u>\$64,500</u> | 4.20% |

The Bank pledges as collateral for the advances its investment securities and has entered into a blanket collateral agreement with the FHLB whereby the Bank maintains, free of other encumbrances, qualifying loans with unpaid principal balances equal to, when discounted at 50% to 75% of the unpaid principal balances, 100% of total advances.

The Corporation had \$11.9 million and \$18.5 million borrowed under agreements to repurchase at March 31, 2010 and December 31, 2009, respectively.

Shareholders' Equity

Shareholders' equity decreased \$261,000, or 1.0%, to \$25.9 million at March 31, 2010 from \$26.1 million at December 31, 2009 due primarily to a \$163,000 increase in unrealized losses on securities available for sale and preferred stock dividend payments of \$116,000, offset by net income of \$18,000. At March 31, 2010, all of the Bank's capital ratios continued to be sufficient to classify it as a well-capitalized institution by regulatory measures.

Liquidity

Liquidity is the ability to meet demand for loan disbursements, deposit withdrawals, repayment of debt, payment of interest on deposits and other operating expenses. The primary sources of liquidity are deposits, loan repayments, borrowings, maturity and sale of securities and interest payments.

While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. The primary investing activities of the Corporation are the origination of commercial and consumer loans, and the purchase of investment and mortgage-backed securities. These activities are funded primarily by principal and interest payments on loans and investment securities, deposit growth, securities sold under agreements to repurchase and FHLB advances.

At March 31, 2010, the Corporation's investment in marketable securities totaled \$131.1 million, nearly all of which was available for sale. In addition, the Corporation had \$20.3 million in fed funds sold at March 31, 2010 compared to \$5.3 million at December 31, 2009. Approximately \$76.5 million and \$94.6 million of debt securities at March 31, 2010 and December 31, 2009, respectively, were pledged by the Bank as collateral to secure deposits of the State of South Carolina, and Union, Laurens and York counties along with additional borrowings and repurchase agreements.

Outstanding loan commitments (including commitments to fund credit lines) totaled \$33.7 million at March 31, 2010. Management of the Corporation anticipates that it will have sufficient funds available to meet its current loan commitments.

The Corporation closely monitors its liquidity position on a daily basis. Time deposits that are scheduled to mature in one year or less from March 31, 2010, totaled \$105.6 million. The Corporation relies primarily on competitive rates, customer service, and long-standing relationships with customers to retain deposits. From time to time, the Corporation will also offer special products to its customers to increase retention and to attract new deposits. Based upon the Corporation's experience with deposit retention and current retention strategies, management believes that, although it is not possible to predict future terms and conditions upon renewal, a significant portion of such deposits will remain with the Corporation. If the Corporation requires funds beyond its ability to generate them internally, additional sources of funds are available through FHLB advances, securities sold under agreements to repurchase and lines of credit. At March 31, 2010, the Corporation had outstanding \$59.5 million of FHLB borrowings and \$11.9 million of securities sold under agreements to repurchase. At March 31, 2010, the Corporation had unused short-term lines of credit to purchase federal funds from unrelated banks totaling \$4.0 million and the ability to borrow an additional \$70.0 million from secured borrowing lines. Lines of credit are available on a one-to-ten day basis for general purposes of the Corporation. All of the lenders have reserved the right to withdraw these lines at their option.

Provident Community Bancshares, Inc. is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Provident Community Bancshares is responsible for paying any dividends declared to its shareholders and paying the obligations on its outstanding debentures and preferred stock. Provident Community Bancshares' primary sources of income are proceeds that it retained from its offering of preferred stock and dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Provident Community Bancshares in any calendar year, without the receipt of prior approval from the Office of the Comptroller of the Currency cannot exceed retained net income for that year combined with retained net income for the prior two years less any transfers to surplus and capital distributions. At March 31, 2010, Provident Community Bancshares, Inc. had liquid assets of \$1.6 million.

Capital Management

The Bank and the Corporation are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated 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 classifications are also subject to qualitative judgments by the regulators about components, risk weights and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the Bank and the Corporation to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets (as defined in the regulations). Management believes, as of March 31, 2010, that the Bank and the Corporation met the capital adequacy requirements to which they are subject.

As of March 31, 2010, the Bank was "well capitalized" under the regulatory framework for prompt corrective action based on its capital ratio calculations. In order to be "well capitalized", the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table.

Under present regulations of the Office of the Comptroller of the Currency, the Bank must have core capital (leverage requirement) equal to 4.0% of assets, of which 1.5% must be tangible capital, excluding intangible assets. The Bank must also maintain risk-based regulatory capital as a percent of risk weighted assets at least equal to 8.0%. In measuring compliance with capital standards, certain adjustments must be made to capital and total assets.

The following tables present the total risk-based, Tier 1 risk-based and Tier 1 leverage requirements for the Corporation and the Bank (dollars in thousands).

March 31, 2010

| | <u>Actual</u> | | <u>Regulatory Minimum</u> | | <u>"Well Capitalized"</u> | |
|--------------------------------|---------------|------------|---------------------------|------------|---------------------------|------------|
| | Amount \$ | Ratio % | Amount \$ | Ratio % | Amount \$ | Ratio % |
| Leverage ratio | | | | | | |
| Corporation | 31,890 | 7.07% | 18,043 | 4.00% | n/a | n/a |
| Bank | 33,537 | 7.44% | 18,035 | 4.00% | 22,543 | 5.00% |
| Tier 1 capital ratio | | | | | | |
| Corporation | 31,890 | 10.99% | 11,610 | 4.00% | n/a | n/a |
| Bank | 33,537 | 11.56% | 11,602 | 4.00% | 17,403 | 6.00% |
| Total risk-based capital ratio | | | | | | |
| Corporation | 38,540 | 13.28% | 23,219 | 8.00% | n/a | n/a |
| Bank | 37,185 | 12.82% | 23,203 | 8.00% | 29,004 | 10.00% |

Off-Balance Sheet Risk

In the normal course of operations, the Corporation engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of legally binding agreements to lend money to customers at predetermined interest rates for a specified period of time. Outstanding loan commitments (including commitments to fund credit lines) totaled \$33.7 million at March 31, 2010. Each customer's credit worthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on the credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. The credit risk on these commitments is managed by subjecting each customer to normal underwriting and risk management processes. For the period ended March 31, 2010, the Corporation did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operation or cash flows.

Results of operations for the three months ended March 31, 2010 and 2009

General

The Corporation recorded a net loss to common shareholders of \$99,000 for the three months ended March 31, 2010 as compared to a net loss of \$1.7 million for the same period in 2009. A decrease in the provision for loan losses to \$896,000 for the three months ended March 31, 2010 compared to \$2.7 million for the same period in 2009, an increase in non-interest income to \$1.1 million for the three months ended March 31, 2010 compared to \$481,000 for the same period in 2009 and a decrease in non-interest expense all had a positive impact on earnings in 2010.

Average Yields and Rates

(dollars in thousands)

| | <u>Three Months Ended March 31,</u> | | | | | |
|---|-------------------------------------|-----------------|----------------------------------|----------------------------|-----------------|----------------------------------|
| | <u>2010</u> | | | <u>2009</u> | | |
| | <u>Average Balance</u> | <u>Interest</u> | <u>Average Yield/Cost(2)</u> | <u>Average Balance</u> | <u>Interest</u> | <u>Average Yield/Cost(2)</u> |
| Interest-earning assets: | | | | | | |
| Loans (1) | \$247,998 | \$3,120 | 5.03% | \$283,804 | \$3,596 | 5.07% |
| Mortgage-backed securities | 43,735 | 429 | 3.92% | 65,311 | 895 | 5.48% |
| Investment securities | 97,181 | 962 | 3.96% | 47,581 | 624 | 5.24% |
| Other interest-earning assets | <u>25,306</u> | <u>19</u> | 0.31% | <u>21,160</u> | <u>23</u> | 0.43% |
| Total interest-earning assets | 414,220 | <u>4,530</u> | 4.37% | 417,856 | <u>5,138</u> | 4.92% |
| Non-interest-earning assets | <u>40,716</u> | | | <u>30,491</u> | | |
| Total assets | <u>\$454,936</u> | | | <u>\$448,347</u> | | |
| Interest-bearing liabilities: | | | | | | |
| Deposits | 312,594 | 1,547 | 1.98% | 302,668 | 2,092 | 2.77% |
| Floating rate junior subordinated deferrable interest debentures | 12,372 | 118 | 3.82% | 12,372 | 151 | 4.87% |
| FHLB advances and other borrowings | <u>81,532</u> | <u>744</u> | 3.65% | <u>88,131</u> | <u>784</u> | 3.77% |
| Total interest-bearing liabilities | 406,498 | <u>2,409</u> | 2.37% | 403,171 | <u>3,027</u> | 3.00% |
| Non-interest-bearing sources: | | | | | | |
| Non-interest-bearing deposits | 18,733 | | | 19,069 | | |
| Non-interest-bearing liabilities | <u>3,228</u> | | | <u>3,138</u> | | |
| Total liabilities | 428,459 | | | 425,378 | | |
| Shareholders' equity | <u>26,477</u> | | | <u>22,969</u> | | |
| Total liabilities and shareholders' equity | <u>\$454,936</u> | | | <u>\$448,347</u> | | |
| Net interest income | | <u>\$2,121</u> | | | <u>\$2,111</u> | |
| Interest rate spread | | | 2.00% | | | 1.92% |
| Impact of non-interest-bearing deposits | | | <u>0.05</u> | | | <u>0.10</u> |
| Net interest margin | | | 2.05% | | | <u>2.02%</u> |

(1) Average balances of loans include non-accrual loans.

(2) Annualized

Interest Income

Interest income decreased \$608,000, or 11.8%, to \$4.5 million for the three months ended March 31, 2010 as compared to the same period in 2009. Interest income on loans decreased by 13.2%, or \$476,000, to \$3.1 million for the three months ended March 31, 2010 from \$3.6 million for the three months ended March 31, 2009, due primarily to lower average balances. Interest on deposits and federal funds sold, combined with interest and dividends on investment and mortgage-backed securities decreased \$132,000, or 8.6%, for the three months ended March 31, 2010 to \$1.4 million from \$1.5 million during the same period in 2009 due to lower yields due to declining market interest rates and a decrease in the average balance of mortgage-backed securities, offset by higher average balances of investment securities.

Interest Expense

Interest expense decreased \$618,000, or 20.4%, to \$2.4 million for the three months ended March 31, 2010 as compared to \$3.0 million for the three months ended March 31, 2009. Interest expense on deposit accounts decreased \$545,000, or 26.1%, to \$1.5 million for the three months ended March 31, 2010 from \$2.1 million during the same period in 2009 due primarily to lower market interest rates and a shift in the composition of the deposit portfolio from certificates of deposits to transaction accounts, offset by higher average balances. The Corporation continues to target lower cost demand deposit accounts versus higher cost certificates of deposits in order to reduce overall funding costs. Interest expense on FHLB advances and other borrowings decreased \$40,000, or 5.1%, for the three months ended March 31, 2010 as compared to the same period in the previous year due primarily to lower average balances and lower rates paid. Interest expense on floating rate junior subordinated deferrable interest debentures decreased \$33,000, or 21.8%, to \$118,000 for the three months ended March 31, 2010 from \$151,000 during the same period in 2009 due to lower market rates.

Provision for Loan Losses

We have developed policies and procedures for evaluating the overall quality of our credit portfolio and the timely identification of potential problem credits. The Board of Directors reviews and approves the appropriate level for

Provident Community Bancshares allowance for loan losses quarterly based upon our recommendations, the results of the internal monitoring and reporting system, quarterly external independent loan reviews and the analysis of economic conditions in our local markets. Additions to the allowance for loan losses, which are expensed as the provision for loan losses on our income statement, are periodically made to maintain the allowance at an appropriate level based on our analysis of the potential risk in the loan portfolio. Loan losses, which include write downs and charge-offs are charged directly to the allowance while recoveries are credited against the allowance. The amount of the provision is a function of the level and composition of loans outstanding, the level of classified and non-performing loans, historical loan loss experience, the amount of loan losses actually charged against the reserve during the given period, and current and anticipated economic conditions.

Our allowance for loan losses is based upon judgments and assumption of risk elements in the portfolio, future economic conditions and other factors affecting borrowers. The process includes identification and analysis of loss potential in various portfolio segments utilizing a credit risk grading process and specific reviews and evaluations of significant problem credits. In addition, we monitor overall portfolio quality through observable trends in delinquency, charge offs, and general and economic conditions in the market area. The adequacy of the allowance for loan losses and the effectiveness of our monitoring and analysis system are also reviewed periodically by the banking regulators which may require that we increase the allowance for loan losses. Risks are inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

Our judgment about the adequacy of the allowance is based upon a number of assumptions about future events, which we believe to be reasonable, but which may not prove to be accurate. Thus, charge-offs in future periods could exceed the allowance for loan losses, or substantial additional increases in the allowance for loan losses could be required. Additions to the allowance for loan losses would result in a decrease of our net income and, possibly, our capital. Based on present information we believe the allowance for loan losses is adequate at March 31, 2010 to meet presently known and inherent risks in the loan portfolio.

During the three months ended March 31, 2010, the provision for loan losses was \$896,000 as compared to \$2.7 million for the same period in the previous year. The previous year provision was higher than the current year due to higher specific reserves required on nonperforming loans along with a reduction in classified loans for the current period. Non-performing loans increased \$5.3 million from \$16.6 million at March 31, 2009 to \$21.9 million at March 31, 2010. The increase in non-performing loans over the previous year related primarily to

commercial real estate relationships that have been affected by the downturn in the residential housing market. Slow housing conditions have affected these borrowers' ability to sell the completed projects in a timely manner. Specific reserves for non-performing loans at March 31, 2010 were \$720,000 compared to \$4.8 million for nonperforming loans at March 31, 2009. All specific reserves for commercial real estate loans that were deemed collateral dependent were charged off against the loans as of December 31, 2009. Management believes the specific reserves allocated to these and other non accrual loans will offset losses, if any, arising from less than full recovery of the loans from the supporting collateral. Management has sought to provide the amount estimated to be necessary to maintain an allowance for loan losses that is adequate to cover the level of loss that management believed to be inherent in the portfolio as a whole, taking into account the Corporation's experience, economic conditions and information about borrowers available at the time of the analysis. However, management expects further deterioration of economic conditions in the Corporation's market areas is likely in the short-term, especially with respect to real estate related activities and real property values. Consequently, management expects that further additions in provisions for loan losses could be needed in the future.

The changes in the allowance for loan losses consisted of the following for the three months ended March 31, 2010 and 2009 (in thousands):

| | March 31, <u>2010</u> | March 31, <u>2009</u> |
|--------------------------------|--------------------------|--------------------------|
| Balance at beginning of period | \$5,579 | \$6,778 |
| Provision for loan losses | 896 | 2,700 |
| Charge-offs, net | <u>(1,042)</u> | <u>(1,339)</u> |
| Balance at end of period | <u>\$5,433</u> | <u>\$8,139</u> |

Non-Interest Income

Total non-interest income increased \$578,000, or 120.2%, to \$1.1 million for the three months ended March 31, 2010 from \$481,000 for the same period in the previous year. The increase was due primarily to higher gains on the sale of investments. Gain on sale of investments were \$677,000 for the three months ended March 31, 2010 compared to \$95,000 for the same period in the previous year. The Corporation sold approximately \$26 million of primarily mortgage backed securities to better position the investment portfolio for the potential of rising interest rates. An other-than-temporary impairment charge of \$303,000 from write-downs on trust preferred securities as a result of projected shortfalls of interest and principal payments in the cash flow analysis of the securities was recorded for the three months ended March 31, 2010 compared to \$309,000 for the same period in 2009. Fees from financial services decreased \$11,000, or 1.6%, to \$662,000 for the three months ended March 31, 2010 from \$673,000 for the same period in the previous year. The decrease was due to lower service charges on checking accounts.

Non-Interest Expense

For the three months ended March 31, 2010, total non-interest expense decreased \$177,000, or 7.0%, to \$2.3 million from \$2.5 million for the same period in 2009. Compensation and employee benefits decreased \$70,000, or 5.9%, to \$1.1 million for the three months ended March 31, 2010 from \$1.2 million for the same period in 2009 due primarily to reductions in mortgage commission compensation expense due to lower loan volumes and reductions in employee compensation costs due to prior year staffing reductions. Deposit insurance premiums expense increased \$88,000, to \$144,000 for the three months ended March 31, 2010 from \$56,000 for the same period in 2009, due to higher industry-wide FDIC premium assessments. Advertising and public relations expense decreased \$17,000, or 56.7%, to \$13,000 for the three months ended March 31, 2010 from \$30,000 for the same period in 2009 due primarily to lower deposit product and promotion expenses. Loan operations expense decreased \$17,000, or 15.5%, to \$93,000 for the three months ended March 31, 2010 from \$110,000 for the same period in 2009 due primarily to lower foreclosure expenses. All goodwill and related deposit premium intangibles

were charged off in 2009 thereby eliminating amortization expenses. Items processing expense decreased \$12,000, or 13.5%, to \$77,000 for the three months ended March 31, 2010 from \$89,000 for the same period in 2009, due primarily to expense savings from the prior year installation of branch capture units in banking centers. Telephone expense decreased \$15,000, or 28.9%, to \$37,000 for the three months ended March 31, 2010 from \$52,000 for the same period in 2009 due primarily to improvements in data line services. Other expense decreased \$34,000, or 18.1%, to \$154,000 for the three months ended March 31, 2010 from \$188,000 for the same period in 2009, due primarily to reductions in courier expense as a result of the prior year installation of branch capture and lower loan expense due to reduced loan volumes.

Income taxes

Our benefit for income taxes was \$73,000 for the three months ended March 31, 2010 as compared to a benefit of \$929,000 for the same period in 2009.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable as the registrant is a smaller reporting company.

Item 4T. Controls and Procedures

The Corporation's management, including the Corporation's principal executive officer and principal financial officer, have evaluated the effectiveness of the Corporation's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Corporation's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Corporation files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Corporation's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Corporation's internal control over financial reporting identified in connection with the evaluation required by Rule 13(a)-15(e) that occurred during the quarter that has materially affected or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation is not involved in any legal proceedings. The Bank is not involved in any pending legal proceedings other than routine legal proceedings occurring in the normal course of business. Management believes that these proceedings are immaterial to the Corporation's financial condition and results of operations.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

In May 2005, the Corporation implemented a share repurchase program under which the Board of Directors of the Corporation authorized the repurchase of up to 5% of the outstanding shares or 98,000 shares. The program was expanded by an additional 5%, or 92,000 shares, in August 2006. The Corporation did not repurchase any shares during the three months ended March 31, 2010 and 36,034 shares remain under the previously authorized plans. As part of the Corporation's participation in the Troubled Asset Relief Capital Purchase Program, prior to the earlier of March 6, 2012 or the date on which the preferred stock issued to the Treasury Department has been redeemed in full or transferred to non-affiliates, the Corporation cannot repurchase any shares of its common stock without the prior approval of the Treasury Department.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Reserved

None

Item 5. Other Information

None

Item 6. Exhibits

31(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32(a) Chief Executive Officer Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32(b) Chief Financial Officer Certification Pursuant to 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.

PROVIDENT COMMUNITY BANCSHARES, INC.
(Registrant)

Date: May 12, 2010

By: /s/ Dwight V. Neese
Dwight V. Neese, President and
Chief Executive Officer

Date: May 12, 2010

By: /s/ Richard H. Flake
Richard H. Flake, Executive Vice President
and Chief Financial Officer

EXHIBIT 31(a)
CERTIFICATION

I, Dwight V. Neese, certify that:

1. I have reviewed this Form 10-Q of Provident Community Bancshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted account principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2010

/s/ Dwight V. Neese _____
Dwight V. Neese
President and Chief Executive Officer

EXHIBIT 31(b)
CERTIFICATION

I, Richard H. Flake, certify that:

1. I have reviewed this Form 10-Q of Provident Community Bancshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted account principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2010

/s/ Richard H. Flake

Richard H. Flake

Executive Vice President and Chief Financial Officer

EXHIBIT 32(a)
CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADDED BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Provident Community Bancshares, Inc. (the “Company”) on Form 10-Q for the quarter ended March 31, 2010 as filed with the Securities and Exchange Commission (the “Report”), I, Dwight V. Neese, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

/s/ Dwight V. Neese
Dwight V. Neese
President and Chief Executive Officer

Date: May 12, 2010

EXHIBIT 32(b)
CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADDED BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Provident Community Bancshares, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2010 as filed with the Securities and Exchange Commission (the "Report"), I, Richard H. Flake, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

/s/ Richard H. Flake _____
Richard H. Flake
Executive Vice President and Chief Financial Officer

Date: May 12, 2010