FIRST RELIANCE BANCSHARES INC
Form 10-Q
November 12, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

(Mark One)

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2010

OR

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _________to_________

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.
(Exact name of small business issuer as specified in its charter)

South Carolina (State or other jurisdiction of incorporation or organization)	80-0030931 (I.R.S. Employer Identification No.)

2170 West Palmetto Street
Florence, South Carolina 29501
(Address of principal executive offices, including zip code)

(843) 656-5000
(Issuer's telephone number, including area code)

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

4,113,539 shares of common stock, par value $0.01 per share, as of October 31, 2010

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.
x 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 (§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.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company x

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

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FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Balance Sheets

	September 30, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 2,729,387	$ 2,942,295
Interest-bearing deposits with other banks	57,715,023	50,356,191
Total cash and cash equivalents	60,444,410	53,298,486
Time deposits in other banks	100,000	502,089
Securities available-for-sale	90,403,646	121,948,744
Nonmarketable equity securities	4,525,300	4,812,100
Total investment securities	94,928,946	126,760,844
Mortgage loans held for sale	3,213,184	5,100,609
Loans receivable	364,399,841	406,627,401
Less allowance for loan losses	(6,819,964)	(9,800,746)
Loans, net	357,579,877	396,826,655
Premises and equipment, net	26,050,487	26,469,436
Accrued interest receivable	2,347,994	2,661,030
Other real estate owned	12,742,086	8,954,214
Cash surrender value life insurance	11,723,592	11,409,937
Other assets	10,864,654	13,525,073
Total assets	$ 579,995,230	$ 645,508,373
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 42,170,819	$ 44,298,626
Interest-bearing transaction accounts	37,563,382	47,733,229
Savings	113,914,458	103,604,793
Time deposits $100,000 and over	170,851,463	195,346,191
Other time deposits	123,715,653	161,780,140
Total deposits	488,215,775	552,762,979
Securities sold under agreement to repurchase	920,166	598,342
Advances from Federal Home Loan Bank	26,000,000	34,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	534,549	680,880
Other liabilities	2,904,488	1,932,345
Total liabilities	528,884,978	600,284,546
Shareholders' Equity		

Preferred stock, no par value, authorized 10,000,000 shares:		
Series A cumulative perpetual preferred stock 15,349 issued and outstanding at September 30, 2010 and December 31, 2009	14,681,684	14,536,176
Series B cumulative perpetual preferred stock 767 shares issue and outstanding at September 30, 2010 and December 31, 2009	823,615	835,960
Series C cumulative mandatory convertible preferred stock 2,293 shares issued and outstanding at September 30, 2010	2,293,000	-
Common stock, $0.01 par value; 20,000,000 shares authorized, 4,113,539 and 3,582,691 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	41,135	35,827
Capital surplus	28,133,315	26,181,576
Treasury stock at cost at 12,632 and 11,535 shares at September 30, 2010 and December 31, 2009, respectively	(168,408)	(163,936)
Nonvested restricted stock	(771,993)	(206,004)
Retained earnings	4,186,029	5,269,463
Accumulated other comprehensive income (loss)	1,891,875	(1,265,235)
Total shareholders’ equity	51,110,252	45,223,827
Total liabilities and shareholders’ equity	$ 579,995,230	$ 645,508,373

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Operations
(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Interest income:				
Loans, including fees	$ 17,719,753	$ 21,583,188	$ 5,653,540	$ 7,745,134
Investment securities:				
Taxable	1,742,007	1,690,701	548,823	687,731
Nontaxable	1,903,865	1,327,111	596,994	581,312
Federal funds sold	-	1,346	-	14
Other interest income	88,258	105,096	32,786	68,376
Total	21,453,883	24,707,442	6,832,143	9,082,567
Interest expense:				
Time deposits over $100,000	4,217,795	4,106,264	1,314,398	1,530,962
Other deposits	3,696,742	5,353,235	1,098,707	1,919,434
Other interest expense	1,175,163	2,153,744	394,111	576,774
Total	9,089,700	11,613,243	2,807,216	4,027,170
Net interest income	12,364,183	13,094,199	4,024,927	5,055,397
Provision for loan losses	3,541,650	8,122,271	1,475,751	3,266,449
Net interest income after provision for loan losses	8,822,533	4,971,928	2,549,176	1,788,948
Noninterest income:				
Service charges on deposit accounts	1,378,482	1,430,484	466,792	495,390
Gain on sales of mortgage loans	597,653	2,017,670	217,190	803,133
Income from bank owned life insurance	313,655	316,071	105,308	107,916
Other charges, commissions and fees	498,781	412,040	174,785	144,137
Gain on sale of securities	803,398	1,875,486	801,797	846,027
Gain on sale of fixed assets	-	86,810	-	-
Other non-interest income	237,764	332,007	62,764	51,239
Total	3,829,733	6,470,568	1,828,636	2,447,842
Noninterest expenses:				
Salaries and employee benefits	7,117,834	7,921,638	2,454,159	2,598,865
Occupancy expense	1,153,239	1,079,855	375,324	369,823
Furniture and equipment expense	868,036	811,838	269,680	249,269
Other operating expenses	5,032,370	4,782,213	2,124,208	1,882,893
Total	14,171,479	14,595,544	5,223,371	5,100,850
Loss before income taxes	(1,519,213)	(3,153,048)	(845,559)	(864,060)
Income tax benefit	(1,259,612)	(1,681,227)	(534,977)	(532,988)

Net Loss	(259,601)	(1,471,821)	(310,582)	(331,072)
Preferred stock dividends	704,048	478,971	249,247	210,839
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	133,163	101,948	44,876	44,876
Net loss available to common shareholders	$ (1,096,812)	$ (2,052,740)	$ (604,705)	$ (586,787)
Average common shares outstanding, basic	3,878,476	3,559,592	4,110,007	3,585,572
Average common shares outstanding, diluted	3,878,476	3,559,592	4,110,007	3,585,572
Loss per share				
Basic loss per share	$ (0.28)	$ (0.58)	$ (0.15)	$ (0.16)
Diluted loss per share	$ (0.28)	$ (0.58)	$ (0.15)	$ (0.16)

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss)
For the Nine Months Ended September 30, 2010 and 2009
(Unaudited)

	Preferred Stock	Common Stock	Capital Surplus	Treasury Stock	Nonvested Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	$ -	$ 35,250	$ 26,120,460	$ (159,777)	$ (207,653)	$ 11,839,005	$ (201,527)	$ 37,425,758
Issuance of Series A preferred stock, net of issuance cost of $116,786	14,375,740							14,375,740
Issuance of Series B preferred stock, net of issuance cost $6,902	849,572							849,572
Net loss						(1,471,821)		(1,471,821)
Other comprehensive income, net of tax expense of $262,763							510,069	510,069
Comprehensive loss								(961,752)
Preferred stock dividends						(369,446)		(369,446)
Accretion of Series A Preferred stock discount	111,399					(111,399)		-
Amortization of Series B Preferred stock	(9,451)					9,451		-

premium								
Issuance of stock to employees		2	998					1,000
Issuance of restricted stock		566	65,704		51,769			118,039
Purchase of treasury stock				(4,130)				(4,130)
Balance, September 30, 2009	$ 15,327,260	$ 35,818	$ 26,187,162	$ (163,907)	$ (155,884)	$ 9,895,790	$ 308,542	$ 51,434,781
Balance, December 31, 2009	$ 15,372,136	$ 35,827	$ 26,181,576	$ (163,936)	$ (206,004)	$ 5,269,463	$ (1,265,235)	$ 45,223,827
Issuance of Series C	2,293,000							2,293,000
Issuance of common stock net of issuance cost of $329,390		3,404	1,198,860					1,202,264
Net loss						(259,601)		(259,601)
Other comprehensive gain, net of tax expense of $1,617,391							3,157,110	3,157,110
Comprehensive income								2,897,509
Preferred Stock Dividend						(690,670)		(690,670)
Accretion of Series A Preferred stock discount	145,508					(145,508)		-
Amortization of Series B	(12,345)					12,345		-

Preferred stock premium								
Issuance Restricted Stock		1,904	752,879		(565,989)			188,794
Purchase of treasury stock				(4,472)				(4,472)
Balance September 30, 2010	$ 17,798,299	$ 41,135	$ 28,133,315	$ (168,408)	$ (771,993)	$ 4,186,029	$ 1,891,875	$ 51,110,252

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net loss	$ (259,601)	$ (1,471,821)
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,541,650	8,122,271
Depreciation and amortization expense	818,696	821,799
Gain on sale of premises, furniture and equipment	-	(86,810)
Gain on sale of available-for-sale securities	(803,398)	(1,875,486)
Impairment loss on available-for-sale securities	18,750	-
Loss (gain) on sale of other real estate owned	(525,872)	32,892
Write down of other real estate owned	202,597	-
Discount accretion and premium amortization	218,600	92,669
Disbursements for loans held-for-sale	(26,938,340)	(149,964,244)
Proceeds from loans held-for-sale	28,825,044	149,732,281
Net increase in valuation allowance for loans held-for-sale	721	3,282
Decrease in interest receivable	313,036	47,287
Increase in cash surrender value of life insurance	(313,655)	(316,070)
Decrease in interest payable	(146,331)	(10,011)
Amortization of deferred compensation on restricted stock	188,794	118,039
Increase in other liabilities	6,540	1,004,234
(Increase) decrease in other assets	1,852,457	(3,436,537)
Net cash provided by operating activities	6,999,688	2,813,775
Cash flows from investing activities:		
Net decrease in loans receivable	26,493,504	25,787,643
Purchases of securities available-for-sale	(8,283,383)	(111,450,874)
Proceeds on sales of securities available-for-sale	40,631,817	103,217,000
Maturities of securities available-for-sale	4,537,212	8,071,301
(Increase) decrease in nonmarketable equity securities	286,800	(237,400)
(Increase) decrease in time deposits in other banks	402,089	(250,529)
Proceeds from sales of other real estate owned	5,896,143	222,608
Improvements on other real estate owned	(149,116)	-
Proceeds from disposal of premises, furniture, and equipment	-	2,286,810
Purchases of premises and equipment	(243,572)	(809,269)
Net cash provided by investing activities	69,571,494	26,837,290
Cash flows from financing activities:		
Net increase (decrease) in demand deposits, interest-bearing and savings accounts	(1,987,989)	13,701,833
Net increase (decrease) in certificates of deposit and other time deposits	(62,559,215)	96,024,986
Net increase (decrease) in securities sold under agreements to repurchase	321,824	(7,324,112)
Decrease in advances from the Federal Home Loan Bank	(8,000,000)	(30,000,000)
Repayment of note payable	-	(6,950,000)
Net proceeds from issuance of preferred stock	2,293,000	15,225,312

Net proceeds from issuance of common stock	1,201,262	-
Issuance of shares to employees	1,002	1,000
Preferred stock dividends paid	(690,670)	(369,446)
Purchase of treasury stock	(4,472)	(4,130)
Net cash provided (used) by financing activities	(69,425,258)	80,305,443
Net increase in cash and cash equivalents	7,145,924	109,956,508
Cash and cash equivalents, beginning of period	53,298,486	5,708,607
Cash and cash equivalents, end of period	$ 60,444,410	$ 115,665,115
Cash paid during the period for		
Income taxes	$ -	$ 4,257
Interest	$ 9,236,031	$ 11,623,254
Supplemental noncash investing and financing activities		
Foreclosures on loans	$ 9,211,624	$ 7,019,811

See notes to condensed consolidated financial statements

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures, which would appear in audited annual consolidated financial statements. The condensed consolidated financial statements as of September 30, 2010 and for the interim periods ended September 30, 2010 and 2009 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The consolidated financial information as of December 31, 2009 has been derived from the audited consolidated financial statements as of that date. For further information, refer to the consolidated financial statements and the notes included in First Reliance Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2009.

Note 2 - Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

In July 2010, the "Receivables" topic of the Accounting Standards Codification ("ASC") was amended to require expanded disclosures related to a company's allowance for credit losses and the credit quality of its financing receivables. The amendments will require the allowance disclosures to be provided on a disaggregated basis. The Company is required to begin to comply with the disclosures in its financial statements for the year ended December 31, 2010.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes several provisions that will affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage, and impose new capital requirements on bank and thrift holding companies. The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting originator compensation, minimum repayment standards, and pre-payments. Management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on the Company's business, financial condition, and results of operations.

In August 2010, two updates were issued to amend various Securities and Exchange Commission (the "SEC") rules and schedules pursuant to Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies and based on the issuance of SEC Staff Accounting Bulletin 112. The amendments related primarily to business combinations and removed references to "minority interest" and added references to "controlling" and "non-controlling interest(s)". The updates were effective upon issuance but had no impact on the Company's financial statements.

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

Note 3 - Reclassifications

Certain captions and amounts in the financial statements in the Company's Form 10-Q for the quarter ended September 30, 2009 were reclassified to conform to the September 30, 2010 presentation. The reclassification did not have an impact on shareholders' equity or net loss from operations.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 4 - Comprehensive Income

Comprehensive Income - Accounting principles generally require that recognized income, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	Pre-tax Amount	Tax Expense	Net-of-tax Amount
For the Nine Months Ended September 30, 2010:			
Unrealized gains on securities available-for-sale	$ 5,577,899	$ (1,890,546)	$ 3,687,353
Reclassification adjustment for gains (losses) in net income	803,398	(273,155)	530,243
	$ 4,774,501	$ (1,617,391)	$ 3,157,110
For the Nine Months Ended September 30, 2009:			
Unrealized gains on securities available-for-sale	$ 2,648,318	$ (900,429)	$ 1,747,889
Reclassification adjustment for gains (losses) in net income	1,875,486	(637,666)	1,237,820
	$ 772,832	$ (262,763)	$ 510,069
For the Three Months Ended September 30, 2010:			
Unrealized gains on securities available-for-sale	$ 2,753,576	$ (936,360)	$ 1,817,216
Reclassification adjustment for gains (losses) realized in net income	801,797	(272,611)	529,186
	$ 1,951,779	$ (663,749)	$ 1,288,030
For the Three Months Ended September 30, 2009:			
Unrealized gains on securities available-for-sale	$ 3,335,971	$ (1,134,230)	$ 2,201,741
Reclassification adjustment for gains (losses) realized in net income	846,027	(287,649)	558,378
	$ 2,489,944	$ (846,581)	$ 1,643,363

Note 5 – Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value

September 30, 2010				
U.S. Government agencies	$ 5,094	$ 189	$ -	$ 5,283
Mortgage-backed securities	37,521,038	1,032,523	-	38,553,561
Municipals	49,820,036	2,083,006	98,865	51,804,177
Other	200,000	-	159,375	40,625
	$ 87,546,168	$ 3,115,718	$ 258,240	$ 90,403,646

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 – Investment Securities – (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2009				
U.S. Government agencies	$ 3,021,782	$ 751	$ 11,167	$ 3,011,366
Mortgage-backed securities	59,324,978	-	1,192,307	58,132,671
Municipals	61,300,256	460,262	1,023,326	60,737,192
Other	218,750	-	151,235	67,515
	$ 123,865,766	$ 461,013	$ 2,378,035	$ 121,948,744

The following is a summary of maturities of securities available-for-sale as of September 30, 2010. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Securities Available-For-Sale	
	Amortized Cost	Estimated Fair Value
Due after one year but within five years	$ 3,586,962	$ 3,623,917
Due after five years but within ten years	21,636,368	22,322,736
Due after ten years	24,601,800	25,862,807
	49,825,130	51,809,460
Mortgage-backed securities	37,521,038	38,553,561
Other	200,000	40,625
Total	$ 87,546,168	$ 90,403,646

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 September 30, 2010 and December 31, 2009.

	September 30, 2010		December 31, 2009	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Less Than 12 Months				
U.S. government agencies and corporations	$ -	$ -	$ 2,995,629	$ 11,167
Mortgage-backed securities	-	-	58,132,671	1,192,307
Municipals	-	-	27,850,269	688,885
	-	-	88,978,569	1,892,359
12 Months or More				
Municipals	2,389,983	98,865	4,314,797	334,441

Other	40,625	159,375	67,515	151,235
	2,430,608	258,240	4,382,312	485,676
Total securities available-for-sale	$ 2,430,608	$ 258,240	$ 93,360,881	$ 2,378,035

At September 30, 2010, securities classified as available-for-sale are recorded at fair market value. All of the unrealized losses at September 30, 2010, consisted of five individual securities that had been in a continuous loss position for twelve months or more. The Company believes that the deterioration in value is attributable to changes in market interest rates and not in credit quality and considers these losses temporary. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized costs. Management evaluates investment securities in a loss position based on length of impairment, severity of impairment and other factors.

An impairment loss of $18,750 was recognized during the nine months ended September 30, 2010. Management determined that the Company's investment in Beach First National Bancshares, Inc. was worthless, since that Company's bank subsidiary was taken into receivership by the Federal Deposit Insurance Corporation in April 2010.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 – Investment Securities – (continued)

During the first nine months of 2010 and 2009, gross proceeds from the sale of available-for-sale securities were $40,631,817 and $103,217,000, respectively. Gains on available-for-sale securities totaled $803,398 and $1,875,486 for the first nine months of 2010 and 2009, respectively.

Note 6 – Shareholders' Equity

On April 9, 2010, the Company issued 340,145 shares of its common stock at $4.50 per share and 2,293 shares of its newly created Series C Preferred Stock at $1,000 per share. The gross proceeds from the issuance and sale of these securities was $3,823,653. Of the shares issued, 119,179 shares of common stock and 335 shares of Series C Preferred Stock were issued to related parties.

Common Stock – The following is a summary of the changes in common shares outstanding for the nine months ended September 30, 2010 and 2009.

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Common shares outstanding at beginning of the period	3,582,691	3,525,004
Issuance of common stock	340,145	-
Issuance of restricted shares	191,043	62,222
Forfeitures of restricted shares	(633)	(5,643)
Issuance of stock to employees	293	200
Common shares outstanding at end of the period	4,113,539	3,581,783

Preferred Stock - The Company's Articles of Incorporation authorizes the issuance of a class of 10,000,000 shares of preferred stock, having no par value. Subject to certain conditions, the amendment authorizes the Company's Board of Directors to issue preferred stock without shareholders' approval. Under the Articles of Incorporation, the Board is authorized to determine the terms of one or more series of preferred stock, including the preferences, rights, and limitations of each series.

On March 6, 2009, the Company completed a transaction with the United States Treasury (the "Treasury") under the Troubled Asset Relief Program Capital Purchase Program ("TARP CPP"), which was amended by the enactment of the American Recovery and Reinvestment Act of 2009 on February 17, 2009. Under the TARP CPP, the Company sold 15,349 shares of its Series A Cumulative Perpetual Preferred Stock. In addition, the Treasury received a warrant to purchase 767 shares of the Company's Series B Cumulative Perpetual Preferred Stock, which was immediately exercised by the Treasury for a nominal exercise price. The preferred shares issued to the Treasury qualify as tier 1 capital for regulatory purposes.

The Series A Preferred Stock is a senior cumulative perpetual preferred stock that has a liquidation preference of $1,000 per share, pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. Dividends are payable quarterly. At any time, the Company may, at its option and with regulatory approval, redeem the Series A Preferred Stock at par value plus accrued and unpaid dividends. The Series A Preferred Stock is generally non-voting. Prior to March 6, 2012, unless the Company has redeemed the Series A Preferred Stock or the Treasury has transferred the Series A Preferred Stock to a third party, the consent of the Treasury will be required for the Company to increase its common stock dividend or repurchase its common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practices and certain other circumstances. A consequence of the Series A Preferred Stock purchase includes certain restrictions on executive compensation that could limit the tax deductibility of compensation the Company pays to executive management.

The Series B Preferred Stock is a cumulative perpetual preferred stock that has the same rights, preferences, privileges, voting rights and other terms as the Series A Preferred Stock, except that dividends will be paid at the rate of 9% per year and may not be redeemed until all the Series A Preferred Stock has been redeemed.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 6 – Shareholders' Equity – (continued)

The Series C Preferred Stock consists of 7% cumulative mandatory convertible preferred stock, which will be convertible into common shares for up to three years at the lesser of $6.50 per share or tangible common equity per share as of the calendar quarter ending on or before the conversion date and will mandatorily and automatically convert on July 31, 2013 under the same terms. Dividends are payable quarterly on March 1, June 1, September 1, and December 1 of each year. The Series C Preferred Stock ranks on par with the Company's Series A and Series B Preferred Stock and senior to the common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution, and winding up of the Company. The Series C Preferred Stock is non-voting, except as required by law.

The proceeds from the issuance of the Series A and Series B were allocated based on the relative fair value of each series based on a discounted cash flow model. As a result of the valuations, $14,492,526 and $856,474 was allocated to the Series A Preferred Stock and Series B Preferred Stock, respectively. This resulted in a discount of $973,260 for the Series A stock and a premium of $82,572 for the Series B stock. The discount and premium are being accreted and amortized, respectively, through retained earnings over a five-year estimated life using the effective interest method.

The following is a summary of the accretion of the Series A discount and the amortization of the Series B premium for the nine months and three months ended September 30, 2010 and 2009.

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Accretion of Series A preferred stock discount	$ 145,508	$ 111,399	$ 49,036	$ 49,036
Amortization of Series B preferred stock premium	(12,345)	(9,451)	(4,160)	(4,160)
Accretion net of amortization	$ 133,163	$ 101,948	$ 44,876	$ 44,876

The net amount of the accretion and amortization was treated as a deemed dividend to preferred shareholders in the computation of loss per share.

Note 7 – Net Loss Per Share

Net loss available to common shareholders represents net loss adjusted for preferred dividends including dividends declared, accretions of discounts and amortization of premiums on preferred stock issuances and cumulative dividends related to the current dividend period that have not been declared as of period end.

The following is a summary of the loss per share calculations for the nine months and three months ended September 30, 2010 and 2009.

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Net Loss available to common shareholders				

Net loss	$ (259,601)	$ (1,471,821)	$ (310,582)	$ (331,072)
Preferred stock dividends	704,048	478,971	249,247	210,839
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	133,163	101,948	44,876	44,876
Net loss available to common shareholders	$ (1,096,812)	$ (2,052,740)	$ (604,705)	$ (586,787)
Basic Net loss per share:				
Net loss available to common shareholders	$ (1,096,812)	$ (2,052,740)	$ (604,705)	$ (586,787)
Average common shares outstanding – basic	3,878,476	3,559,592	4,110,007	3,585,572
Basic net loss per share	$ (0.28)	$ (0.58)	$ (0.15)	$ (0.16)

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 7 – Net Loss Per Share – (continued)

Diluted Net loss per share:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Net loss available to common shareholders	$ (1,096,812)	$ (2,052,740)	$ (604,705)	$ (586,787)
Average common shares outstanding – basic	3,878,476	3,559,592	4,110,007	3,585,572
Dilutive potential common shares	-	-	-	-
Average common shares outstanding – diluted	3,878,476	3,559,592	4,110,007	3,585,572
Diluted net loss per share	$ (0.28)	$ (0.58)	$ (0.15)	$ (0.16)

Due to the net loss, common shares equivalents were not included in loss per share calculations as their effect would be anti-dilutive.

Note 8 - Equity Incentive Plan

On January 19, 2006, the Company adopted the 2006 Equity Incentive Plan, which provides for the granting of dividend equivalent rights options, performance unit awards, phantom shares, stock appreciation rights and stock awards, each of which shall be subject to such conditions based upon continued employment, passage of time or satisfaction of performance criteria or other criteria as permitted by the plan. The plan, as amended on September 17, 2010, allows granting up to 950,000 shares of stock, to officers, employees, and directors, consultants and service providers of the Company or its affiliates. Awards may be granted for a term of up to ten years from the effective date of grant. Under this Plan, our Board of Directors has sole discretion as to the exercise date of any awards granted. The per-share exercise price of incentive stock awards may not be less than the market value of a share of common stock on the date the award is granted. Any awards that expire unexercised or are canceled become available for re-issuance.

The Company can issue the restricted shares as of the grant date either by the issuance of share certificate(s) evidencing restricted shares or by documenting the issuance in uncertificated or book entry form on the Company's stock records. Except as provided by the Plan, the employee does not have the right to make or permit to exist any transfer or hypothecation of any restricted shares. When restricted shares vest the employee must either pay the Company within two business days the amount of all tax withholding obligations imposed on the Company or make an election pursuant to Section 83(b) of the Internal Revenue Code to pay taxes at grant date.

Restricted shares may be subject to one or more objective employment, performance or other forfeiture conditions as established by the Plan Committee at the time of grant. Any shares of restricted stock that are forfeited will again become available for issuance under the Plan. An employee or director has the right to vote the shares of restricted stock after grant until they are forfeited or vested. Compensation cost for restricted stock is equal to the market value of the shares at the date of the award and is amortized to compensation expense over the vesting period. Dividends, if any, will be paid on awarded but unvested stock.

During the nine months ended September 30, 2010 and 2009 the Company issued 191,043 and 62,222 shares, respectively, of restricted stock pursuant to the 2006 Equity Incentive Plan. The shares cliff vest in three years and are fully vested in 2012 and 2011, respectively. The weighted-average fair value of restricted stock issued during the nine months ended September 30, 2010 and 2009 was $3.99 and $2.25 per share, respectively. The aggregate compensation cost associated with the issuance for 2010 and 2009 was $762,302 and $139,999, respectively and is being amortized over the life of the service of the recipients. There were 633 and 5,643 shares of restricted stock that were forfeited during the first nine months of 2010 and 2009 at a weighted-average fair value of $11.88 and $13.07 per share, respectively. Deferred compensation expense of $188,794 and $118,039, relating to restricted stock, was amortized to income during nine months ended September 30, 2010 and 2009, respectively.

The 2006 Equity Incentive Plan allows for the issuance of Stock Appreciation Rights ("SARs"). The SARs entitle the participant to receive the excess of (1) the market value of a specified or determinable number of shares of the stock at the exercise date over the fair value at grant date or (2) a specified or determinable price which may not in any event be less than the fair market value of the stock at the time of the award. Upon exercise, the Company can elect to settle the awards using either Company stock or cash. The shares start vesting after five years and vest at 20% per year until fully vested. Compensation cost for SARs is amortized to compensation expense over the vesting period.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 8 - Equity Incentive Plan – (continued)

The SARs compensation expense for both the nine months ended September 30, 2010 and 2009 was $55,681.

A summary of the status of the Company's SARs as of September 30, 2010 and 2009 and changes during the period then ended is presented below.

	2010		2009	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	89,293	$ 14.95	93,981	$ 14.95
Forfeited	(4,959)	14.95	(4,688)	14.95
Outstanding at end of period	84,334	$ 14.95	89,283	$ 14.95

Note 9 – Stock-Based Compensation

The Company terminated its 2003 Employee Stock Option Plan and replaced it with the 2006 Equity Incentive Plan. No stock options have been granted since 2005 and none were exercised during 2010 or 2009. The 206,547 options outstanding at December 31, 2009 were forfeited during the nine months ended September 30, 2010.

Note 10 – Fair Value Measurements

The current accounting literature requires the disclosure of fair value information for financial instruments, whether or not they are recognized in the consolidated balance sheets, when it is practical to estimate the fair value. The guidance defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash, or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment, accrued interest receivable and payable, and other assets and liabilities.

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts, which could be realized, in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair values presented.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks and Interest-bearing Deposits with Other Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Time Deposits in other Banks - The carrying amount is a reasonable estimate of fair value.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

Securities Available-for-Sale - Investment securities available-for-sale 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, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable – For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk, fair values are based on the carrying amounts. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. However, from time to time, a loan is considered impaired and an allowance for loan losses 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. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2010, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan 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 Company records the impaired loan as nonrecurring Level 3.

Other Real Estate Owned - 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 Company 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 Company records the OREO as nonrecurring Level 3.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company's current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures - The carrying value of the junior subordinated debentures approximates their fair value since they were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance Sheet Financial Instruments - Fair values of 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 counterparties' credit standing.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

The carrying values and estimated fair values of the Company's financial instruments were as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 2,729,387	$ 2,729,387	$ 2,942,295	$ 2,942,295
Interest-bearing deposits with other banks	57,715,023	57,715,023	50,356,191	50,356,191
Time deposits in other banks	100,000	100,000	502,089	502,089
Securities available-for-sale	90,403,646	90,403,646	121,948,744	121,948,744
Nonmarketable equity securities	4,525,300	4,525,300	4,812,100	4,812,100
Loans, including loans held for sale	367,613,025	367,179,000	411,728,010	410,265,000
Accrued interest receivable	2,347,994	2,347,994	2,661,030	2,661,030
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	$ 193,648,659	$ 193,648,659	$ 195,636,648	$ 195,636,648
Certificates of deposit	294,567,116	294,427,000	357,126,331	352,318,000
Securities sold under agreements				