Oak Ridge Financial Services, Inc.
Form 10-Q
November 13, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

Commission File Number: 000-52640

OAK RIDGE FINANCIAL SERVICES, INC

(Exact name of registrant as specified in its charter)

North Carolina	**20-8550086**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**

Post Office Box 2

2211 Oak Ridge Road

Oak Ridge, North Carolina 27310

(Address of principal executive offices)

(336) 644-9944

(Registrant s telephone number, including area code)

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 x 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	¨	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

The number of shares outstanding of each of the registrant s classes of common stock, as of November 12, 2009, was as follows:

Class	Number of Shares
Common Stock, no par value	**1,791,474**

Oak Ridge Financial Services, Inc.

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This form contains certain forward-looking statements with respect to the financial condition, results of operations and business of the Company. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on the information available to management at the time that these disclosures were prepared. These statements can be identified by the use of words like expect, anticipate, estimate and believe, variations of these words and other similar expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, (1) competition in the Company s markets, (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environment and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in the Company s other filings with the Securities Exchange Commission. The Company undertakes no obligation to update any forward-looking statements.

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Item 1. Financial Statements

Consolidated Balance Sheets

September 30, 2009 and December 31, 2008

(Dollars in thousands)

	2009 (Unaudited)	2008 (Audited)
Assets		
Cash and due from banks	$ 3,276	$ 3,988
Interest-bearing deposits with banks	3,655	2,314
Total cash and cash equivalents	6,931	6,302
Federal funds sold		3,282
Securities available-for-sale	55,028	35,594
Securities held-to-maturity (fair values of $9,924 and $12,781 in 2009 and 2008, respectively)	10,830	13,155
Federal Home Loan Bank Stock, at cost	1,342	1,462
Loans, net of allowance for loan losses of $3,315 in 2009 and $2,450 in 2008	246,384	243,031
Property and equipment, net	10,892	8,926
Foreclosed assets	1,295	1,508
Accrued interest receivable	1,526	1,297
Bank owned life insurance	4,579	4,431
Other assets	875	1,684
Total assets	$ 339,682	$ 320,672
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 20,469	$ 18,181
Interest-bearing	264,644	252,423
Total deposits	285,113	270,604
Short-term debt	2,000	7,000
Long-term debt	15,000	15,000
Junior subordinated notes related to trust preferred securities	8,248	8,248
Accrued interest payable	408	502
Other liabilities	1,255	1,123
Total liabilities	312,024	302,477
Commitments and contingencies		
Stockholders equity		
Preferred stock, Series A	7,059	

Common stock, no par value; 50,000,000 shares authorized; 1,791,474 issued and outstanding in 2009 and 2008	15,831	15,831
Warrants	811	
Retained earnings	2,582	2,470
Accumulated other comprehensive income (loss)	1,375	(106)
Total stockholders equity	27,658	18,195
Total liabilities and stockholders equity	$ 339,682	$ 320,672

See Notes to Consolidated Financial Statements

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Consolidated Statements of Operations (Unaudited)

For the three and nine months ended September 30, 2009 and 2008

(Dollars in thousands except per share data)

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Interest and dividend income				
Loans and fees on loans	$ 3,825	$ 3,920	$ 11,447	$ 11,793
Federal funds sold		27	1	136
Interest on deposits in banks	16	27	44	98
Federal Home Loan Bank stock dividends	3	10	3	48
Taxable investment securities	1,130	473	3,219	1,283
Total interest and dividend income	4,974	4,457	14,714	13,358
Interest expense				
Deposits	1,637	1,930	5,598	6,146
Federal Funds purchased		2		2
Short-term and long-term debt	122	249	422	799
Total interest expense	1,759	2,181	6,020	6,947
Net interest income	3,215	2,276	8,694	6,411
Provision for loan losses	877	74	1,546	337
Net interest income after provision for loan losses	2,338	2,202	7,148	6,074
Noninterest income				
Service charges on deposit accounts	237	222	645	575
Mortgage loan origination fees	102	98	403	330
Investment and insurance commissions	159	237	495	687
Fee income from accounts receivable financing	186	209	541	561
Income earned on bank owned life insurance	51	41	148	121
Other service charges and fees	115	91	312	275
Total noninterest income	850	898	2,544	2,549
Noninterest expense				
Salaries and employee benefits	1,474	1,339	4,258	3,885
Occupancy expense	209	171	574	434
Equipment expense	216	158	560	438
Data and item processing	162	122	462	334
Professional and advertising	350	259	964	850
Stationary and supplies	52	48	188	192
Other real estate expenses and write-downs	12		314	

Telecommunications expense	77	55	218	194
FDIC Assessment	110	67	402	179
Accounts receivable financing expense	56	66	165	210
Total other-than-temporary impairment loss	21		126	
Other expense	240	216	726	616
Total noninterest expense	2,979	2,501	8,957	7,332
Income before income taxes	209	599	735	1,291
Income tax expense	50	224	234	471
Net income	159	375	501	820
Preferred stock dividends	98		259	
Accretion of discount	68		178	
Income (loss) available to common stockholders	$ (7)	$ 375	$ 64	$ 820
Basic earnings per weighted average common share	$ 0.00	$ 0.21	$ 0.04	$ 0.46
Diluted earnings per weighted average common share	$ 0.00	$ 0.21	$ 0.04	$ 0.45
Basic weighted average common shares outstanding	1,791,474	1,791,474	1,791,474	1,791,474
Diluted weighted average common shares outstanding	1,791,474	1,791,474	1,791,474	1,809,404

See Notes to Consolidated Financial Statements

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Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income (Unaudited)

Nine months ended September 30, 2009 and 2008 (Unaudited)

(In thousands except shares of common stock)

	Preferred stock, Series A	Common Stock Number	Common Stock Amount	Common stock warrant	Retained earnings	Accumulated other comprehensive income	Comprehensive income	Total
Balance December 31, 2007	$	1,791,474	$ 15,831	$	$ 1,590	$ 263		$ 17,684
Unrealized loss, net of income tax benefit of $29						(51)	$ (51)	(51)
Net income					820		820	820
Total comprehensive income							$ 769	
Cumulative effect of a change in accounting principle					(259)			(259)
Balance September 30, 2008	$	1,791,474	$ 15,831	$	$ 2,151	$ 212		$ 18,194
Balance December 31, 2008	$	1,791,474	$ 15,831	$	$ 2,470	$ (106)		$ 18,195
Unrealized loss, net of income tax expense of $693						1,481	$ 1,481	1,481
Net income					501		501	501
Total comprehensive income							$ 1,982	
Issuance of preferred stock in connection with Capital Purchase Program, net of discount on preferred stock	6,888							6,888
Preferred stock dividends					(209)			(209)
Issuance of common stock warrant in connection with Capital Purchase Program				812				812
Costs associated with issuance of preferred stock and common warrants	(9)			(1)				(10)
Preferred stock accretion	178				(178)			
Balance September 30, 2009	$ 7,057	1,791,474	$ 15,831	$ 811	$ 2,584	$ 1,375		$ 27,658

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

Nine months ended September 30, 2009 and 2008 (Unaudited)

(Dollars in thousands)

	2009	2008
Cash flows from operating activities		
Net income	$ 501	$ 820
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	583	455
Provision for loan losses	1,546	337
Impairment on held-to-maturity security	125	
Income earned on bank owned life insurance	(148)	(121)
Deferred income tax benefit	(58)	(63)
Loss from sale of foreclosed assets	7	
Income taxes payable	(70)	(479)
Net (accretion) amortization of discounts and premiums on securities	(692)	(160)
Changes in assets and liabilities:		
Accrued interest receivable	(229)	(82)
Other assets	809	(219)
Accrued interest payable	(94)	(55)
Other liabilities	202	161
Net cash provided by operating activities	2,482	594
Cash flows from investing activities		
Net decrease in federal funds sold	3,282	458
Activity in available-for-sale securities:		
Purchases	(25,996)	(16,861)
Sales		
Maturities and repayments	9,564	5,175
Activity in held-to-maturity securities:		
Purchases		(14,370)
Maturities and repayments	2,300	877
Redemptions (purchases) of Federal Home Loan Bank stock	120	(368)
Net increase in loans	(5,586)	(25,873)
Purchases of property and equipment	(2,549)	(1,957)
Proceeds from sale of other real estate owned	11	
Net cash used in investing activities	(18,854)	(52,919)
Cash flows from financing activities		
Net increase in deposits	14,509	41,125
Proceeds from issuance of preferred stock and warrant	7,700	
Proceeds from issuance of debt	2,000	13,000
Repayment of borrowings	(7,000)	(7,000)
Dividends paid on preferred stock	(208)	

Net cash provided by financing activities	17,001	47,125
Net increase (decrease) in cash and cash equivalents	629	(5,200)
Cash and cash equivalents, beginning	6,302	10,108
Cash and cash equivalents, ending	$ 6,931	$ 4,908

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

Nine months ended September 30, 2009 and 2008 (Unaudited)

(Dollars in thousands)

	2009	2008
Supplemental disclosure of cash flow information		
Cash paid for:		
Interest	$ 6,113	$ 7,002
Taxes	$ 154	$ 885
Non-cash investing and financing activities		
Other real estate acquired in settlement of loans	$ 806	$ 92

See Notes to Consolidated Financial Statements

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Notes to Unaudited Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

The results presented here are for Oak Ridge Financial Services, Inc. (the Company), the parent company of Bank of Oak Ridge (the Bank). In 2006, the Bank s Board of Directors and shareholders approved the formation of a bank holding company, of which the Bank would become a wholly owned subsidiary. The reorganization was effected through a share exchange in which each of the Bank s shareholders received one share of common stock of the Company in exchange for each of his or her shares of the Bank s common stock. The Company became the Bank s parent holding company in April of 2007. Because the Company has no separate operations and conducts no business on its own other than owning the Bank, this discussion concerns primarily the business of the Bank. However, because the financial statements are presented on a consolidated basis, the Company and the Bank are collectively referred to as the Company unless otherwise noted.

The Bank was organized and incorporated under the laws of the State of North Carolina and commenced operations on April 10, 2000. Including its main office, the Bank operates five (5) full service branch offices in Oak Ridge, Summerfield, and Greensboro, North Carolina. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the North Carolina Commissioner of Banks (the Commissioner) and the Federal Deposit Insurance Corporation (the FDIC). The Bank has formed an investment subsidiary, Oak Ridge Financial Corporation, that has not been funded and is inactive.

The Company formed Oak Ridge Statutory Trust I (the Trust) during 2007 to facilitate the issuance of trust preferred securities. The Trust is a statutory business trust formed under the laws of the state of Connecticut, of which all common securities are owned by the Company. Under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), Topic 810, Consolidation*,* Oak Ridge Financial Statutory Trust I is not included in the Company s consolidated financial statements. The Company s equity interests for junior subordinated debentures issued by the Company to the Trust are included in other assets.

The accounting and reporting policies of the Company follow generally accepted accounting principles and general practices within the financial services industry. In management s opinion, the financial information, which is unaudited, reflects all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial information as of and for the three- and nine-month periods ended September 30, 2009 and 2008, in conformity with accounting principles generally accepted in the United States of America (GAAP).

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the financial statements, as well as the amounts of income and expense during the reporting period. Actual results could differ from those estimates. Operating results for the three- and nine-month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2009.

The balance sheet as of December 31, 2008 has been derived from audited financial statements. The unaudited financial statements of the Company have been prepared in accordance with instructions from Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation have been included.

The organization and business of the Company, accounting policies followed by the Company and other relevant information are contained in the notes to the financial statements filed as part of the Company s Annual Report on Form 10-K for the year ended December 31, 2008 (the Annual Report). This quarterly report should be read in conjunction with the Annual Report.

Certain reclassifications have been made to the prior period s financial statements to place them on a comparable basis with the current year. Net income and stockholders equity previously reported were not affected by these reclassifications.

Basis of Presentation

The accompanying consolidated financial statements include the accounts and transactions of the Company and the Bank, its wholly owned subsidiary. All significant intercompany transactions and balances have been eliminated in consolidation.

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 1. Organization and Summary of Significant Accounting Policies, continued

Reclassification

Certain reclassifications have been made to the prior period s financial statements to place them on a comparable basis with the current year. Net income and stockholders equity previously reported were not affected by these reclassifications.

Subsequent Events

In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through November 13, 2009, the date the financial statements were issued.

Note 2. Earnings Per Share

Basic Earnings per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

Diluted Earnings per Share

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

Stock options outstanding of 347,483 shares and the warrant issued to the U.S. Treasury Department covering 159,830 shares were not included in the computation of diluted earnings per share because their exercise price exceeded the average market price of the Company s exercise price for the respective periods ending September 30, 2009. For the nine-months ended September 30, 2008, 17,930 potential common shares were included in the computation of diluted earnings per share.

Note 3. Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	September 30, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available-for-Sale				
Government-sponsored enterprise securities	$ 2,891	$ 186	$	$ 3,077
FNMA mortgage-backed securities	9,918	620		10,538

Private label mortgage-backed securities	29,505	1,349	(61)	30,793
SBIC or SBA debentures	9,976	156	(12)	10,120
Other domestic debt securities	500			500
Total securities available-for-sale	$ 52,790	$ 2,311	$ (73)	$ 55,028
Held-to-Maturity				
Private label mortgage-backed securities	10,830	16	(922)	9,924
Total securities held-to-maturity	$ 10,830	$ 16	$ (922)	$ 9,924

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 3. Securities, continued

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available-for-Sale				
Government-sponsored enterprise securities	$ 2,045	$ 108	$	$ 2,153
FNMA mortgage-backed securities	10,903	544		11,447
Private label mortgage-backed securities	22,319	77	(902)	21,494
Other domestic debt securities	500			500
Total securities available-for-sale	$ 35,767	$ 729	$ (902)	$ 35,594
Held-to-Maturity				
Private label mortgage-backed securities	13,155	26	(400)	12,781
Total securities held-to-maturity	$ 13,155	$ 26	$ (400)	$ 12,781

The Bank had $1,342,000 and $1,462,000 at September 30, 2009 and December 31, 2008, respectively, of investments in stock of the Federal Home Loan Bank of Atlanta (FHLB), which is carried at cost. The FHLB requires financial institutions to make equity investments in the FHLB in order to borrow money. The Bank is required to hold that stock so long as it borrows from the FHLB.

Investment securities with amortized costs of $10,247,000 and $6,801,000 at September 30, 2009 and December 31, 2008, respectively, were pledged as collateral on public deposits or for other purposes as required or permitted by law.

There were no gross realized gains and losses for the nine or three months ended September 30, 2009 or 2008.

The following tables detail unrealized losses and related fair values in the Company s held-to-maturity and available-for-sale investment securities portfolios at September 30, 2009 and December 31, 2008. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2009 and December 31, 2008.

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
September 30, 2009						
Available-for-sale						
Private label mortgage-backed securities	$ 2,904	$ 61	$	$	$ 2,904	$ 61

SBIC or SBA debentures	1,787		13					1,787		13
Total temporarily impaired securities	$ 4,691	$	73	$		$		$ 4,691	$	73
Held-to-maturity										
Private label mortgage-backed securities	$ 3,081	$	472	$	5,364	$	450	$ 8,445	$	922
Total temporarily impaired securities	$ 3,081	$	472	$	5,364	$	450	$ 8,445	$	922

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 3. Securities, continued

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
December 31, 2008						
Available-for-sale						
Private label mortgage-backed securities	$ 17,793	$ 902	$	$	$ 17,793	$ 902
Total temporarily impaired securities	$ 17,793	$ 902	$	$	$ 17,793	$ 902
Held-to-maturity						
Private label mortgage-backed securities	$ 10,727	$ 400	$	$	$ 10,727	$ 400
Total temporarily impaired securities	$ 10,727	$ 400	$	$	$ 10,727	$ 400

Management considers the nature of the investment, the underlying causes of the decline in market value, the severity and duration of the decline in market value and other evidence, on a security by security basis, in determining if the decline in market value is other than temporary. Management believes all unrealized losses presented in the table above to be temporary in nature.

There were no debt securities that had been in a continuous unrealized loss position for more than twelve months at September 30, 2009. In analyzing an issuer s or a securities financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary, with the exception of one held-to-maturity security where, at the present time, the collection of all principal is not likely. As a result, the Company recognized impairment losses of $25,000 and $126,000 for the three and nine months, respectively, ended September 30, 2009 that are reflected in the Consolidated Statements of Operations.

Maturities of mortgage-backed securities are presented based on contractual amounts. Actual maturities will vary as the underlying loans prepay. The scheduled maturities of securities at September 30, 2009 were as follows:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in thousands)			
Due in one year or less	$	$	$	$
Due after one year through five years	987	1,085		
Due after five years through ten years	16,203	16,821		
Due after ten years	35,600	37,122	10,830	9,924

	$ 52,790	$ 55,028	$ 10,830	$ 9,924

Note 4. Critical Accounting Policies

The Company s financial statements are prepared in accordance with GAAP. The notes to the audited financial statements included in the Annual Report contain a summary of its significant accounting policies. Management believes the Company s policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments, such as the recoverability of intangible assets, involve a higher degree of complexity and require management to make difficult and subjective judgments that often require assumptions or estimates about highly uncertain matters. Accordingly, the Company considers the policies related to those areas as critical.

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

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

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 4. Critical Accounting Policies, continued

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on the historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

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

Note 5. Stock-based Compensation

The Company has adopted both the *Employee Stock Option Plan* (Incentive Plan) and the *Director Stock Option Plan* (Nonstatutory Plan), and together with the Incentive Plan, each a Plan and collectively the Plan . Under each Plan up to 178,937 shares may be issued for a total of 357,874 shares. Options granted under both Plans expire no more than 10 years from date of grant. The option exercise price under both Plans shall be set by a committee of the Board of Directors (the Committee) at the date of the grant, but shall not be less than 100 percent of fair market value at the date of the grant. Options granted under either Plan vest according to the terms of each particular grant.

Activity under the Plans during the nine months ended September 30, 2009 is summarized below:

	Incentive Plan		Nonstatutory Plan	
	Available For Grant	Granted	Available For Grant	Granted
Balance, December 31, 2008	6,163	170,674	3	178,934
Forfeited	2,125	(2,125)		
Balance, September 30, 2009	8,288	168,549	3	178,934

There were no options exercised during the nine months ended September 30, 2009 and 2008.

A stock option may be exercised, in whole or in part, by giving written notice of exercise to the Corporate Secretary of the Company, or such other officer of the Company as the Committee shall designate, specifying the number of shares to be purchased along with payment in full of the exercise price. The Committee may, in the relevant award agreement, also permit a participant (either on a selective or group basis) to simultaneously exercise stock options and sell the shares of common stock thereby acquired, and use the proceeds from such sale as payment of the exercise price of such stock options. Payment instruments shall be received by the Company subject to collection. The proceeds received by the Company upon exercise of any stock option may be used by the Company for general corporate purposes.

There were no options granted in the nine months ended September 30, 2009.

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 5. Stock-based Compensation, continued

Information regarding the stock options outstanding at September 30, 2009 is as follows (dollars in thousands):

Range of Exercise Prices	Number Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Aggregate Intrinsic Value
$8.80-9.99	101,513	1.58 Years	$ 8.80	$
$10.00-10.39	139,668	4.92 Years	$ 10.00	
$10.40-11.20	106,302	4.76 Years	$ 10.70	
	347,483	3.89 Years	$ 9.86	$

The weighted average exercise price for options outstanding at September 30, 2009 was $9.86. No compensation expense was recognized during the first nine months of 2008 and 2009 as all outstanding stock options had vested.

Note 6. Guaranteed Preferred Beneficial Interest in the Company s Junior Subordinated Debentures

The Trust was created by the Company on September 28, 2007, at which time the Trust issued $8.0 million in aggregate liquidation amount of $1 par value preferred capital trust securities that mature on September 28, 2037. Distributions are payable on the securities at the floating rate equal to the three-month London Interbank Offered Rate (LIBOR) plus 1.60%, and the securities may be prepaid at par by the Trust at any time after September 17, 2012. The principal assets of the Trust are $8.3 million of the Company s junior subordinated debentures which mature on September 17, 2037, and bear interest at the floating rate equal to the three month LIBOR plus 1.60%, and which are callable by the Company after September 28, 2012. All $248,000 in the aggregate liquidation amount of the Trust s common securities are held by the Company.

Note 7. Fair Value of Financial Instruments

Fair value estimates are made by management at a specific point in time, based on relevant information about the financial instrument and the market. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company s entire holdings of a particular financial instrument nor are potential taxes and other expenses that would be incurred in an actual sale considered. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. Beginning with the year ended December 31, 2008, fair value estimates are determined in accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC (ASC 820), formerly SFAS 157. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and/or the methodology used could significantly affect the estimates disclosed. Similarly, the fair values disclosed could vary significantly from amounts realized in actual transactions.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and due from banks: The carrying amounts reported in the balance sheet for cash and due from banks approximate their fair values.

Interest-bearing deposits with banks: Fair values for time deposits are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. Carrying values of interest-bearing deposits approximate their fair values.

Federal funds sold: The carrying amounts for Federal Home Loan Bank of Atlanta (FHLB) stock owned by the Bank approximate fair value.

Available-for-sale and held-to-maturity securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLB: The carrying amounts for FHLB Stock approximate fair value.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable. The carrying amount of accrued interest receivable approximates its fair value.

Bank owned life insurance: The carrying values of bank owned life insurance approximates the fair value.

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 7. Fair Value of Financial Instruments, continued

Deposit liabilities: The fair values disclosed for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date. The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.

Short-term debt: The carrying values of short-term debt approximate their fair values.

Long-term debt: The fair values of the Company s junior subordinated debentures are estimated using discounted cash flow analysis based on the Company s current incremental borrowing rates for similar types of borrowings.

Junior subordinated debentures: The fair values of the Company s long-term debt are estimated using discounted cash flow analysis based on the Company s current incremental borrowing rates for similar types of borrowings.

The following table presents the carrying values and estimated fair values of the Company s financial instruments at September 30, 2009 and December 31, 2008 (dollars in thousands):

	September 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 6,931	$ 6,931	$ 6,302	$ 6,302
Federal funds sold			3,282	3,282
Securities, available-for-sale	55,028	55,028	35,594	35,594
Securities, held-to-maturity	10,830	9,924	13,155	12,781
Federal Home Loan Bank stock	1,342	1,342	1,462	1,462
Net loans	246,384	261,673	243,031	266,338
Bank owned life insurance	4,528	4,528	4,431	4,431
Financial liabilities:				
Deposits	$ 285,113	$ 285,137	$ 270,604	$ 271,699
Short-term borrowings	2,000	2,000	7,000	7,000
Junior subordinated notes relating to trust preferred securities	8,248	8,248	8,248	8,248
Long-term debt	15,000	14,521	15,000	15,000

Fair Value Hierarchy

Under ASC 820 (formerly SFAS 157), the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

There were no changes to the techniques used to measure fair value during the period.

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 7. Fair Value of Financial Instruments, continued

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

Investment 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, mortgage-backed securities issued by non government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis. 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. Once a loan is identified as individually impaired, management measures impairment in accordance with the Receivables Topic of the FASB ASC (ASC 210), formerly SFAS 114. The fair value of impaired loans is estimated using one of several methods, including collateral value, market price 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, 2009, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC 820, 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.

Real Estate and Repossessions Acquired in Settlement of Loans

Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charged to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded 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 foreclosed asset as nonrecurring Level 3.

Assets and liabilities recorded at fair value on a recurring basis as of September 30, 2009

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Investment securities available-for-sale	$ 55,028	$	$ 54,528	$ 500
Total assets at fair value	$ 55,028	$	$ 54,528	$ 500
Total liabilities at fair value	$	$	$	$

Assets and liabilities recorded at fair value on a recurring basis as of December 31, 2008

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Investment securities available-for-sale	$ 35,594	$ 4,113	$ 30,981	$ 500
Total assets at fair value	$ 35,594	$ 4,113	$ 30,981	$ 500
Total liabilities at fair value	$	$	$	$

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 7. Fair Value of Financial Instruments, continued

Assets and liabilities recorded at fair value on a nonrecurring basis as of September 30, 2009

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Impaired loans in accordance with ASC 310	$ 3,591	$	$	$ 3,591
Real estate and repossessions acquired in settlement of loans	1,295			1,295
Total assets at fair value	$ 4,886	$	$	$ 4,886
Total liabilities at fair value	$	$	$	$

Assets and liabilities recorded at fair value on a nonrecurring basis as of December 31, 2008

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Impaired loans in accordance with ASC 310	$ 2,932	$	$	$ 2,932
Real estate and repossessions acquired in settlement of loans	1,508			1,508
Total assets at fair value	$ 4,440	$	$	$ 4,440
Total liabilities at fair value	$	$	$	$

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2009.

Total Fair Value Measurements

Balance, December 31, 2008	$ 500
Total gains or losses (realized/unrealized):	
Included in earnings	
Included in other comprehensive loss	
Purchases, issuances, and settlements	
Transfers in to/out of Level 3	
Balance, September 30, 2009	$ 500

There were no unrealized net gains included in net income related to assets held as of September 30, 2009.

Note 8. U.S. Treasury s Troubled Asset Relief Program Capital Purchase Program

On January 30, 2009, the Company issued Series A Preferred Stock (the Preferred Stock) in the amount of $7,700,000 and a warrant to purchase 159,530 shares of common stock to the U.S. Treasury as a participant in the Troubled Asset Relief Program Capital Purchase Program. The Preferred Stock qualifies as Tier 1 capital for purposes of regulatory capital requirements and will pay cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. Prior to January 30, 2012, unless the Company has redeemed all of the Preferred Stock or the U.S. Treasury has transferred all of the Preferred Stock to a third party, the consent of the U.S. Treasury will be required to, among other things, declare or pay a common stock dividend or repurchase common stock except in limited circumstances. In addition, until the U.S. Treasury ceases to own the Preferred Stock sold under the Troubled Asset Relief Program Capital Purchase Program, the compensation arrangements for senior executive officers must comply in all respects with the U.S. Emergency Economic Stabilization Act of 2008 and the rules and regulations thereunder.

Note 9. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 168, The *FASB Accounting Standards Codification* ™ and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162, (SFAS 168). SFAS 168 establishes the *FASB Accounting Standards Codification*™ (Codification) as the source of authoritative generally accepted accounting principles (GAAP) for nongovernmental entities. The Codification does not change GAAP. Instead, it takes the thousands of individual pronouncements that currently comprise GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with FASB ASC, where ASC stands for *Accounting Standards Codification*. Changes to the ASC subsequent to June 30, 2009 are referred to as Accounting Standards Updates (ASU).

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 9. Recent Accounting Pronouncements, continued

In conjunction with the issuance of SFAS 168, the FASB also issued its first Accounting Standards Update No. 2009-1, Topic 105 Generally Accepted Accounting Principles (ASU 2009-1) which includes SFAS 168 in its entirety as a transition to the ASC. ASU 2009-1 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Company s financial position or results of operations but will change the referencing system for accounting standards. Certain of the following pronouncements were issued prior to the issuance of the ASC and adoption of the ASUs. For such pronouncements, citations to the applicable Codification by Topic, Subtopic and Section are provided where applicable in addition to the original standard type and number.

In December 2008 the FASB issued FASB Staff Position (FSP) SFAS 132(R)-1 (FASB ASC 715-20-65), Employers Disclosures about Postretirement Benefit Plan Assets, (FSP SFAS 132(R)-1). This FSP provides guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. The objective of the FSP is to provide the users of financial statements with an understanding of: (a) how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies; (b) the major categories of plan assets; (c) the inputs and valuation techniques used to measure the fair value of plan assets; (d) the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period; and (e) significant concentrations of risk within plan assets. The FSP also requires a nonpublic entity, as defined in Statement of Financial Accounting Standard (SFAS) 132, to disclose net periodic benefit cost for each period for which a statement of income is presented. FSP SFAS 132(R)-1 is effective for fiscal years ending after December 15, 2009. The Staff Position will require the Company to provide additional disclosures related to its benefit plan.

The FASB issued SFAS 166 (not yet reflected in FASB ASC), Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140, (SFAS 166) in June 2009. SFAS 166 limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire financial asset by taking into consideration the transferor s continuing involvement. The standard requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor s beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The concept of a qualifying special-purpose entity is removed from SFAS 140 along with the exception from applying FIN 46(R). The standard is effective for the first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the standard to have any impact on the Company s financial statements.

SFAS 167 (not yet reflected in FASB ASC), Amendments to FASB Interpretation No. 46(R), (SFAS 167) was also issued in June 2009. The standard amends FIN 46(R) to require a company to analyze whether its interest in a variable interest entity (VIE) gives it a controlling financial interest. A company must assess whether it has an implicit financial responsibility to ensure that the VIE operates as designed when determining whether it has the power to direct the activities of the VIE that significantly impact its economic performance. Ongoing reassessments of whether a company is the primary beneficiary is also required by the standard. SFAS 167 amends the criteria to qualify as a primary beneficiary as well as how to determine the existence of a VIE. The standard also eliminates certain exceptions that were available under FIN 46(R). SFAS 167 is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Comparative disclosures will be required for periods after the effective date. The Company does not expect the standard to have any impact on the Company s financial position.

The FASB issued ASU 2009 05, Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value in August, 2009 to provide guidance when estimating the fair value of a liability. When a quoted price in an active market for the identical liability is not available, fair value should be measured using (a) the quoted price of an identical liability when traded as an asset; (b) quoted prices for similar liabilities or similar liabilities when traded as assets; or (c) another valuation technique consistent with the principles of Topic 820 such as an income approach or a market approach. If a restriction exists that prevents the transfer of the liability, a separate adjustment related to the restriction is not required when estimating fair value. The ASU was effective October 1, 2009 for the Company and will have no impact on financial position or operations.

ASU 2009-12, Fair Value Measurements and Disclosures (Topic 820) Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), issued in September, 2009, allows a company to measure the fair value of an investment that has no readily determinable fair market value on the basis of the investee s net asset value per share as provided by the investee. This allowance assumes that the investee has calculated net asset value in accordance with the GAAP measurement principles of Topic 946 as of the reporting entity s measurement date. Examples of such investments include investments in hedge funds, private equity funds, real estate funds and venture capital funds. The update also provides guidance on how the investment should be classified within the fair value hierarchy based on the value for which the investment can be redeemed. The amendment is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted. The Company does not have investments in such entities and, therefore, there will be no impact to our financial statements.

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Notes to Unaudited Consolidated Financial Statements (Continued)

Note 9. Recent Accounting Pronouncements, continued

Issued October, 2009, ASU 2009-15, Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing amends ASC Topic 470 and provides guidance for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity s own shares should be measured at fair value in accordance with Topic 820 and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Company has no plans to issue convertible debt and, therefore, does not expect the update to have an impact on its financial statements.

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

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

Management s discussion and analysis is intended to assist readers in understanding and evaluating our consolidated financial condition and results of operations. This discussion should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008.

We are a commercial bank holding company, incorporated in 2006. The accompanying consolidated financial statements include the accounts and transactions of Oak Ridge Financial Services, Inc. and its wholly owned subsidiary, Bank of Oak Ridge. All significant intercompany transactions and balances are eliminated in consolidation.

Bank of Oak Ridge (the Bank) was incorporated and began banking operations in 2000. The Bank is engaged in commercial banking predominantly in Guilford and Forsyth Counties, North Carolina. The Bank is operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation (FDIC) and the North Carolina Commissioner of Banks. The Bank s primary source of revenue is derived from loans to customers, who are predominantly individuals and small to medium size businesses in Guilford and Forsyth Counties.

Executive Summary

In the first nine months of 2009, with the growing impact of an economic slowdown, management has continued to focus on managing credit quality, building liquidity sources, managing capital, and improving operational earnings of the Company. As always, we continue our on-going efforts of meeting the financial services needs of our customers and communities, especially in this challenging economic environment.

Managing Credit Quality

Senior management continues to work closely with credit administration and our lending staff to insure that adequate resources are in place to proactively manage through the current slowdown in the real estate markets and overall economy. When problems are identified, management remains diligent in assessing the situation, moving quickly to minimize losses, while being sensitive to the borrower s effectiveness as an operator, the long-term viability of the business or project, and the borrower s commitment to working with the Bank to achieve an acceptable resolution of the credit. If the economic slowdown continues, we will most likely to continue to experience a rise in non-performing assets as we address each situation on a case-by-case basis. When faced with possible loss situations, management may determine it is in the shareholders best long-term interest to work with the borrower or oversee a viable project through to completion.

Despite North Carolina s resiliency during the current real estate downturn, we do anticipate that a prolonged economic slowdown will place significant pressure on the consumers and businesses in our state. Through our Community Investment Loan Program we have been able to move approximately 7 out of 20 jumbo homes and 4 out of 18 conforming homes out of our builder construction portfolio either to permanent mortgages placed with other lenders or permanent mortgages financed by our bank to qualified borrowers. We have extended this program to cover the residential lot inventory of our development borrowers. This program can be accessed through our website at http://www.bankofoakridge.com/112318.html.

Building Liquidity Sources

Management has continued to focus on providing additional liquidity sources, both on-balance sheet and off. During the nine months ended September 30, 2009, we reduced our borrowings with the FHLB from $22 million to $17 million by increasing noninterest and interest bearing deposits by approximately $14.5 million. This has increased our availability at the FHLB, and is available to meet certain unforeseen liquidity demands that may arise. We currently have securities with a market value of $4.2 million pledged to the FHLB, and have unpledged securities held in safekeeping at the FHLB with a market value of $55.3 million that could be pledged if needed. The Bank also has unused Federal Funds purchased lines of approximately $5.7 million with two correspondent banks. In addition, management has plans to continue to build off-balance sheet sources of liquidity. In the fourth quarter of 2009, the Bank intends to pledge commercial loans that qualify as loan collateral through the Federal Reserve Discount Window.

Managing Capital

The Company was able to bolster its capital levels through its $7.7 participation in the United States Treasury s Capital Purchase Program (CPP) in the fourth quarter of 2008. Of the total $7.7 million CPP funds received, $1.1 million of the CPP funds were contributed to the Bank as additional equity capital. The remaining funds, approximately $6.6 million, are retained by the Company

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but could be pushed down to the Bank if needed. With total risk-based capital levels at the Bank of 10.94% and 10.50% at September 30, 2009 and December 31, 2008, respectively, the Bank is above the minimum 10% requirement to be classified as well-capitalized. If the remaining $6.6 million of available capital at the Company were contributed to the Bank as additional equity capital, the Bank s total risk-based capital ration would be 13.29% and would place it well above the minimum well-capitalized requirement of 10%. Despite healthy capital levels, with significant uncertainty surrounding the depth or the length of the current economic slowdown, management continues to be diligent in its efforts to maintain healthy levels of excess capital above minimum requirements.

Improving Operational Earnings

Pretax, pre-loan loss provision, post-CPP dividend payment, earnings were $1.2 million for the third quarter of 2009, compared to $673,000 for the third quarter of 2008, an increase of approximately $511,000. Pretax, pre-loan loss provision, post-CPP dividend payment, earnings were $2.5 million for the first nine months of 2009, compared to $1.6 million for the first nine months of 2008, an increase of approximately $912,000.

During the fourth quarter of 2008, in anticipation of receiving the CPP funds, management began implementing a strategy to deploy these funds into private label mortgage-backed and government agency securities, well before mortgage rates in this sector began to decline due to aggressive purchases by the Federal Reserve, the U.S. Treasury, and other community banks seeking to leverage their new CPP funds. That strategy resulted in the Company purchasing $13.1 in private label mortgage-backed securities and government agency securities in the fourth quarter of 2008, and an additional $24.8 million of SBIC debentures, SBA debentures and private label mortgage-backed securities during the first six months of 2009. Although one private label security was determined to be impaired by management and resulted in a $126,000 write-down during the nine months ended September 30, 2009, the investment purchase strategy by management has resulted in an effective deployment of part of the CPP funds, and has positively offset the Company s CPP dividends and loan loss provisions in 2009.

Comparison of Results of Operations for the Three-Month Periods Ending September 30, 2009 and 2008

Net Income

For the three months ended September 30, 2009, the Company s net income decreased 58 percent to $159,000 compared to $375,000 for the same period in 2008. Net income available to common stockholders decreased to a loss of $7,000 in 2009 compared to income of $375,000 in 2008. The Company recorded net income per diluted share of $0.00 compared to $0.21 for the prior year period. Returns on average assets and average equity were 0.22 percent and 1.20 percent, respectively, for the three months ended September 30, 2009, compared to 0.51 percent and 8.48 percent for the three months ended September 30, 2008.

The decrease in net income was a result of increases in net interest income and a decline in income tax expense, offset by declines in noninterest income, and increases in the provision for loan losses, and noninterest expense. The decrease in net income available to common stockholders was a result of preferred stock dividends and accretion of discount during the three months ended September 30, 2009 of $166,000. There were no preferred stock dividends and accretion of discount in 2008.

Net Interest Income

Net interest income was $3.2 million for the three months ended September 30, 2009 compared to $2.3 million for the prior year. The 39 percent increase in net interest income was due both to growth in average earning assets and an increase in the net interest margin in 2009 compared to 2008.

Net interest margin is interest income earned on loans, securities, and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the three months ended September 30, 2009 was 3.95 percent compared to 3.27 percent for the prior year period. The average yield on earning assets for the three months ended September 30, 2009 was 6.02 percent compared to 6.52 percent for the prior year period, and the average cost of interest-bearing liabilities was 2.34 percent for the three months ended September 30, 2009 compared to 3.34 percent for the prior year period. The net interest margin has increased during the past year as interest-bearing liabilities have repriced downward faster than interest-earning assets.

Provision for Loan Losses

The provision for loan losses charged to operations during the three months ended September 30, 2009 was $877,000 compared to $74,000 recorded in the prior year period. The Bank had net charge-offs of $596,000 thousand for the quarter ended September 30, 2009 compared to net charge-offs of $36,000 during the third quarter of 2008. Net charge-offs increased mainly due to the Bank writing-down several large collateral dependent loans in addition to several loans that were deemed uncollectible and charged off. A large portion of these loans had previously been identified and reserved for in the allowance for loan loss earlier in 2009. Declining economic conditions resulted in an increased number of impaired collateral dependant loans. As a result the bank has been very proactive in recognizing the losses associated with these loans.

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We use the results of our allowance for loan loss model to estimate the dollar amount of provision expense needed to maintain the adequacy of our allowance for loan losses. Our management analyzes the adequacy of the allowance on a monthly basis and adjustments to the provision expense are made as necessary. Additional information regarding our allowance for loan losses is contained in this discussion under the caption Asset Quality.

Noninterest Income

Noninterest income totaled $850,000 for the three months ended September 30, 2009, down $48,000, or 5 percent, from $898,000 for the same period in 2008.

Service fees and charges, which represent a relatively stable and predictable source of noninterest income, totaled $237,000 for the three months ended September 30, 2009, a 7 percent increase over the $222,000 of service fees and charges earned for the same period in 2008.

Mortgage loan fee income in the third quarter of 2009 was negatively impacted by the failure of a mortgage correspondent lender used by the Bank, and was only up slightly despite a favorable low interest rate and more mortgage originators than in the prior year. The Bank moved quickly to secure new correspondent lending sources, but still lost potential mortgage income due to the transition. Mortgage loan fee income totaled $102,000 for the three months ended September 30, 2009, a 4 percent increase over the $98,000 of mortgage loan fee income earned for 2008.

The Bank s Investment Services Group, which services its banking offices, and the Oak Ridge Wealth Management division, which was formed in 2005 and operates independently of the Bank, comprise all of the investment and insurance commissions noninterest income category. Investment and insurance commissions totaled $159,000 for the three months ended September 30, 2009, a 33 percent decrease from the $237,000 earned in 2008. A large part of this decrease was due to a decline in fees tied to the market value of assets under management due to lower market prices in 2009 on most investments.

Fee income from accounts receivable financing totaled $186,000 for the three months ended September 30, 2009, an 11 percent decrease from the $209,000 earned in the same period in 2008. Fee income in this line of business was negatively impacted by lower client receivable balances in 2009 compared to 2008 due to the weak economic conditions.

Income earned on bank owned life insurance totaled $51,000 for the three months ended September 30, 2009, a 24 percent increase over the $41,000 earned in the same period in 2008. This increase was due to higher rates on the underlying insurance policies in 2009 as compared to 2008.

Other service charges and fees totaled $115,000 for the three months ended September 30, 2009, 27 percent over the $91,000 earned in 2008. The decline was primarily caused by higher income earned off of customer debit card transactions in 2009 as compared to 2008.

Noninterest Expense

Noninterest expenses were $3.0 million for the three months ended September 30, 2009 compared to $2.5 million for the prior year period. The $500,000 or 20 percent increase is largely due to the completion and occupancy of the Company s new corporate center in the third quarter of 2009 as well as expenses of the Bank s wealth management division new facilities that were completed and occupied in the fourth quarter of 2008 and are not reflected in the prior year expenses. Increases in data and items processing, professional and advertising, telecommunication, FDIC assessments, and other noninterest expenses accounted for the majority of the remaining increase.

Salaries and employee benefits for the three months ended September 30, 2009 were $1.5 million reflecting an approximate $200,000 increase when compared to the $1.3 million for the same period in 2008. Most of the increase is due to average salary increases of approximately 4% that were effective January 1, 2009 and additional personnel hired in 2009, offset by lower investment and insurance commissions to the Bank s financial advisors and lower bonuses to managers and executives due to the generally weak economic conditions that are negatively affecting the Company s financial performance.

Occupancy expenses for the three months ended September 30, 2009 were $209,000 reflecting a $38,000 increase when compared to $171,000 for the same period in 2008. Increases in depreciation and other expenses related to the completion and occupancy of the Company s new corporate center and increases in rental expense for the new location for the Bank s wealth management division contributed to the overall upward movement in this expense category.

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Equipment expenses for the three months ended September 30, 2009 were $216,000 reflecting a $58,000 increase when compared to $158,000 for the same period in 2008. Increased depreciation expense associated with equipment purchases for the Company s new corporate center, the Bank s wealth management division, and computers, servers and software contributed to the majority of the increase in this expense category.

Data and item processing expenses for the three months ended September 30, 2009 were $162,000 reflecting a $40,000 increase when compared to $122,000 for the same period in 2008. The increase in this expense was driven both by an increase in the number of products provided, such as mobile banking and merchant capture, as well as a continued increase in the number of Bank clients, which tends to influence increases in expenses such as items processing, bill payment, internet banking, and telephone banking.

Professional and advertising expenses for the three months ended September 30, 2009 were $350,000 reflecting a $91,000 increase when compared to $259,000 for the same period in 2008. The overall increases were due to higher legal, audit and accounting, consulting, and marketing and advertising expenses in 2009 as compared to 2008.

Stationary and supplies for the three months ended September 30, 2009 were $52,000 reflecting a $4,000 increase when compared to $48,000 for the same period in 2008. The increase was due to increased mailings to clients and prospective clients as well as expenses associated with the opening in early July of 2009 of the Company s new 14,000 square foot corporate center.

Other real estate owned expenses and write-downs totaled $12,000 for the three months ended September 30, 2009. There was no real estate owned or associated expenses or write-downs in 2008. There were no write-downs of other real estate during the three months ended September 30, 2009, in contrast to the significant write-downs taken during the first three months of 2009. Bank management believes that the local real estate market has improved slightly in 2009, a belief which is based on the sale of two other real estate owned properties in the second quarter of 2009, and one sale during the three months ended September 30, 2009.

FDIC assessment expense for the three months ended September 30, 2009 was $110,000 reflecting a $43,000 increase when compared to $67,000 for the same period in 2008. The FDIC is considering a prepaid assessment that would be payable December 31, 2009, and used as a credit against future premium assessments. The Company expects that prepaid assessment, if approved, will amount to approximately $1.7 million.

Accounts receivable financing expense, which is largely influenced by the fee income from accounts receivable financing, was $56,000 reflecting a $10,000 decrease when compared to $66,000 for the same period in 2008. Expenses in this line of business were positively impacted by lower client receivable balances in 2009 compared to 2008 due to the weak economic conditions.

Total other than temporary impairment losses were $21,000 for the three months ended September 30, 2009, and were the result of management s determination that one private label mortgage-backed security was other than temporarily impaired.

Other expenses for the three months ended September 30, 2009 were $239,000 reflecting a $25,000 increase when compared to the $214,000 for the same period in 2008. Increases in loan collection expenses, dues and memberships, education and training, and taxes other than income taxes, were offset by declines in filing and recording fees and insurance expenses.

Income Taxes

Income tax expense was $50,000 for the three months ended September 30, 2009 and $224,000 for the same period in 2008. The decrease in income tax expense from 2008 to 2009 was primarily due to higher net income before provision for income taxes in 2008 as compared to 2009.

Comparison of Results of Operations for the Nine-Month Periods Ending September 30, 2009 and 2008

Net Income

For the nine months ended September 30, 2009, the Company s net income decreased 39 percent to $501,000 compared to $820,000 for the same period in 2008. Net income available to common stockholders decreased 92 percent to $64,000 in 2009 compared to $820,000 in 2008. Net income per diluted share decreased 91 percent to $0.04 compared to $0.45 for the prior year period. Returns on average assets and average equity were 0.19 percent and 1.89 percent, respectively, for the nine months ended September 30, 2009, compared to 0.38 percent and 6.21 percent for the prior year period.

The decrease in net income was a result of an increase in net interest income and a decline in income tax expense, offset by a decline in noninterest income and increases in the provision for loan losses, and noninterest expense. The decrease in net income available to common shareholders was a result of preferred stock dividends and accretion of discount in 2009 totaling $437,000. There were no preferred stock dividends and accretion of discount in 2008.

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Net Interest Income

Net interest income was $8.7 million for the nine months ended September 30, 2009 compared to $6.4 million for the prior year. The 36 percent increase in net interest income was due both to growth in average earning assets and an increase in the net interest margin in 2009 compared to 2008.

Net interest margin is interest income earned on loans, securities, and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the nine months ended September 30, 2009 was 3.59 percent compared to 3.10 percent for the prior year period. The average yield on earning assets for the nine months ended September 30, 2009 was 6.14 percent compared to 6.56 percent for the prior year period, and the average cost of interest-bearing liabilities was 2.71 percent for the nine months ended September 30, 2009 compared to 3.71 percent for the prior year period. The net interest margin has increased during the past year as interest-bearing liabilities have repriced downward faster than interest-earning assets.

Provision for Loan Losses

The provision for loan losses charged to operations during the three months ended September 30, 2009 was $1.5 million compared to $337,000 recorded in the prior year period. The Bank had net charge-offs of $679,000 thousand for the quarter ended September 30, 2009 compared to net charge-offs of $76,000 during the third quarter of 2008. Net charge-offs increased mainly due to the Bank writing-down several large collateral dependent loans in addition to several loans that were deemed uncollectible and charged off. A large portion of these loans had previously been identified and reserved for in the allowance for loan loss earlier in 2009. Declining economic conditions resulted in an increased number of impaired collateral dependant loans. As a result the bank has been very proactive in recognizing the losses associated with these loans.

We use the results of our allowance for loan loss model to estimate the dollar amount of provision expense needed to maintain the adequacy of our allowance for loan losses. Our management analyzes the adequacy of the allowance on a monthly basis and adjustments to the provision expense are made as necessary. Additional information regarding our allowance for loan losses is contained in this discussion under the caption Asset Quality.

Noninterest Income

Noninterest income totaled $2.5 million for the nine months ended September 30, 2009, and was relatively unchanged from the same prior year period.

Service fees and charges, which represent a relatively stable and predictable source of noninterest income, totaled $645,000 for the nine months ended September 30, 2009, a 12 percent increase over the $575,000 of service fees and charges earned for the same period in 2008.

Mortgage loan fee income was positively impacted in 2009 by low mortgage rates as well as more mortgage originators in 2009 compared to 2008, although there was some disruption to this income source in the third quarter of 2009 when a third party mortgage correspondent utilized by the Bank failed. The Bank moved quickly to secure new correspondent lending sources, but still lost potential mortgage loan fee income during the transition. Mortgage loan fee income totaled $403,000 for the nine months ended September 30, 2009, a 22 percent increase over the $330,000 of mortgage loan fee income earned for 2008.

The Bank s Investment Services Group, which services its banking offices, and the Oak Ridge Wealth Management division, which was formed in 2005 and operates independently of the Bank, comprise all of the investment and insurance commissions noninterest income category. Investment and insurance commissions totaled $495,000 for the nine months ended September 30, 2009, a 28 percent decrease from the $687,000 earned in 2008. A large part of the decrease in this category was due to a decline in fees tied to the market value of assets under management due to lower market prices in 2009 on most investments.

Fee income from accounts receivable financing totaled $541,000 for the nine months ended September 30, 2009, a 4 percent decrease under the $561,000 earned in the same period in 2008. Fee income in this line of business was negatively impacted by lower client receivable balances in 2009 compared to 2008 due to the weak economic conditions.

Income earned on bank owned life insurance totaled $148,000 for the nine months ended September 30, 2009, a 22 percent increase over the $121,000 earned in the same period in 2008. This increase was due to higher rates on the underlying insurance policies in 2009 as compared to 2008.

Other service charges and fees benefited from an increase in income earned off of customer debit card transactions, and totaled $312,000 for the nine months ended September 30, 2009, a 13 percent increase over the $275,000 earned in 2008.

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Noninterest Expense

Noninterest expenses were $9.0 million for the nine months ended September 30, 2009 compared to $7.3 million for the prior year period. The increase of $1.7 million, or 23 percent, is largely due to the completion and occupancy of the Company s new corporate center in the third quarter of 2009 as well as expenses of the Bank s wealth management division new facilities that were completed and occupied in the fourth quarter of 2008 and are not reflected in the prior year expenses. Increases in data and items processing, professional and advertising, telecommunication, FDIC assessments, and other noninterest expenses accounted for the majority of the remaining increase.

Salaries and employee benefits for the nine months ended September 30, 2009 were $4.3 million reflecting a $400,000 increase when compared to $3.9 million for the same period in 2008. Most of the increase is due to average salary increases of approximately 4% that were effective January 1, 2009 and additional personnel hired in 2009, offset by lower investment and insurance commissions to the Bank s financial advisors and lower bonuses to managers and executives due to the generally weak economic conditions that are negatively affecting the Company s financial performance.

Occupancy expenses for the nine months ended September 30, 2009 were $574,000 reflecting a $140,000 increase when compared to $434,000 for the same period in 2008. Increases in repairs and maintenance expenses associated with the Company s infrastructure, increases in depreciation and other expenses related to the completion and occupancy of the Company s new corporate center, and increases in rental expense for the new location for the Bank s wealth management division contributed to the overall upward movement in this expense category. Lastly, the Company had eight months of occupancy expenses in 2008 compared to nine months of expenses in 2009 related to the fifth banking office, which opened on January 31, 2008.

Equipment expenses for the nine months ended September 30, 2009 were $560,000 reflecting a $122,000 increase when compared to $438,000 for the same period in 2008. Increased depreciation expense associated with equipment purchases for the Company s new corporate center, the Bank s wealth management division, and computers, servers and software contributed to the majority of this increase.

Data and item processing expenses for the nine months ended September 30, 2009 were $462,000 reflecting a $128,000 increase when compared to $334,000 for the same period in 2008. The increase in this expense was driven both by an increase in the number of products such as mobile banking and merchant capture as well as a continued increase in the number of bank clients, which tends to influence increases in expenses such as items processing, bill payment, internet banking, and telephone banking.

Professional and advertising expenses for the nine months ended September 30, 2009 were $964,000 reflecting a $114,000 increase when compared to $850,000 for the same period in 2008. The overall increases were due to higher legal, audit and accounting, and consulting expenses in 2009 as compared to 2008.

Stationary and supplies for the nine months ended September 30, 2009 were $188,000 reflecting a $4,000 decrease when compared to $192,000 for the same period in 2008. The decrease was a reduction in expenses associated with the increasing usage of electronic statements by the Bank s customers.

Other real estate owned expenses and write-downs totaled $314,000 for the nine months ended September 30, 2009. There was no real estate owned or associated expenses or write-downs in 2008. The write-downs in real estate owned were due to the continuing evaluation of the net realizeable values of these types of assets that are on the Company s balance sheet. A general decline in local housing and real estate values during the first quarter of 2009 contributed to the write-downs. Management believes that the local real estate market has improved slightly during 2009, a belief based on the sale of three other real estate owned properties in the first nine months of 2009.

FDIC assessment expense for the nine months ended September 30, 2009 was $402,000 reflecting a $223,000 increase when compared to $179,000 for the same period in 2008. The FDIC mandated a special assessment for all financial institutions in the second quarter of 2009 equivalent to 5 basis points on total assets minus Tier One capital. For the Bank the special assessment amounted to $162,000. The FDIC is considering a prepaid assessment that would be payable December 31, 2009, and used as a credit against future premium assessments. The Company expects that prepaid assessment, if approved, will amount to approximately $1.7 million.

Accounts receivable financing expense, which is influenced by the fee income from accounts receivable financing, decreased $45,000 to $165,000 for the nine months ended September 30, 2009, compared to $210,000 for the same period in 2008. This expense represents the amount paid by the Company to the vendor that provides the servicing of the accounts receivable program. For the most part, the expense represents a participation, expressed as a percentage of revenue, in the Company s income from financing the receivable, and can vary anywhere from 25 to 35 percent. However, in the prior year this expense was higher due to the cost of acquiring several new customers from an area bank that was exiting the accounts receivable financing business.

Total other than temporary impairment losses were $126,000 for the nine months ended September 30, 2009, and were a result of management s determination that one private label mortgage-backed security was other than temporarily impaired.

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Other expenses for the nine months ended September 30, 2009 were $726,000 reflecting a $92,000 increase when compared to $616,000 for the same period in 2008. Increases in appraisal fees, loan collection expenses, education and training, and taxes other than income taxes, were offset by declines in filing and recording fees and insurance expenses.

Income Taxes

Income tax expense was $234,000 for the nine months ended September 30, 2009 and $471,000 for the same period in 2008. The decrease in income tax expense from 2008 to 2009 was primarily due to higher net income before provision for income taxes in 2008 as compared to 2009.

Analysis of Financial Condition from December 31, 2008 to September 30, 2009

Total assets increased to $339.7 million at September 30, 2009, or 6 percent, from $320.7 million at December 31, 2008. The primary contributors to the growth between the two periods were increases in available-for-sale securities, loans receivable, and property and equipment of $19.4 million, $3.4 million, and $2.0 million, respectively, offset by a decline in securities held-to-maturity of $2.3 million.

Cash and Cash Equivalents

Cash and cash equivalents totaled $6.9 million at September 30, 2009, up $600,000, or 10 percent, from $6.3 million at December 31, 2008. This large increase was due to the inability of the Company s primary correspondent bank to place Federal Funds sold with other banks.

Federal Funds Sold

Federal Funds sold declined $3.3 million from December 31, 2008 to September 30, 2009. The Bank moved its primary correspondent relationship during the third quarter to the Federal Reserve Bank of Richmond (the Fed). Since the Fed pays interest on available balances and due to the overall low interest rate environment the Bank currently does not place excess balances into Federal Funds sold.

Investment Securities

The Company s portfolios of investment securities, which are classified as either available-for-sale or held-to-maturity, consist of government-sponsored enterprises, government-sponsored enterprises guaranteed mortgage-backed securities, and mortgage-backed securities not guaranteed by government-sponsored enterprises.

Available-for-sale securities totaled $55.0 million at September 30, 2009, up $19.4 million, or 55 percent, from $35.6 million at December 31, 2008. In 2009, funds from deposit growth were used to purchase Small Business Administration (SBA) government guaranteed securities and private label mortgage-backed securities not guaranteed by government-sponsored enterprises, offset by repayments on existing available-for-sale securities.

Held-to-maturity securities totaled $10.8 million at September 30, 2009, down $2.4 million, or 18 percent, from $13.2 million at December 31, 2008. The decrease was due to repayments on existing held-to-maturity securities.

Loans Receivable

The Company makes both commercial and consumer loans to borrowers in all neighborhoods within its market areas, including low- and moderate-income areas. The Company emphasizes commercial loans to small- and medium-sized businesses, real estate loans, and consumer loans.

Net loans receivable totaled $246.4 million at September 30, 2009, up $3.4 million, from $243.0 million at December 31, 2008. The increase in loans is a result of the Bank s continuing expansion in the Triad. Although the number of loan opportunities that meet the Company s underwriting standards has declined, there are some opportunities with existing and new clients of the Company, and the Company makes every effort to extend credit to credit qualified consumers and businesses.

Asset Quality

At September 30, 2009, our allowance for loan losses as a percentage of loans was 1.33%, up from 1.00% at December 31, 2008. The increase in part reflects the increase in our historical loss rate as our charge-offs have increased during the past year. Also, the increase reflects the recognition of additional loans identified as being impaired. In evaluating the allowance for loan losses, we prepare an analysis of our current loan portfolio through the use of historical loss rates, homogeneous risk analysis grouping to include probabilities for loss in each group by risk grade, estimation of years to impairment in each homogeneous grouping, analysis of internal credit processes, past due loan portfolio performance and overall economic conditions, both regionally and nationally.

Historical loss calculations for each homogeneous risk group are based on a weighted average loss ratio calculation. The most previous quarter s loss history is used in the loss history and is adjusted to reflect current losses in the homogeneous risk groups. Current losses translate into a higher loss ratio which is further increased by the associated risk grades within the group. The impact is to more quickly recognize and increase the loss history in a respective grouping, resulting in an increase in the allowance for that particular homogeneous group. For those groups with little or no loss history, management bases the historical factor based on current economic conditions and their potential impact on that particular loan group.

Loans are considered impaired if, based on current information and events, it is probable that the bank will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is based on either the fair value of the underlying collateral, the present value of the future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, or the estimated market value of the loan. In measuring the fair value of the collateral, management uses a comparison to the recent selling price of similar assets, which is consistent with those that would be utilized by unrelated third parties.

While we believe that our management uses the best information available to determine the allowance for loan losses, unforeseen market conditions could result in adjustments to the allowance for loan losses, and net income could be significantly affected, if circumstances differ substantially from the assumptions used in making the final determination. Because these factors and management s assumptions are subject to change, the allocation is not necessarily indicative of future loan portfolio performance.

Loans are charged-off against the Bank s allowance for loan losses as soon as the loan becomes uncollectible. Unsecured loans are considered uncollectible when no regularly scheduled monthly payment has been made within three months, the loan matured over 90 days ago and has not been renewed or extended or the borrower files for bankruptcy. Secured loans are considered uncollectible when the liquidation of collateral is deemed to be the most likely source of repayment. Once secured loans reach 90 days past due, they are placed into non-accrual status unless the loan is considered to be well secured and in process of collection. If the loan is deemed to be collateral dependent, the principal balance is either written down immediately or reserved as a write-down in the Bank s allowance model to reflect the current market valuation based on a independent appraisal which may be adjusted by management based on more recent market conditions. Included in the write-down is the estimated expense to liquidate the property and typically an additional allowance for the foreclosure discount. Generally, if the loan is unsecured the loan must be charged-off in full while if it is secured the loan is charged down to the net liquidation value of the collateral.

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The following table presents an analysis of the changes in the allowance for loan losses for the nine months ended September 30, 2009 and 2008.

Analysis of Changes in Allowance for Loan Losses

	For the nine months Ended September 30, 2009	2008
	(Dollars in thousands)	
Total loans outstanding at end of period-gross	$ 249,699	$ 238,616
Average loans outstanding-gross	$ 248,539	$ 225,398
Allowance for loan losses at beginning of period	$ 2,448	$ 2,119
Loans charged off:		
Real estate	(433)	(20)
Installment and Demand Deposit overdraft program	(39)	(46)
Commercial and all other loans	(316)	(42)
Total charge-offs	(788)	(108)
Recoveries of loans previously charged off:		
Real estate		
Installment loans		
Installment and Demand Deposit overdraft program	25	24
Commercial and all other loans	84	8
Total recoveries	109	32
Net charge-offs	(679)	(76)
Provision for loan losses	1,546	337
Allowance for loan losses at end of period	$ 3,315	$ 2,380
Ratios		
Annualized net charge-offs to average loans during the period	0.36%	0.04%
Allowance for loan losses to loans at period end	1.33%	1.00%
Allowance for loan losses to nonperforming loans at period end	135.3%	361.2%
Allowance for loan losses to impaired loans at period end	70.8%	88.9%

The ratio of annualized net charge-offs to average loans increased to 0.36% at September 30, 2009 from 0.04% at September 30, 2008 mainly due to the Bank writing-down or charging off several large collateral dependent loans. Declining economic conditions, resulted in an increased number of impaired collateral dependant loans which resulted in a portion of these loans being charged-off. The increase in the allowance for loan losses to loans to 1.33% at September 30, 2009 from 1.00% at September 30, 2008 reflects the increase in our historical loss rate as our charge-offs have increased during the past year. Also, the increase reflects the recognition of additional loans identified as being impaired. The ratio of our allowance for loan losses to nonperforming loans decreased to 135.3% as of September 30, 2009 compared to 361.2% at September 30, 2008. The decrease is the result of our nonperforming loans increasing 272% year over year while our allowance increased approximately 39% year over year. Even though the allowance for loan losses to nonperforming loans at period end has decreased, management believes the allowance for loan loss adequately the losses in the nonperforming loans as of September 30, 2009.

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Construction, land and development (CLD) loans make up 21.6% of the Bank s loan portfolio. This sector of the economy has been particularly impacted by declines in housing activity, and has had a disproportionate impact on the declining credit quality of the Company. The Bank has implemented a number of strategies to mitigate the eventual loss on these loans, including accepting short sales on 1-4 family residential construction loans as well as our Community Investment Loan Program, which has resulted in moving approximately 7 out of 20 jumbo homes and 4 out of 18 conforming homes out of our builder construction portfolio - either to permanent mortgages placed with other lenders or permanent mortgages financed by our bank to qualified borrowers. Our efforts have resulted in a reduction of CLD to total loans as of September 30, 2009 of the 21.6% referenced above from 23.6% as of September 30, 2008. The 2% decrease does not take into account the advances between October 1, 2008 to September 30, 2009 on unfunded or partially funded 1-4 residential construction loans. We have extended this program to cover the residential lot inventory of our development borrowers. This program can be accessed through our website at http://www.bankofoakridge.com/112318.html.

Nonperforming assets as of September 30, 2009 consist substantially of completed or substantially completed 1-4 residential homes, with the remaining concentrated in developed 1-4 residential lots and commercial properties.

Property and Equipment, Net

Property and equipment, net totaled $10.9 million at September 30, 2009, up approximately $2.0 million or 22%, from $8.9 million at December 30, 2008. The increase is due to the construction of the Company s new corporate headquarters, which was completed in July of 2009.

Deposits

Deposits totaled $285.1 million at September 30, 2009, up $14.5 million, or 5 percent, from $270.6 million at December 31, 2008. The increase in noninterest-bearing deposits was due to a Company wide focus on gathering noninterest-bearing deposits, particularly deposits held by business and non-profit entities, as well as the Company s continued expansion into Greensboro, North Carolina. The Bank also believes that some portion of this increase can be attributed to the negative perception of larger financial institutions that has persisted since the current economic slowdown began.

Borrowings

Borrowings, which consist of short and long-term debt, and junior subordinated notes related to trust preferred securities, totaled $25.2 million at September 30, 2009, down $5.0 million, or 17 percent, from $30.2 million at December 31, 2008. The increase in deposits noted above provided the Bank with additional liquidity to repay a FHLB of Atlanta advance of $7.0 million at maturity in the second quarter of 2009, offset by a $2.0 overnight borrowing in the third quarter of 2009.

Stockholders Equity

Stockholders equity totaled $27.7 million at September 30, 2009, up approximately $9.5 million, or 52 percent, from $18.2 million at December 31, 2008. The majority of the increase was due to the issuance of $7.7 million in preferred stock and warrants to the U.S. Treasury as part of its Capital Purchase Program, as well as an increase in accumulated other comprehensive income of $1.5 million from December 31, 2008 to September 30, 2009. Net income of $501,000 for the nine months ended September 30, 2009 also contributed to the increase, offset by preferred stock dividends of $209,000 during the nine-month period ended September 30, 2009.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Pursuant to Item 305(e) of Regulation S-K, the Company, as a smaller reporting company, is not required to provide the information required by this Item.

Item 4T. Controls And Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures in accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). Our management, including our principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2008 and concluded that the disclosure controls and procedures were not effective as a whole, and that the deficiency involving internal controls constituted a material weakness. The material weakness related to our early adoption of SFAS 159 on April 30, 2007. We had previously reported our 2007 financial results in our 2007 Form 10-KSB, which included early adoption of SFAS 159 for our investment portfolio. In 2008, based on an SEC comment letter and further evaluation by management, the Company amended its 2007 financial results in its 2008 Form 10-K and reversed its early adoption of SFAS 159. On September 8, 2009, the SEC notified the Company that it had completed its review of the Company s 2008 Form 10-K and had no further comments at that time.

The material weakness resulted in the restatement of the previously reported financial statements and other related financial disclosures. The Company has implemented new procedures to mitigate the risk of ineffective disclosure controls and procedures related to accounting for the adoption of new accounting standards in the future that include a thorough review of all applicable guidance, consultation with the Company s external auditors and legal counsel and other experts, including consultation with the SEC, if necessary.

The Company reviews its disclosure controls and procedures on an ongoing basis and from time to time makes changes aimed at enhancing their effectiveness. Based on their evaluation and on the new procedures noted above, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective to provide reasonable assurance that we are able to record, process, summarize and report in a timely manner the information required to be disclosed in reports the Company files under the Exchange Act.

The Company also reviews its internal control over financial reporting, on an ongoing basis and may from time to time make changes aimed at enhancing their effectiveness.

Based on this evaluation, management evaluated and concluded that the Company s internal control over financial reporting was ineffective as of December 31, 2008 as a result of a material weakness. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness was a result of the Company s adoption of SFAS 159 noted above.

The Company has implemented new procedures to mitigate the risk of ineffective internal controls over financial reporting related to accounting for the adoption of new accounting standards in the future that include a thorough review of all applicable guidance, consultation with the Company s external auditors and legal counsel and other experts, including consultation with the SEC, if necessary. The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of the Company s internal controls. This results in modifications to its processes throughout the Company. However, other than noted above, there has been no change in its internal control over financial reporting that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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Part II. Other Information

ITEM 6. EXHIBITS

15(a) Exhibits

Exhibit (3)(i)	Articles of Incorporation, incorporated herein by reference to Exhibit (3)(i) to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (3)(ii)	Bylaws, incorporated herein by reference to Exhibit (3)(ii) to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (4)(i)	Specimen Stock Certificate, incorporated herein by reference to Exhibit 4 to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (4)(ii)	Articles of Amendment and Exhibits 4.2 and 4.3, incorporated herein by reference, to Exhibit 4.1 to the Form 8-k filed with the SEC on February 2, 2009.
Exhibit (10)(i)	Employment Agreement with Ronald O. Black, as amended, incorporated herein by reference to Exhibit (10)(i) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(ii)	Employment Agreement with L. William Vasaly, III, as amended, incorporated herein by reference to Exhibit (10)(ii) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(iii)	Employment Agreement with Thomas W. Wayne, as amended, incorporated herein by reference to Exhibit (10)(iii) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(iv)	Outparcel Ground Lease between J.P. Monroe, L.L.C. and Bank of Oak Ridge dated September 1, 2002, incorporated herein by reference to Exhibit (10)(iv) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(v)	Ground and Building Lease between KRS of Summerfield, LLC and Bank of Oak Ridge dated September 25, 2002, incorporated herein by reference to Exhibit (10)(v) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(vi)	Ground Lease between Friendly Associates XVIII LLLP and Bank of Oak Ridge dated September 13, 2004, incorporated herein by reference to Exhibit (10)(vi) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(vii)	Bank of Oak Ridge Second Amended and Restated Director Stock Option Plan (amended March 16, 2004; approved by stockholders September 8, 2004), incorporated herein by reference to Exhibit 10(ix) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(viii)	Bank of Oak Ridge Second Amended and Restated Employee Stock Option Plan (amended March 16, 2004; approved by stockholders September 8, 2004), incorporated herein by reference to Exhibit (10)(x) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(ix)	Salary Continuation Agreements with Ronald O. Black, L. William Vasaly III and Thomas W. Wayne dated January 20, 2006, incorporated herein by reference to Exhibits (10)(ix) to (10)(xi) to Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(x)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and Ronald O. Black, incorporated herein by reference to Exhibit (10)(xiii) to the Form 8-K filed with the SEC on December 21, 2007.
Exhibit (10)(xi)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and L. William Vasaly III, incorporated herein by reference to Exhibit (10)(xiv) to the Form 8-K filed with the SEC on December 21, 2007.

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Exhibit (10)(xii)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and Thomas W. Wayne, incorporated herein by reference to Exhibit (10)(xv) to the Form 8-K filed with the SEC on December 21, 2007.
Exhibit (10)(xiii)	Indemnification Agreement, incorporated herein by reference to Exhibit (10)(xvi) to the Form 8-K filed with the SEC on March 7, 2008.
Exhibit (10)(xiv)	Contract for the Purchase and Sale of Real Property, incorporated herein by reference to Exhibit 99.1 to the Form 8-K filed with the SEC on January 14, 2008.
Exhibit (10)(xv)	Oak Ridge Financial Services, Inc. Long-Term Stock Incentive Plan, incorporated herein by reference to Exhibit (10)(xiii) to the Form 10-QSB filed with the SEC on May 15, 2007.
Exhibit (10)(xvi)	Bank of Oak Ridge 2008 Semi-Annual Incentive Plan, incorporated herein by reference to Exhibit 10(xvi) to the Form 10-K filed with the SEC on March 31, 2009.
Exhibit (10)(xvi)	Form of Employment Agreement Amendment, dated January 30, 2009 among the Company, the Bank and the senior executive officers, incorporated herein by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the SEC on February 2, 2009.
Exhibit (31.1)	Certification of Ronald O. Black. (filed herewith)
Exhibit (31.2)	Certification of Thomas W. Wayne. (filed herewith)
Exhibit (32)	Certificate of Periodic Financial Report Pursuant to 18 U.S.C. Section 1350. (filed herewith)

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Oak Ridge Financial Services, Inc.

Signatures

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Oak Ridge Financial Services, Inc.
(Registrant)

Date: November 13, 2009

/s/ Ronald O. Black
Ronald O. Black
President and Chief Executive Officer
(Duly Authorized Representative)

Date: November 13, 2009

/s/ Thomas W. Wayne
Thomas W. Wayne
Chief Financial Officer
(Duly Authorized Representative)

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