# FIRST BANK

# 2012 ANNUAL REPORT


WELCOME HOME

On April 23, 2007, First Bank commenced operations at its office in **Williamstown, New Jersey**. In October 2008, an investor group led by Patrick L. Ryan and Leslie E. Goodman recapitalized the bank with an investment of $19 million from various local investors.

In February 2009, First Bank opened its second branch office in **Lawrence, New Jersey**. A third branch office was opened shortly thereafter in **Ewing, New Jersey**. Both locations were examples of the bank's low-cost strategy of entering previously-occupied bank locations and re-opening with minimal cost and capital investment.

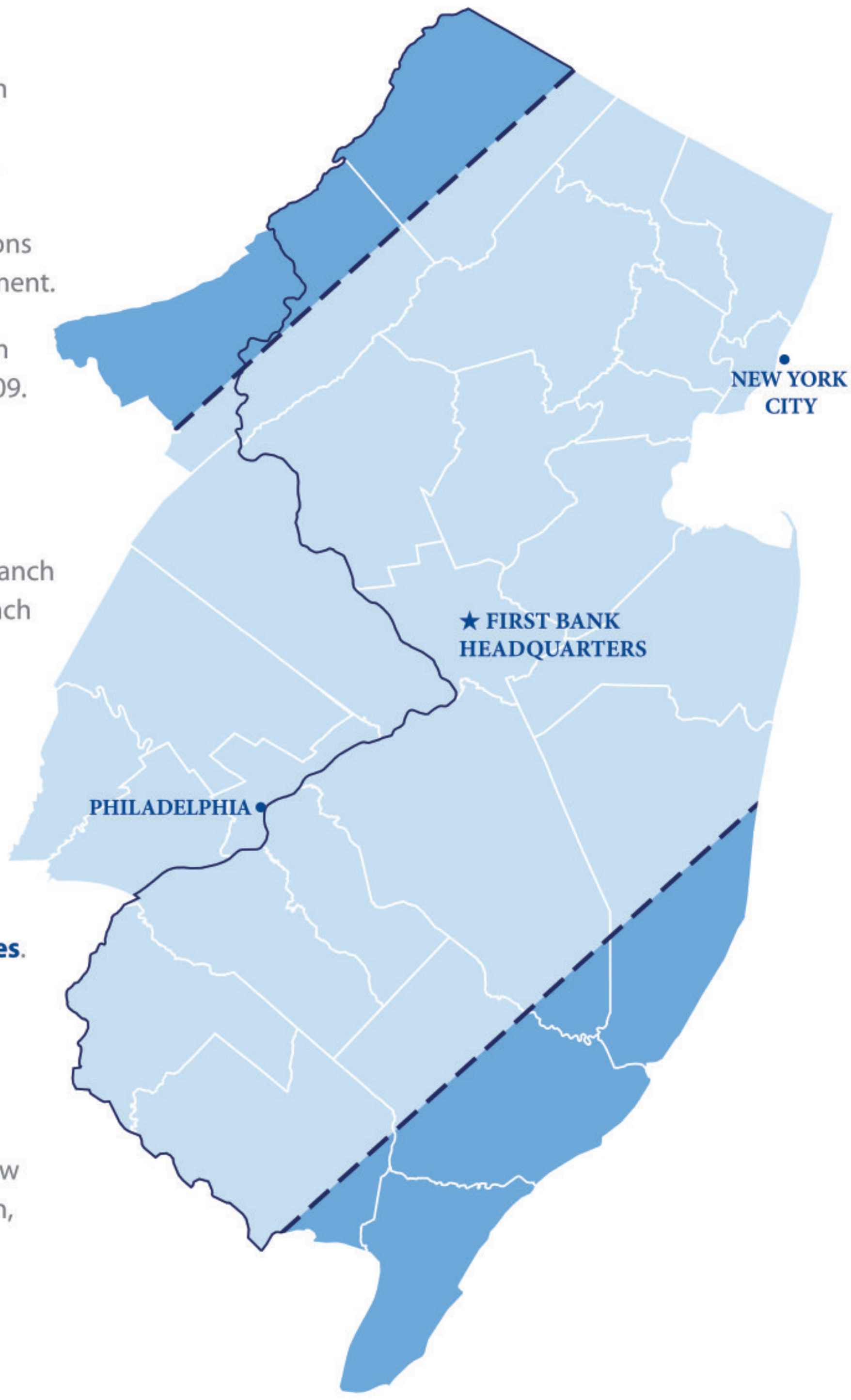
Construction of the bank's full-service branch location in **Williamstown** was completed in September of 2009.

In December of 2010, First Bank established a true corporate headquarters by moving into the old Yardville National Bank (YNB) headquarters building located in **Hamilton, New Jersey**. The former YNB branch at that same location was opened as a First Bank branch one year later in December 2011. As the bank has continued to expand, the First Bank team now occupies almost the entire first floor of the building.

As of December 31, 2012, First Bank had four branches, over $350 million in assets, $260 million in loans and approximately $309 million in deposits. First Bank has 48 full-time equivalent employees working throughout **Mercer** and **Gloucester Counties**.

In a very difficult economic environment we have made loans to help individuals and small businesses and we have added significantly to our staff. We are doing our part to help grow the economy and help grow First Bank. With new branches, new markets, new products and new technology all under consideration, we're excited for the future…

## New York City/Philadelphia Corridor



FIRST BANK

## To our Shareholders, Stakeholders, Employees and Friends:

### *2012: moving past the start up phase…*

2012 was an important year for First Bank. In addition to meeting our growth and profitability goals, we turned the corner in our development. We have moved past the "start-up" phase and we're entering a period of enhanced strength, growth and stability. This should not be interpreted to mean we have reached a level of satisfaction and complacency – far from it. We know we have a lot of work to do.

Nevertheless, the work we're doing now is different work. The start-up phase meant focusing on must-have, immediate projects and investments. With much of the core foundation in place, our next phase involves tackling our nice to have efficiency and optimization type projects. Throughout the bank we've developed prioritized lists and we're moving through them with purpose.

Over time, we hope to be evolving from "Good to Great," but we're not there yet. Rather, this next phase involves "Getting to Good." While that doesn't sound real exciting, it's probably a fair assessment of where we stand. Importantly, we have the tools, the management, the Board and the strategy to make it happen. We know where we're going, and we know how to get there; we just need to execute.

### *With that as a backdrop, let us describe in more detail the important progress and key developments in 2012:*

**Profitability:** With seven consecutive quarters of profitability (and eight of the last nine), the Bank has reached a level of consistent earnings. For the year, net income was $2,588,000, an improvement of $485,000 or 23%, compared to 2011. When adjusting for the impact of the tax benefits we enjoyed both years, pre-tax profit increased by $1.9 million.

Interest income (money earned from loans and investments) for 2012 was up over $2.6 million or 23% compared to 2011. Interest expense (money paid on deposits and borrowings) for 2012 was up only $334,000 or 11% compared to 2011. That differential led to net interest income growth of $2.3 million or 27% compared to 2011. This growth is very important as net interest income makes up over 75% of total bank revenue.

An improving asset quality profile allowed us to reduce our provision for loan loss expense by $714,000 in 2012 compared to 2011. Investments in staff and costs to manage and dispose OREO properties drove non-interest expense higher by $1.0 million or 16% in 2012. While expense growth of 16% is higher than we'd like to see, it was still significantly less than the 27% growth we experienced in net interest income. As you may recall, revenue growth well in excess of expense growth is an important part of our plan for achieving solid profit metrics as we grow.

With margins basically flat in 2012, loan growth became the primary driver of revenue and profit growth in 2012.

**Loan growth:** The loan portfolio increased from $207 million at the end of 2011 to $260 million at the end of 2012, an increase of $53 million or 26%. This growth occurred in a continuing low interest rate environment, which has resulted in elevated loan refinancing. Growth came from all segments of the portfolio, but commercial loans remain our primary market niche and growth engine. Our strong loan growth compared very favorably to other banks in our peer group. Based on our pipeline, we are hopeful this level of growth will continue.

**Net interest margin:** With interest rates at historically low levels, we are pleased we were able to keep our net interest margin (NIM) essentially flat throughout 2012. In Q4 2012, our annualized NIM was 3.75%, which was down just slightly compared to our NIM of 3.77% in Q4 2011. Moving deposit costs lower was critical in this effort as loan yields continued to move lower as well. In fact, our cost of interest bearing liabilities declined 0.30% when comparing Q4 2012 to Q4 2011. A NIM of 3.75% is near the average for banks our size and in our markets.

In summary, our recipe for value creation continued during 2012: we achieved above-average loan growth coupled with solid, peer-level profit margins.

## *We had other accomplishments throughout the year that should be discussed.*

**Improving asset quality:** Several important asset quality indicators improved throughout the year. Nonperforming assets (NPAs) as a percentage of total assets declined from 2.41% at the end of 2011 to 1.69% at the end of 2012. Net charge offs declined from 0.67% of average loans in 2011 to 0.25% in 2012. Our ALLL as a percentage of our nonperforming loans (NPLs) increased from 57% at the end of 2011 to 123% at the end of 2012. Lastly, our Texas Ratio (NPAs / Equity + ALLL) finished the year at 17%, a level better than the average of our 35-bank peer group and well below the 50% to 100% level deemed to be the high risk zone for banks.

**Enhanced equity capital position:** Director and Founding Shareholder Sidney L. Hofing led a strong capital offering during the second half of 2012 which brought in $4.2 million in additional common equity capital. Thanks to Sid's great efforts, not only did we meet the high end of our goal, the offering was significantly oversubscribed. As a result, unfortunately, we had to return portions of some subscriptions. With the addition of strong earnings for the year, our equity capital position increased from $24.0 million at the end of 2011 to $31.0 million at the end of 2012, an increase of 29%.

**Improved book value per share:** Our book value per share was $6.62 at the end of 2012. This is an increase of 23% from a low-point of $5.39 per share back in Q1 2011.

**Execution of the low-cost, low overhead-expense banking model:** We watch and track our expenses very closely. Our non-interest expense to average earning assets ratio in Q4 2012 was 2.59%. That was significantly better than our stated goal of 3.00%, and placed us in the top five out of thirty-five peer banks. Another way to look at efficiency is revenue per employee. We earned $243,000 in revenue per employee in 2012, placing us in the top quartile of the peer group. Similarly, we ended the year with $6.6 million in assets per employee, ranking us second in the group.

To summarize our results, we ramped up revenue to deliver consistent quarterly profitability and we finished the year with growth and profits in line with our ambitious objectives.

## *What can we expect for 2013?*

**Continued organic balance sheet growth:** Our loan and deposit pipelines remain very active. The competition for quality loans is increasing, but we will be working hard to try and make sure we get our share. We have made important investments in our commercial lending staff in an effort to provide continued loan growth while maintaining our strong credit administration standards. Balance sheet growth should drive continued net interest income growth.

**Net interest margin compression:** While we intend to keep a close eye on our deposit costs, increased competition for loans may produce lower loan yields. With deposit costs at historically low levels, it may prove difficult to lower deposit costs enough to offset potentially lower loan yields. While we believe margin compression is inevitable, we think it can be managed effectively to still preserve solid net profits.

**Potential for M&A activity:** After several years of minimal activity throughout the industry, it appears that the M&A market may finally show signs of life in 2013. It is very difficult to tell if that means we'll find an opportunity that meets our stated criterion. Nevertheless, we are interested in exploring good opportunities that would help us achieve additional economies of scale and enhanced earnings per share growth.

**New branches:** In February, we submitted an application for our fifth branch location. The new site is actually a former bank branch that was recently closed in Somerset, NJ. Prior to closing, the branch had over $90 million in deposits. We are very excited about this new location. It fits very well with our branch philosophy: it's low cost; move-in ready; and it helps open a new market for us. Our model is working and we will need additional branches to continue our organic growth plans. Pending regulatory approval, we are hopeful to have the branch open at some point during the summer. Our business plan calls for additional branches each year for the next three years.

**Exploring capital options:** While we were pleased to complete a successful capital offering in 2012, our Board realizes that we will need additional capital to take advantage of the organic and M&A opportunities that could present themselves over the next couple of years. While it is too early to speculate regarding if (or when) another capital offering may happen, and what any future offering might look like, we want our shareholders to know the Board is actively exploring the potential options for improving the bank's capital position and the liquidity in the stock. The winners over the next several years will be the banks that can and do raise significant capital to execute organic and M&A growth strategies. Achieving a reasonable valuation for any new shares issued will be a key factor when considering capital raising alternatives.

## *What could prevent us from achieving our goals in 2013?*

**Asset quality issues:** Strong asset quality is always a top priority. In addition to hurting profitability, asset quality problems erode investor and regulator confidence. A lack of confidence prevents banks from achieving key strategic goals and from raising capital for growth. All the pieces need to fit together for us to achieve our goals. Deterioration in asset quality can stop our momentum quickly. Through prudent underwriting and strong credit administration, we're working hard to ensure asset quality metrics remain solid.

**Continued dysfunction in Washington DC:** Our success is closely tied to the overall economy. The impact of the sequester on overall economic output remains to be seen. Perhaps even more worrisome, a long term answer on the debt ceiling and deficit reduction remain illusive. Unfortunately, the dysfunction in Washington could derail an economy that finally appears to be coming back to life.

**A lack of investor confidence in community banks:** Continued growth and profitability can help, but significant increases in shareholder value will not materialize without investors who are willing to look at banks for their inherent franchise value and earnings power, not the expected liquidation value derived by subtracting liabilities from assets. Predicting market sentiment is a difficult business. While it appears interest in the community bank space is returning, time will tell if the recent up-tick in community bank valuations is a trend or an aberration.

## *Getting in the game…*

New and exciting opportunities are in front of us. To use an analogy, First Bank is moving from being on the sidelines to being a player in the game.

We still need to be careful. New players have fewer opportunities than the established players and less room for error. Nevertheless, these new opportunities show we're making progress.

Getting into the game is the first step. Becoming a strong and respected player comes next. It will take time, but we're taking the right steps to get there. We're not taking undue risk or pursuing short term gain. We're pursuing a focused plan with the goal of creating long-term shareholder value.

In closing: a special thanks to our customers, employees, and shareholders. These three legs of the stool make the strength of the franchise. Without all three working together the bank cannot be successful. We appreciate your support and dedication and we hope to have more good news to report as we move forward.

Sincerely,

Leslie E. Goodman
Chairman of the Board

Patrick L. Ryan
President and CEO

Note: The foregoing material contains forward-looking statements concerning the financial condition, results of operations and business of the Bank. We caution that such statements are subject to a number of uncertainties, including but not limited to those set forth above under the caption "What could prevent us from achieving our goals in 2013", changes in economic activity in our markets, changes in interest rates and changes in regulation and the regulatory environment, and actual results could differ materially, and, therefore, readers should not place undue reliance on any forward-looking statements. The Bank does not undertake, and specifically disclaims, any obligation to publicly release the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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Financial Report

December 31, 2012

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FIRSTBANK

2012 Annual Report

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ParenteBeard

# Independent Auditors' Report

Board of Directors
First Bank

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of First Bank and Subsidiary, which comprise the consolidated statements of condition as of December 31, 2012 and 2011, and the related statements of operations, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2012, and the related notes to the financial statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of First Bank as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

ParenteBeard LLC

Wilmington, Delaware
March 12, 2013

# First Bank and Subsidiary

## CONSOLIDATED STATEMENTS OF CONDITION

| (In thousands, except share data) | December 31, 2012 | 2011 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 6,180 | $ 6,311 |
| Federal funds sold | – | 1,053 |
| Interest bearing deposits with banks | 17,686 | 14,465 |
| Cash and Cash Equivalents | 23,866 | 21,829 |
| Interest bearing time deposits with banks | 1,469 | 3,584 |
| Securities available for sale | 43,265 | 16,551 |
| Securities held to maturity (fair value of $7,052 in 2012 and $2,267 in 2011) | 6,693 | 2,000 |
| Restricted investment in bank stocks | 824 | 542 |
| Other investments | 5,000 | 5,000 |
| Loans | 260,039 | 207,024 |
| Less: Allowance for loan losses | 4,084 | 3,307 |
| Loans, net | 255,955 | 203,717 |
| Premises and equipment, net | 1,901 | 2,139 |
| Other real estate owned | 2,604 | 623 |
| Accrued interest receivable | 1,033 | 743 |
| Bank-owned life insurance | 5,154 | 5,012 |
| Deferred tax asset | 2,225 | 1,787 |
| Other assets | 731 | 1,382 |
| Total Assets | $ 350,720 | $ 264,909 |
| **Liabilities and Stockholders' Equity** | | |
| Deposits: | | |
| Non-interest bearing | $ 27,398 | $ 22,325 |
| Interest bearing | 281,588 | 212,336 |
| Total Deposits | 308,986 | 234,661 |
| Long-term borrowings | 10,219 | 5,428 |
| Accrued interest payable | 139 | 135 |
| Other liabilities | 351 | 703 |
| Total Liabilities | 319,695 | 240,927 |
| Stockholders' Equity: | | |
| Common stock, $5 par value; authorized 10,000,000 shares; issued and outstanding 4,686,965 in 2012 and 3,886,965 in 2011 | 23,433 | 19,433 |
| Paid-in capital | 11,279 | 11,037 |
| Accumulated deficit | (3,998) | (6,586) |
| Accumulated other comprehensive income | 311 | 98 |
| Total Stockholders' Equity | 31,025 | 23,982 |
| Total Liabilities and Stockholders' Equity | $ 350,720 | $ 264,909 |

*See Notes to Consolidated Financial Statements.*

# First Bank and Subsidiary

## CONSOLIDATED STATEMENTS OF OPERATIONS

| (In thousands) | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **Interest and Dividend Income** | | | |
| Loans, including fees | **$ 13,323** | $ 10,909 | $ 8,271 |
| Securities | **689** | 533 | 1,296 |
| Interest bearing deposits and other | **197** | 114 | 110 |
| Federal funds sold | **1** | 6 | 28 |
| Total Interest and Dividend Income | **14,210** | 11,562 | 9,705 |
| **Interest Expense** | | | |
| Deposits | **3,136** | 2,824 | 3,234 |
| Borrowings | **142** | 120 | 117 |
| Total Interest Expense | **3,278** | 2,944 | 3,351 |
| Net Interest Income | **10,932** | 8,618 | 6,354 |
| Provision for Loan Losses | **1,366** | 2,080 | 2,279 |
| Net Interest Income after Provision for Loan Losses | **9,566** | 6,538 | 4,075 |
| **Non-Interest Income** | | | |
| Service fees on deposit accounts | **82** | 78 | 51 |
| Title insurance fees | **59** | 21 | – |
| Gains on sales of securities, net | **–** | 41 | 640 |
| Gains on sales of loans held for sale | **–** | 239 | – |
| Income on bank-owned life insurance | **142** | 12 | – |
| Other non-interest income | **111** | 49 | 39 |
| Total Non-Interest Income | **394** | 440 | 730 |
| **Non-Interest Expense** | | | |
| Salaries and employee benefits | **3,942** | 3,439 | 3,073 |
| Occupancy and equipment | **1,083** | 965 | 887 |
| FDIC insurance premium | **214** | 300 | 453 |
| Legal fees | **143** | 274 | 212 |
| Other professional fees | **305** | 258 | 248 |
| Data processing operations | **228** | 262 | 264 |
| Marketing and advertising | **233** | 199 | 128 |
| Telecommunications | **165** | 151 | 138 |
| Insurance | **139** | 224 | 203 |
| Travel and entertainment | **167** | 113 | 81 |
| Litigation settlement | **150** | – | – |
| Other real estate owned expense, net | **420** | 17 | – |
| Other expense | **513** | 460 | 224 |
| Total Non-Interest Expense | **7,702** | 6,662 | 5,911 |
| Net Income (Loss) before Income Tax (Benefit) Expense | **2,258** | 316 | (1,106) |
| Income Tax (Benefit) Expense | **(330)** | (1,787) | 2 |
| Net Income (Loss) | **$ 2,588** | $ 2,103 | $ (1,108) |

*See Notes to Consolidated Financial Statements.*

# First Bank and Subsidiary

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| (In thousands) | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Net Income (Loss) | **$ 2,588** | $ 2,103 | $ (1,108) |
| Other Comprehensive Income, Net of Tax: | | | |
| Unrealized gains and losses on securities available for sale | | | |
| Net gains arising during the period | **373** | 107 | 15 |
| Less: reclassification adjustment for gains included in net income | **–** | (41) | (640) |
| | **373** | 66 | (625) |
| Tax effect | **160** | – | – |
| Total Other Comprehensive Income (Loss) | **213** | 66 | (625) |
| Total Comprehensive Income (Loss) | **$ 2,801** | $ 2,169 | $ (1,733) |

*See Notes to Consolidated Financial Statements.*

# First Bank and Subsidiary

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

| (In thousands, except share amounts) | Common Stock | Paid-In Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|
| Balance - December 31, 2009 | $ 17,055 | $ 10,990 | $ (7,581) | $ 657 | $ 21,121 |
| Net loss | – | – | (1,108) | – | (1,108) |
| Other comprehensive loss | – | – | – | (625) | (625) |
| Stock-based compensation expense | – | 15 | – | – | 15 |
| Sale of 476,029 shares of common stock, net of issuance costs of $30 | 2,378 | (30) | – | – | 2,348 |
| Balance - December 31, 2010 | 19,433 | 10,975 | (8,689) | 32 | 21,751 |
| Net income | – | – | 2,103 | – | 2,103 |
| Other comprehensive income | – | – | – | 66 | 66 |
| Stock-based compensation expense | – | 62 | – | – | 62 |
| Balance - December 31, 2011 | 19,433 | 11,037 | (6,586) | 98 | 23,982 |
| Net income | **–** | **–** | **2,588** | **–** | **2,588** |
| Other comprehensive income, net of tax | **–** | **–** | **–** | **213** | **213** |
| Stock-based compensation expense | **–** | **68** | **–** | **–** | **68** |
| Sale of 800,000 shares of common stock, net of issuance costs of $26 | **4,000** | **174** | **–** | **–** | **4,174** |
| Balance - December 31, 2012 | **$ 23,433** | **$ 11,279** | **$ (3,998)** | **$ 311** | **$ 31,025** |

*See Notes to Consolidated Financial Statements.*

# First Bank and Subsidiary

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands) | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **Cash Flows from Operating Activities** | | | |
| Net income (Loss) | **$ 2,588** | $ 2,103 | $ (1,108) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | **1,366** | 2,080 | 2,279 |
| Depreciation and amortization of premises and equipment | **408** | 422 | 424 |
| Net amortization of premiums and accretion of discounts on securities | **195** | 80 | 232 |
| Amortization of deferred loan costs | **217** | 199 | 41 |
| Gains on sales of securities available for sale | **–** | (41) | (640) |
| Origination of loans held for sale | **–** | (2,220) | (378) |
| Proceeds from sales of loans held for sale | **–** | 2,459 | 378 |
| Gains on sales of loans held for sale | **–** | (239) | – |
| Gains on sale of other real estate owned | **(7)** | – | – |
| Writedowns of other real estate owned | **283** | – | – |
| Stock-based compensation expense | **68** | 62 | 15 |
| Deferred taxes | **(598)** | (1,789) | – |
| (Increase) decrease in accrued interest receivable | **(290)** | (93) | 106 |
| Increase in cash surrender value of bank-owned life insurance | **(142)** | (12) | – |
| Decrease (increase) in other assets | **651** | (22) | 278 |
| Increase (decrease) in accrued interest payable | **4** | 45 | (110) |
| (Decrease) increase in other liabilities | **(352)** | 364 | (1) |
| Net Cash Provided by Operating Activities | **4,391** | 3,398 | 1,516 |
| **Cash Flows from Investing Activities** | | | |
| Net decrease (increase) in interest bearing time deposits with banks | **2,115** | 7,458 | (3,804) |
| Net increase in loans | **(56,138)** | (55,037) | (32,184) |
| Purchases of securities available for sale | **(36,557)** | (9,371) | (24,174) |
| Purchases of securities held to maturity | **(4,714)** | – | – |
| Proceeds from sales of securities available for sale | **–** | 10,460 | 47,848 |
| Proceeds from maturities, calls and paydowns of securities available for sale | **10,042** | 7,878 | 25,086 |
| Proceeds from maturities, calls and paydowns of securities held to maturity | **–** | – | 3,500 |
| Proceeds from sale of other real estate owned | **60** | – | – |
| Purchases of restricted stocks | **(282)** | (145) | (149) |
| Purchases of other investments | **–** | (5,000) | – |
| Purchase of bank-owned life insurance | **–** | (5,000) | – |
| Purchases of premises and equipment | **(170)** | (149) | (147) |
| Net Cash (Used in) Provided by Investing Activities | **(85,644)** | (48,906) | 15,976 |
| **Cash Flows from Financing Activities** | | | |
| Net increase (decrease) in deposits | **74,325** | 46,902 | (7,910) |
| Proceeds from long-term borrowings | **5,000** | 5,000 | – |
| Repayments of long-term borrowings | **(209)** | (1,199) | (1,291) |
| (Repayments of) proceeds from collateralized borrowings | **–** | (417) | 417 |
| Proceeds from sale of common stock | **4,200** | – | 2,378 |
| Issuance cost of common stock | **(26)** | – | (30) |
| Net Cash Provided by (Used in) Financing Activities | **83,290** | 50,286 | (6,436) |
| Net Increase in Cash and Cash Equivalents | **2,037** | 4,778 | 11,056 |
| Cash and Cash Equivalents - Beginning | **21,829** | 17,051 | 5,995 |
| Cash and Cash Equivalents - Ending | **$ 23,866** | $ 21,829 | $ 17,051 |
| **Supplementary Cash Flows Information** | | | |
| Noncash activities: | | | |
| Transfers of loans to other real estate owned | **$ 2,317** | $ 623 | $ – |
| Cash paid during year for: | | | |
| Interest on deposits and borrowings | **$ 3,274** | $ 2,899 | $ 3,461 |
| Income taxes paid | **$ 72** | $ 2 | $ 2 |

*See Notes to Consolidated Financial Statements.*

## Note 1 - Summary of Significant Accounting Policies

### Business

First Bank (the "Bank") is a New Jersey chartered commercial bank, incorporated in 2007. The Bank provides a range of lending, deposit and other financial products and services with an emphasis on commercial real estate and commercial and industrial loans to small- to mid-sized businesses and individuals. Our existing and targeted markets are located in the corridor between New York City and Philadelphia. As of December 31, 2012, we operated four full-service branches, including three branches and our administrative headquarters in our primary market of Mercer County, New Jersey. Our fourth branch facility is located in Williamstown, New Jersey, in Gloucester County. The Bank also has a wholly-owned subsidiary which holds foreclosed assets. The Bank is subject to competition from other financial institutions and non-bank providers of financial services. The Bank is subject to regulation by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation.

### Principles of Consolidation

The consolidated financial statements of First Bank and Subsidiary are prepared on an accrual basis and include the accounts of First Bank's wholly-owned subsidiary, BC1 LLC. All significant inter-company accounts and transactions have been eliminated from the accompanying consolidated financial statements.

### Basis of Financial Statement Presentation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles.

### Subsequent Events

The Bank has evaluated subsequent events through March 12, 2013, which was the date this report was available to be issued. Management believes there were no events that occurred after December 31, 2012, but before the financial statements were available to be issued, that would require disclosure.

### Use of Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, assessment of other than temporary impairment of securities, restricted stocks and other investments, the valuation of other real estate owned, the income tax provision and the valuation of deferred tax assets.

### Significant Group Concentrations of Credit Risk

During 2012, our business was generated principally in central New Jersey. We generated additional business in Gloucester, Atlantic and Camden Counties in southern New Jersey. Note 2 discusses the types of securities that the Bank currently invests in. Note 3 discusses the types of lending that the Bank engages in. Although the Bank intends to have a diversified loan portfolio, its debtors' ability to honor their contracts will be influenced by the region's economy. The Bank does not have any significant concentrations to any one industry or customer.

### Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits with banks, and Federal funds sold. Generally, Federal funds are purchased or sold for one day periods.

### Securities

Management determines the appropriate classification of securities at the time of purchase and re-evaluates such designation as of each balance sheet date.

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time, but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Amortization of premiums and accretion of discounts are recognized in interest income using the interest method over the terms of the securities.

## Note 1 - Summary of Significant Accounting Policies (Continued)

### Securities (Continued)

Securities that the Bank has the positive intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions are classified as held to maturity securities. These securities are carried at amortized cost adjusted for the amortization of premiums and accretion of discounts, computed by a method which approximates the interest method over the terms of the securities.

Declines in the fair value of securities held to maturity and securities available for sale below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the ability of the Bank to hold its investment, and whether the Bank will be required to sell the security before a recovery in fair value. The Bank recorded no impairment losses in 2012, 2011 and 2010.

### Other Investments

Other investments consist of the Solomon Hess SBA Loan Fund ("Fund"), utilized for the purpose of assisting the Bank in satisfying its CRA lending requirements. As this fund operates as a private fund, shares in the Fund are not publicly traded and therefore have no readily determinable market value. An investor can have its interest in the Fund redeemed for the balance of its capital account at any quarter end, assuming it gives the Fund sixty (60) days notice. The investment in this Fund is recorded at cost. The Bank does not record other investments at fair value on a recurring basis, as this investment's carrying amount approximates fair value.

The Bank recorded no impairment charge on other investments in 2012, 2011 and 2010.

### Restricted Investment in Bank Stocks

Restricted stock, which represents required investments in the common stock of correspondent banks, is carried at cost and as of December 31, 2012 and 2011, consists of common stock of the Federal Home Loan Bank ("FHLB") of New York and Atlantic Central Bankers Bank ("ACBB").

Management evaluates the restricted stock for impairment in accordance with ASC 942-10, *Financial Services – Depository and Lending*. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB and ACBB as compared to the capital stock amount for the FHLB and ACBB and the length of time this situation has persisted, (2) commitments by the FHLB and ACBB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB and ACBB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB and ACBB.

The Bank recorded no impairment charge related to the FHLB or ACBB stocks in 2012, 2011 and 2010.

### Loans

The loan portfolio includes commercial and industrial, commercial real estate, residential and consumer segments. Commercial and industrial loans typically consist of loans to finance equipment, inventory, receivables and other working capital needs of small- to mid-sized businesses. The commercial real estate portfolio includes mortgage loans on owner-occupied and tenanted investment properties, and construction and land development loans. Residential loans are comprised of loans secured by 1–4 family and multi-family residential properties. Consumer and other loans include auto loans, personal loans, traditional installment loans and other loans.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank generally amortizes these amounts over the contractual life of the loan.

The accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently

## Note 1 - Summary of Significant Accounting Policies (Continued)

### Loans (Continued)

performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income is reversed. Interest received on nonaccrual loans is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

### Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses and decreased by charge offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance for loan losses consists of specific and general components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential, consumer and other loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Experience, ability, and depth of lending management and staff.
5. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.
6. Quality of the Bank's loan review system, and the degree of oversight by the Bank's Board of Directors.
7. Existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. Effect of external factors, such as competition and legal and regulatory requirements.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

## Note 1 - Summary of Significant Accounting Policies (Continued)

### Allowance for Loan Losses (Continued)

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

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The fair values of substantially all impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, which are comprised of investor-owned, owner-occupied, and construction, land development, and other land loans, fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the fair value. The discounts include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual residential loans, consumer loans, or other loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to an accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial and industrial and commercial real estate loans or when credit deficiencies arise, such as delinquent loan payments, for residential and consumer and other loans.

Credit quality risk ratings include the regulatory classifications of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as doubtful have all the weaknesses inherent in loans classified as substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

## Note 1 - Summary of Significant Accounting Policies (Continued)

### Allowance for Loan Losses (Continued)

On a quarterly basis the Bank's Asset Quality Review Committee formally reviews the ratings on all criticized and classified loans. The Bank engages an independent third-party loan review consultant to review the loan portfolio. As part of their scope they review a significant portion of criticized and classified loans.

In addition, Federal and state regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on its comprehensive analysis of the loan portfolio, management believes that the level of the allowance for loan losses at December 31, 2012 and 2011 is adequate.

### Reserve for Unfunded Loan Commitments

The reserve for unfunded loan commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statements of condition. The determination of the adequacy of the reserve is based upon an evaluation of the unfunded credit facilities, including an assessment of historical commitment utilization experience and credit risk. Net adjustments to the reserve for unfunded loan commitments are recorded in non-interest expense.

### Other Real Estate Owned

Other real estate owned is real estate that is acquired through foreclosure or deed in lieu of foreclosure in partial or total satisfaction of loans. The properties are recorded at fair value less estimated disposal costs at the date acquired. When a property is acquired, the excess of the loan balance over the fair value is charged to the allowance for loan losses. Any subsequent writedowns that may be required to the carrying value of the property are recorded in non-interest expense.

### Transfers of Financial Assets

Transfers of financial assets, including loan and loan participation sales, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets, ranging from one to seven years, except for leasehold improvements, which are depreciated over the term of the lease or estimated useful lives, whichever is shorter.

### Bank-Owned Life Insurance

The Bank owns bank-owned life insurance ("BOLI") to help offset the cost of employee benefits. BOLI is recorded at its cash surrender value. The change in the cash surrender value is included as a component of non-interest income and is exempt from federal and state income taxes as long as the policies are held until the death of the insured individuals.

### Advertising Costs

Advertising costs are expensed as incurred.

### Income Taxes

Income taxes are accounted for in accordance with FASB ASC Topic 740, *Income Taxes*. Income tax accounting results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to taxable income. The Bank determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

## Note 1 - Summary of Significant Accounting Policies (Continued)

### Income Taxes (Continued)

Deferred income tax expense or benefit results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Bank accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

The Bank recognizes interest and penalties on income taxes, if any, as a component of the provision for income taxes. There were no interest and penalties recognized in 2012, 2011 and 2010.

### Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated statements of condition when they are funded.

### Stock-Based Compensation

The Bank applies FASB ASC Topic 718 *Compensation – Stock-Based Compensation*, which contains a fair value-based method for valuing stock-based compensation, and measures compensation cost at the grant date based on the fair value of the award. Compensation is recognized over the service period, which is usually the vesting period.

### Earnings Per Share

Basic earnings per share represents the effect of earnings upon the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the effect of earnings upon weighted average shares including the potential dilution that could occur if securities or contracts to issue common stock were converted or exercised, utilizing the treasury stock method.

### Comprehensive Income (Loss)

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, and gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the stockholders' equity section of the consolidated statements of condition, such items, along with net income (loss), are components of comprehensive income (loss).

The components of accumulated other comprehensive income included in stockholders' equity are as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| (In thousands) | 2012 | 2011 | 2010 |
| Net unrealized gain on securities available for sale | **$ 471** | $ 98 | $ 32 |
| Tax effect | **(160)** | – | – |
| Accumulated other comprehensive income, net of tax | **$ 311** | $ 98 | $ 32 |

There was no tax effect for the years ended December 31, 2011 and 2010 due to the Bank's lack of taxable earnings history.

### New Accounting Standard

In 2012, the Bank was required to adopt a new accounting standard related to the presentation of comprehensive income (loss). The standard eliminated the option to report other comprehensive income (loss) and its components in the consolidated statement of stockholders' equity. The Bank has chosen to present comprehensive income in a separate consolidated statement of comprehensive income (loss).

### Reclassifications

Certain reclassifications have been made to 2011 and 2010 information to conform to the 2012 presentation. The reclassifications had no effect on the results of operations.

## Note 2 - Securities

The amortized cost and fair value of securities available for sale are as follows:

| (In thousands) | December 31, 2012 Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Mortgage-backed securities: | | | | |
| Issued by FNMA/FHLMC | $ 30,818 | $ 322 | $ (27) | $ 31,113 |
| Issued by GNMA | 7,742 | 38 | (3) | 7,777 |
| Corporate obligations | 4,233 | 142 | – | 4,375 |
| Total | $ 42,793 | $ 502 | $ (30) | $ 43,265 |

| (In thousands) | December 31, 2011 Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government-sponsored agencies | $ 3,000 | $ 1 | $ – | $ 3,001 |
| Mortgage-backed securities: | | | | |
| Issued by FNMA/FHLMC | 8,975 | 173 | – | 9,148 |
| Issued by GNMA | 1,521 | 4 | – | 1,525 |
| Corporate obligations | 2,956 | 6 | (85) | 2,877 |
| Total | $ 16,452 | $ 184 | $ (85) | $ 16,551 |

The amortized cost and fair value of securities held to maturity are as follows:

| (In thousands) | December 31, 2012 Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government-sponsored agencies | $ 2,000 | $ 318 | $ – | $ 2,318 |
| Obligations of state and political subdivisions | 4,693 | 46 | (5) | 4,734 |
| | $ 6,693 | $ 364 | $ (5) | $ 7,052 |

| (In thousands) | December 31, 2011 Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Government-sponsored agencies | $ 2,000 | $ 267 | $ – | $ 2,267 |

## Note 2 - Securities (Continued)

The amortized cost and fair value of securities available for sale and securities held to maturity by contractual maturity are shown below. Certain of these securities have call features which allow the issuer to call the security prior to maturity at the issuer's discretion.

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Available for Sale | | Held to Maturity | |
| (In thousands) | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due after one year through five years | $ 4,233 | $ 4,375 | $ 576 | $ 581 |
| Due after five years through ten years | – | – | 5,414 | 5,765 |
| Due after ten years | – | – | 703 | 706 |
| Mortgage-backed securities: | | | | |
| Issued by FNMA/FHLMC | 30,818 | 31,113 | – | – |
| Issued by GNMA | 7,742 | 7,777 | – | – |
| Total | $ 42,793 | $ 43,265 | $ 6,693 | $ 7,052 |

The following tables provide additional information regarding securities available for sale with unrealized losses.

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| (In thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Mortgage-backed securities: | | | | | | |
| Issued by FNMA/FHLMC | $ 8,968 | $ (27) | $ – | $ – | $ 8,968 | $ (27) |
| Issued by GNMA | 1,486 | (3) | – | – | 1,486 | (3) |
| Total | $ 10,454 | $ (30) | $ – | $ – | $ 10,454 | $ (30) |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| (In thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate obligations | $ 1,877 | $ (85) | $ – | $ – | $ 1,877 | $ (85) |

## Note 2 - Securities (Continued)

The following table provides additional information regarding securities held to maturity with unrealized losses.

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| (In thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of state and political subdivisions | $ 1,542 | $ (5) | $ – | $ – | $ 1,542 | $ (5) |

There were no securities held to maturity with unrealized losses at December 31, 2011.

Securities with unrealized losses are evaluated quarterly to determine whether the loss is other than temporary. At December 31, 2012, the Bank determined that all unrealized losses were temporary in nature. This conclusion was based on several factors, including the strong credit quality of the securities with unrealized losses and the low level and short time frame of the unrealized losses.

At December 31, 2012 there were 40 issues that made up the securities portfolio. There were nine issues that had unrealized losses of less than 12 months. The nine issues were made up of five mortgage-backed securities and four obligations of state and political subdivisions. The nine issues had a fair value of $12.0 million with unrealized losses of $35,000. There were no issues that had unrealized losses of twelve months or longer.

There were no securities sold in 2012. Proceeds from the sale of securities available for sale during 2011 and 2010 were $10.5 million and $47.8 million, respectively. Gross gains of $113,000 and $744,000 were realized on those sales for 2011 and 2010, respectively. Gross losses of $72,000 and $104,000 were realized on those sales for 2011 and 2010, respectively.

Securities with a carrying value of approximately $13.7 million and $9.5 million at December 31, 2012 and 2011, respectively, were pledged to the FHLB as collateral for advances and for other purposes as required or permitted by law.

## Note 3 - Loans

The composition of loans is as follows:

| | December 31, | |
|---|---|---|
| (In thousands) | 2012 | 2011 |
| Commercial and industrial | $ 52,246 | $ 33,788 |
| Commercial real estate | 155,045 | 134,101 |
| Residential | 45,395 | 29,974 |
| Consumer and other | 7,648 | 9,343 |
| Total Loans | 260,334 | 207,206 |
| Less: Allowance for loan losses | (4,084) | (3,307) |
| Net deferred loan fees | (295) | (182) |
| **Loans, net** | $ 255,955 | $ 203,717 |

Commercial real estate loans are comprised of investor-owned, owner-occupied, and construction, land development, and other land loans. Residential loans are comprised of loans secured by 1-4 family and multi-family residential properties.

During 2011, the Bank sold commercial real estate loans consisting of the guaranteed portion of Small Business Administration ("SBA") loans, aggregating approximately $2.5 million. There were no loan sales in 2012 or 2010.

## Note 4 - Allowance for Loan Losses

The changes in the allowance for loan losses are as follows:

| (In thousands) | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Balance - beginning | **$ 3,307** | $ 2,444 | $ 1,883 |
| Loans charged off | **(632)** | (1,241) | (1,723) |
| Recoveries of loans charged off | **43** | 24 | 5 |
| Net charge offs | **(589)** | (1,217) | (1,718) |
| Provision for loan losses | **1,366** | 2,080 | 2,279 |
| Balance - ending | **$ 4,084** | $ 3,307 | $ 2,444 |

The changes in the allowance for loan losses by loan class are as follows:

**Year Ended December 31, 2012**

| (In thousands) | Commercial and Industrial | Commercial Real Estate | Residential | Consumer and Other | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Balance – beginning | **$ 549** | **$ 2,347** | **$ 62** | **$ 349** | **$ 3,307** |
| Loans charged off | **49** | **349** | **33** | **201** | **632** |
| Recoveries of loans charged off | **(14)** | **(24)** | **(5)** | **–** | **(43)** |
| Net charge offs | **35** | **325** | **28** | **201** | **589** |
| Provision for loan losses | **394** | **689** | **45** | **238** | **1,366** |
| Balance – ending | **$ 908** | **$ 2,711** | **$ 79** | **$ 386** | **$ 4,084** |

Year Ended December 31, 2011

| (In thousands) | Commercial and Industrial | Commercial Real Estate | Residential | Consumer and Other | Total |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Balance – beginning | $ 556 | $ 1,509 | $ 310 | $ 69 | $ 2,444 |
| Loans charged off | 967 | 33 | 222 | 19 | 1,241 |
| Recoveries of loans charged off | (15) | – | (9) | – | (24) |
| Net charge offs | 952 | 33 | 213 | 19 | 1,217 |
| Provision for loan losses | 945 | 871 | (35) | 299 | 2,080 |
| Balance – ending | $ 549 | $ 2,347 | $ 62 | $ 349 | $ 3,307 |

The allowance for loan losses and recorded investment in loans are as follows:

**December 31, 2012**

| (In thousands) | Commercial and Industrial | Commercial Real Estate | Residential | Consumer and Other | Total |
|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | |
| Ending balance | **$ 908** | **$ 2,711** | **$ 79** | **$ 386** | **$ 4,084** |
| Ending balance individually evaluated for impairment | **–** | **–** | **–** | **–** | **–** |
| Ending balance collectively evaluated for impairment | **$ 908** | **$ 2,711** | **$ 79** | **$ 386** | **$ 4,084** |
| **Loans:** | | | | | |
| Ending balance | **$ 52,246** | **$ 155,045** | **$ 45,395** | **$ 7,648** | **$260,334** |
| Ending balance individually evaluated for impairment | **286** | **2,627** | **992** | **326** | **4,231** |
| Ending balance collectively evaluated for impairment | **$ 51,960** | **$ 152,418** | **$ 44,403** | **$ 7,322** | **$256,103** |

## Note 4 - Allowance for Loan Losses (Continued)

| (In thousands) | December 31, 2011 Commercial and Industrial | Commercial Real Estate | Residential | Consumer and Other | Total |
|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | |
| Ending balance | $ 549 | $ 2,347 | $ 62 | $ 349 | $ 3,307 |
| Ending balance individually evaluated for impairment | – | 64 | 5 | – | 69 |
| Ending balance collectively evaluated for impairment | $ 549 | $ 2,283 | $ 57 | $ 349 | $ 3,238 |
| **Loans receivable:** | | | | | |
| Ending balance | $ 33,788 | $134,101 | $ 29,974 | $ 9,343 | $ 207,206 |
| Ending balance individually evaluated for impairment | 223 | 5,800 | 1,134 | 333 | 7,490 |
| Ending balance collectively evaluated for impairment | $ 33,565 | $128,301 | $ 28,840 | $ 9,010 | $ 199,716 |

There were no loans acquired with deteriorated credit quality for the years ended December 31, 2012 and 2011.

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention and substandard within the Bank's internal risk rating system:

| (In thousands) | **December 31, 2012** Pass | Special Mention | Substandard | Total |
|---|---|---|---|---|
| Commercial and industrial | **$ 49,749** | **$ 600** | **$ 1,897** | **$ 52,246** |
| Commercial real estate | **149,272** | **3,172** | **2,601** | **155,045** |
| Residential | **41,684** | **2,719** | **992** | **45,395** |
| Consumer and other | **7,322** | **–** | **326** | **7,648** |
| Total | **$ 248,027** | **$ 6,491** | **$ 5,816** | **$ 260,334** |

| (In thousands) | December 31, 2011 Pass | Special Mention | Substandard | Total |
|---|---|---|---|---|
| Commercial and industrial | $ 33,565 | $ – | $ 223 | $ 33,788 |
| Commercial real estate | 127,054 | 1,247 | 5,800 | 134,101 |
| Residential | 28,654 | 186 | 1,134 | 29,974 |
| Consumer and other | 8,957 | 53 | 333 | 9,343 |
| Total | $ 198,230 | $ 1,486 | $ 7,490 | $ 207,206 |

There were no loans classified as doubtful at December 31, 2012 and 2011.

## Note 4 - Allowance for Loan Losses (Continued)

The performance and credit quality of the loan portfolio are also monitored by analyzing the age of the loans as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by past due status:

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Past Due > 90 Days and Still Accruing | Nonaccrual |
| Commercial and industrial | $ 1,527 | $ 452 | $ 286 | $ 2,265 | $ – | $ 286 |
| Commercial real estate | 4,033 | 814 | 1,751 | 6,598 | – | 1,751 |
| Residential | 615 | 2,539 | 960 | 4,114 | – | 960 |
| Consumer and other | 149 | – | 326 | 475 | – | 326 |
| Total | $ 6,324 | $ 3,805 | $ 3,323 | $ 13,452 | $ – | $ 3,323 |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Past Due > 90 Days and Still Accruing | Nonaccrual |
| Commercial and industrial | $ – | $ – | $ 224 | $ 224 | $ – | $ 224 |
| Commercial real estate | 659 | – | 4,018 | 4,677 | – | 4,018 |
| Residential | – | – | 1,134 | 1,134 | – | 1,134 |
| Consumer and other | – | 36 | 385 | 421 | 52 | 333 |
| Total | $ 659 | $ 36 | $ 5,761 | $ 6,456 | $ 52 | $ 5,709 |

Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans consist of loans on which accrual of interest has been discontinued (nonaccrual) and loans 90 days past due or more on which interest is still accruing.

A summary of nonperforming assets is as follows:

| | December 31, | |
|---|---|---|
| (In thousands) | 2012 | 2011 |
| Nonaccrual loans: | | |
| Commercial and industrial | $ 286 | $ 224 |
| Commercial real estate | 1,751 | 4,018 |
| Residential | 960 | 1,134 |
| Consumer and other | 326 | 333 |
| Total nonaccrual loans | 3,323 | 5,709 |
| Loans past due 90 days or more and still accruing: | | |
| Consumer and other | – | 52 |
| Total loans past due 90 days or more and still accruing | – | 52 |
| Total nonperforming loans | 3,323 | 5,761 |
| Other real estate owned | 2,604 | 623 |
| Total nonperforming assets | $ 5,927 | $ 6,384 |

## Note 4 - Allowance for Loan Losses (Continued)

### Trouble Debt Restructured Loans

From time to time, the Bank may extend, restructure, or otherwise modify the terms of existing loans, on a case-by-case basis, to remain competitive and retain certain borrowers, as well as assist other borrowers who may be experiencing financial difficulties. If a borrower is experiencing financial difficulties and a concession is made by way of a modification of terms the Bank would not otherwise consider, the loan would be classified as a troubled debt restructured loan ("TDR").

The Bank adopted the amendments in FASB ASU 2011-02 as of January 1, 2011. As required, the Bank reassessed all loan restructurings that occurred on or after January 1, 2011 for potential identification as TDRs. As a result of the reassessment the Bank concluded it had no TDRs at December 31, 2011. At December 31, 2012 the Bank had one TDR of approximately $32,000 which is performing pursuant to the terms of its modification. The modification consisted of a reduction in interest rate and an extension of terms.

The following tables summarize information in regards to impaired loans by loan portfolio:

| | December 31, 2012 | | | Year Ended December 31, 2012 | | |
|---|---|---|---|---|---|---|
| (In thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Interest Income Recognized on a Cash Basis |
| Impaired loans without a valuation allowance: | | | | | | |
| Commercial and industrial | $ 286 | $ 915 | $ – | $ 304 | $ – | $ – |
| Commercial real estate | 2,627 | 2,782 | – | 4,670 | 113 | 89 |
| Residential | 992 | 1,179 | – | 1,085 | – | – |
| Consumer and other | 326 | 503 | – | 378 | – | – |
| Total | $ 4,231 | $ 5,379 | $ – | $ 6,437 | $ 113 | $ 89 |
| Impaired loans with a valuation allowance: | | | | | | |
| Commercial and industrial | $ – | $ – | $ – | $ – | $ – | $ – |
| Commercial real estate | – | – | – | – | – | – |
| Residential | – | – | – | – | – | – |
| Consumer and other | – | – | – | – | – | – |
| Total | $ – | $ – | $ – | $ – | $ – | $ – |
| Total impaired loans: | | | | | | |
| Commercial and industrial | $ 286 | $ 915 | $ – | $ 304 | $ – | $ – |
| Commercial real estate | 2,627 | 2,782 | – | 4,670 | 113 | 89 |
| Residential | 992 | 1,179 | – | 1,085 | – | – |
| Consumer and other | 326 | 503 | – | 378 | – | – |
| Total | $ 4,231 | $ 5,379 | $ – | $ 6,437 | $ 113 | $ 89 |

## Note 4 - Allowance for Loan Losses (Continued)

| (In thousands) | December 31, 2011 Recorded Investment | December 31, 2011 Unpaid Principal Balance | December 31, 2011 Related Allowance | Year Ended December 31, 2011 Average Recorded Investment | Year Ended December 31, 2011 Interest Income Recognized | Year Ended December 31, 2011 Interest Income Recognized on a Cash Basis |
|---|---|---|---|---|---|---|
| Impaired loans without a valuation allowance: | | | | | | |
| Commercial and industrial | $ 223 | $ 805 | $ – | $ 263 | $ – | $ – |
| Commercial real estate | 4,864 | 4,863 | – | 3,466 | 42 | – |
| Residential | 963 | 1,150 | – | 854 | – | – |
| Consumer and other | 333 | 343 | – | 191 | – | 1 |
| Total | $ 6,383 | $ 7,161 | $ – | $ 4,774 | $ 42 | $ 1 |
| Impaired loans with a valuation allowance: | | | | | | |
| Commercial and industrial | $ – | $ – | $ – | $ – | $ – | $ – |
| Commercial real estate | 936 | 936 | 64 | 943 | 54 | – |
| Residential | 171 | 206 | 5 | 89 | – | – |
| Consumer and other | – | – | – | – | – | – |
| Total | $ 1,107 | $ 1,142 | $ 69 | $ 1,032 | $ 54 | $ – |
| Total impaired loans: | | | | | | |
| Commercial and industrial | $ 223 | $ 805 | $ – | $ 263 | $ – | $ – |
| Commercial real estate | 5,800 | 5,799 | 64 | 4,409 | 96 | – |
| Residential | 1,134 | 1,356 | 5 | 943 | – | – |
| Consumer and other | 333 | 343 | – | 191 | – | 1 |
| Total | $ 7,490 | $ 8,303 | $ 69 | $ 5,806 | $ 96 | $ 1 |

## Note 5 - Premises and Equipment

The components of premises and equipment are as follows:

| (In thousands) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Leasehold improvements | **$ 2,383** | $ 2,337 |
| Furniture and fixtures | **299** | 249 |
| Equipment and data processing software | **1,146** | 1,071 |
| | **3,828** | 3,657 |
| Less: Accumulated depreciation | **(1,927)** | (1,518) |
| **Total** | **$ 1,901** | $ 2,139 |

Depreciation expense on premises and equipment included in non-interest expense in the consolidated statements of operations for the periods ended December 31, 2012, 2011 and 2010 was $408,000, $422,000 and $424,000, respectively.

## Note 6 - Deposits

The components of deposits are as follows:

| (In thousands) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Non-interest bearing demand | **$ 27,398** | $ 22,325 |
| Interest bearing demand | **11,177** | 7,324 |
| Money market and savings | **145,428** | 98,633 |
| Time, $100 and over | **46,264** | 41,566 |
| Time, other | **78,719** | 64,813 |
| **Total** | **$ 308,986** | $ 234,661 |

There were no brokered deposits at December 31, 2012 and 2011.

At December 31, 2012, the contractual maturities of time deposits are as follows:

| (In thousands) | |
|---|---|
| 2013 | **$ 55,579** |
| 2014 | **49,159** |
| 2015 | **6,499** |
| 2016 | **7,435** |
| 2017 | **6,311** |
| **Total** | **$ 124,983** |

## Note 7 - Borrowings

Long-term borrowings consist of Federal Home Loan Bank advances. The advances mature as follows:

| (In thousands) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| 2012 | **$ –** | $ – |
| 2013 | **219** | 428 |
| 2014 | **–** | – |
| 2015 | **–** | – |
| 2016 | **5,000** | 5,000 |
| 2017 | **5,000** | – |
| **Total** | **$ 10,219** | $ 5,428 |

At December 31, 2012, the Bank had three outstanding advances, all with fixed interest rates. The advance due in 2013 is amortizing, collateralized by securities and carries an interest rate of 4.58%. The advances due in 2016 and 2017 are collateralized by securities and carry interest rates of 2.41% and 1.07%, respectively.

At December 31, 2011, the Bank had two outstanding advances, both with fixed interest rates. The advance due in 2013 is amortizing, collateralized by securities and carries an interest rate of 4.58%. The advance due in 2016 is collateralized by securities and carries an interest rate of 2.41%.

The Bank originates and sells loans guaranteed by the Small Business Administration. The Bank retains the unguaranteed portion of the loans and the servicing on the loans sold and receives a fee based upon the principal balance outstanding. At December 31, 2010, the Bank had one loan in the process of being sold. As required under FASB ASC 860-20, this potential sale was carried on the balance sheet as a collateralized borrowing ($417,000) until the expiration of the recourse provisions with a secondary market purchaser, which was 90 days. This loan was sold in 2011 at the end of the recourse period.

## Note 7 - Borrowings (Continued)

As a member of the FHLB the Bank is eligible to borrow funds up to 50% of total assets from the FHLB subject to its stock and collateral requirements. At December 31, 2012 we had approximately $27.2 million in unpledged securities available as collateral for borrowing. The Bank has a line of credit with ACBB in the amount of $4.0 million. There was no borrowing on this facility at December 31, 2012 or 2011.

## Note 8 - Lease Commitments

The Bank has lease agreements for its four branches and corporate office space. The Hamilton, Lawrence and Ewing leases all had initial terms of five years with options to extend. The Williamstown lease is a ground lease with an initial term of 20 years with options to extend. The Bank's lease agreements include costs related to real estate taxes, insurance, utilities and maintenance costs in addition to the base rent.

Future minimum lease payments by year and in the aggregate, under lease agreements, are as follows:

| (In thousands) | |
|---|---|
| 2013 | $ 444 |
| 2014 | 328 |
| 2015 | 335 |
| 2016 | 337 |
| 2017 | 335 |
| Thereafter | 1,085 |
| **Total** | $ 2,864 |

Total lease rental expense was $422,000, $328,000 and $265,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

## Note 9 - Stockholders' Equity

During 2012, the Bank offered for sale up to 800,000 shares of the Bank's common stock at a price of $5.25 per share to First Bank shareholders and members of the public. The Bank sold all 800,000 shares of common stock which resulted in proceeds of approximately $4.2 million, net of offering costs of approximately $26,000.

During 2010, the Bank offered for sale up to 600,000 shares of the Bank's common stock at a price of $5.00 per share to First Bank shareholders and members of the public. The Bank sold 476,029 shares of common stock which resulted in proceeds of approximately $2.3 million, net of offering costs of $30,000.

In 2008, the Bank sold 2,444,916 units which consisted of one share of common stock and one quarter warrant at $7.90 per unit, which resulted in net proceeds of $19.2 million. One full warrant will enable the holder to purchase one share of common stock at an exercise price of $9.00 per share. A total of 611,204 warrants were issued as part of the recapitalization. The warrants have a term of five years from the date of issuance. The warrants will expire in October 2013. No warrants were exercised during 2012, 2011 or 2010.

In its initial stock offering in 2007, the Bank issued 241,502 warrants. Of these warrants, 96,620 were issued to organizers with a fair value of $205,250. These warrants are immediately exercisable at $10.00 per share and expire ten years from the issue date. The remaining 144,882 warrants which were not issued to organizers expired in 2012. None of these warrants were exercised in 2012, 2011 or 2010.

## Note 10 - Income Taxes

The components of income tax (benefit) expense consist of the following for the years ended December 31:

| (In thousands) | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Federal: | | | |
| Current | **$ 266** | $ – | $ – |
| Deferred | **(463)** | (1,506) | – |
| | **(197)** | (1,506) | – |
| State: | | | |
| Current | **2** | 2 | 2 |
| Deferred | **(135)** | (283) | – |
| | **(133)** | (281) | 2 |
| Total Income Tax (Benefit) Expense | **$ (330)** | $ (1,787) | $ 2 |

The components of the net deferred tax asset are as follows:

| (In thousands) | December 31, 2012 | 2011 |
|---|---|---|
| Deferred Tax Asset | | |
| Allowance for loan loss | **$ 1,140** | $ 836 |
| Contribution carryforward | **7** | – |
| Organization costs | **12** | 13 |
| Net operating loss carryforwards | **1,022** | 2,409 |
| Deferred loan costs | **118** | 97 |
| Non-accrual interest | **193** | – |
| Partnership income | **29** | – |
| Prepaid expense | **36** | – |
| AMT credits | **69** | – |
| Total Deferred Tax Asset | **2,626** | 3,355 |
| Deferred Tax Liability | | |
| Cash basis adjustment | **(151)** | (142) |
| Unrealized gains on AFS securities | **(160)** | – |
| Depreciation | **(90)** | (234) |
| Total Deferred Tax Liability | **(401)** | (376) |
| Valuation Allowance | **–** | $ (1,192) |
| Net Deferred Tax Asset | **$ 2,225** | $ 1,787 |

The Bank has net operating loss carryforwards available for income tax purposes of approximately $2.6 million for federal purposes expiring through 2031 and $2.1 million for state purposes expiring through 2017. The Bank's federal and state income tax returns are open for examination from the 2009 tax return year and forward.

The decreases in valuation allowance at December 31, 2012 and 2011 are the result of utilized net operating loss carryforwards to offset taxable earnings and management's estimate of net operating loss carryforwards more likely than not to be utilized in the foreseeable future.

## Note 10 - Income Taxes (Continued)

Reconciliations of the statutory federal income tax at a rate of 34% to the income tax (benefit) expense reported in the consolidated statements of operations are as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Federal income at statutory rate | **34.0%** | 34.0% | 34.0% |
| State tax, net of federal benefit | **-3.9%** | -6.0% | 0.0% |
| Change in valuation allowance | **-46.0%** | -606.4% | -34.0% |
| Bank-owned life insurance | **-2.1%** | -1.5% | 0.0% |
| Travel and entertainment | **0.2%** | 1.5% | 0.0% |
| Stock-based compensation expense | **1.0%** | 0.0% | 0.0% |
| Other | **2.2%** | 12.9% | 0.0% |
| | **-14.6%** | -565.5% | 0.0% |

## Note 11 - Earnings Per Share

The Bank's calculation of earnings per share in accordance with FASB ASC Topic 260, *Earnings per Share*, is as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| (In thousands, except per share data) | 2012 | 2011 | 2010 |
| Net income (loss) available to common stockholders | **$ 2,588** | $ 2,103 | $ (1,108) |
| Basic weighted average common shares outstanding | **4,083** | 3,887 | 3,649 |
| Plus: Effect of dilutive common stock equivalents | **2** | – | – |
| Diluted weighted average number of common shares outstanding | **4,085** | 3,887 | 3,649 |
| Earnings (loss) per share: | | | |
| Basic | **$ 0.63** | $ 0.54 | $ (0.30) |
| Diluted | **$ 0.63** | $ 0.54 | $ (0.30) |

Common stock equivalents consisting of stock options for 99,000 shares and 338,500 shares for the years ended December 31, 2012 and 2011, respectively, and outstanding warrants of 707,824 and 852,706, respectively, were not considered in computing diluted earnings per share because they were anti-dilutive as the exercise price exceeded the average market price.

## Note 12 - Stock-Based Compensation

In 2009, the Bank adopted both the First Bank 2009 Stock Option Plan–A (the "A" Plan) and the First Bank 2009 Stock Option Plan–B (the "B" Plan). The A Plan authorizes the Board of Directors to grant options to purchase up to an aggregate of 409,640 shares of the Bank's common stock, up to 170,547 of which may be non-qualified options. Under the B Plan, the Bank may grant non-qualified options to purchase up to 102,000 shares of common stock, as of the effective date of the Plans, to officers, other employees and directors. Shares granted under the Plan to directors are non-qualified options. The shares granted under the Plan to officers and other employees can be non-qualified options or incentive stock options ("ISO's"), subject to the limitations under Section 422 of the Internal Revenue Code.

## Note 12 - Stock-Based Compensation (Continued)

All options granted under the Plans have a term that shall not exceed ten years and a vesting period of three years. The exercise price of the options granted under the Plans as ISO's are to be granted at an exercise price of not less than 100% of the fair market value of the Bank's common stock on the date of grant. All non-qualified options must have an exercise price of at least 100% of fair market value at the date of grant. Fair market value is to be determined by the Board of Directors in good faith.

The tables below reflect the activity in the Bank's stock option plans for each of the years presented.

| | **2012** | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Shares** | **Weighted Average Exercise Price** | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Plan A | | | | | | |
| Outstanding at beginning of year | **266,500** | **$ 5.00** | 242,000 | $ 5.00 | – | $ – |
| Granted | **101,500** | **5.24** | 27,500 | 5.00 | 242,000 | 5.00 |
| Forfeited or expired | **(18,500)** | **5.00** | (3,000) | 5.00 | – | – |
| Outstanding at end of year | **349,500** | **5.07** | 266,500 | 5.00 | 242,000 | 5.00 |
| Exercisable at end of year | **158,667** | **5.00** | 82,667 | 5.00 | 3,000 | 5.00 |
| Weighted-average fair value of options granted during the year | **$ 57,062** | | $ 15,460 | | $ 136,050 | |

| | **2012** | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Shares** | **Weighted Average Exercise Price** | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Plan B | | | | | | |
| Outstanding at beginning of year | **72,000** | **$ 5.00** | 80,000 | $ 5.00 | – | $ – |
| Granted | **16,000** | **5.00** | – | – | 80,000 | 5.00 |
| Forfeited or expired | **(8,000)** | **5.00** | (8,000) | 5.00 | – | – |
| Outstanding at end of year | **80,000** | **5.00** | 72,000 | 5.00 | 80,000 | 5.00 |
| Exercisable at end of year | **42,667** | **5.00** | 26,667 | 5.00 | – | – |
| Weighted-average fair value of options granted during the year | **$ 8,995** | | $ – | | $ 44,975 | |

The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for 2012, 2011 and 2010: dividend yield of 0%; expected volatility of approximately 30%; risk-free interest rate of 1.45% and an expected life of the options of six years. The volatility percentage for 2012, 2011 and 2010 was based on the average expected volatility of similar public financial institutions in the Bank's market area. The fair value of options granted in 2012, 2011 and 2010 was approximately $0.56 per option.

The weighted average remaining contractual life of options outstanding at December 31, 2012 is 8.45 years. The aggregate intrinsic value of outstanding options was $83,000 at December 31, 2012.

Stock-based compensation expense related to outstanding stock options was approximately $68,000, $62,000 and $15,000 for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, there was approximately $187,000 of unrecognized compensation costs related to non-vested stock options which is expected to be recognized over an average remaining vesting period of 1.78 years.

## Note 13 - Transactions with Executive Officers, Directors and Principal Stockholders

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans and deposits of related parties totaled $6,047,000 and $10,027,000, respectively, at December 31, 2012.

Loans and deposits of related parties totaled $6,670,000 and $10,408,000, respectively, at December 31, 2011. Payments and originations of loans from related parties during 2012 were $686,000 and $63,000, respectively. Payments and originations of loans receivable from related parties during 2011 were $858,000 and $3,892,000, respectively. Included in the payment number was $326,200 in loans to a former director who did not stand for reelection in 2011. None of our related party loans were past due or on nonaccrual status as of December 31, 2012 or 2011.

The Bank leases its corporate office space and branch facility in Hamilton, New Jersey from North Buffalo Advisors II, LLC, an entity majority owned by members of our Board of Directors. The lease has an initial term of five years with options to extend. Under the terms of the lease, the Bank is obligated to pay $19,692 per month. The Bank's lease agreement includes costs related to real estate taxes, insurance, utilities and maintenance costs in addition to the base rent.

## Note 14 - Other Commitments and Contingencies

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statements of condition.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The credit risk associated with these financial instruments is essentially the same as that involved in extending loans to customers. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2012 and 2011, total commitments to extend credit amounted to $42.9 million and $33.9 million, respectively. At December 31, 2012 the Bank had performance standby letters of credit of $1.9 million. These letters of credit are primarily related to performance guarantees on real estate development.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates up to two years or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The majority of the Bank's commitments are collateralized. The amount of collateral obtained is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

The Bank is party, in the ordinary course of business, to litigation involving collection matters, contract claims and other miscellaneous causes of action arising from its business. Management does not consider that any such proceedings depart from usual routine litigation.

## Note 15 - Litigation Settlement

In 2009, another financial institution commenced an action against First Bank alleging the Bank had breached a loan participation agreement between the two parties. The plaintiffs in that action were seeking to require the Bank to purchase back the loan participation in the amount of $659,000. The Bank defended this action in 2010 and 2011. A settlement was reached in April 2012 under which the Bank agreed to pay $150,000 to the plaintiff in full and complete settlement of the pending action.

## Note 16 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The guidelines require all banks to maintain a minimum ratio of total risk-based capital to total risk-weighted assets of 8%, maintain a minimum ratio of Tier 1 capital to total risk-weighted assets of 4% and Tier 1 capital to average assets of 4%. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Management believes, as of December 31, 2012, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank's capital amounts and ratios, and regulatory minimum capital ratios are presented below:

| | Actual | | For Capital Adequacy Purposes | | To Be Well-Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| (Dollar Amounts in Thousands) | | | | | | |
| **December 31, 2012:** | | | | | | |
| Total capital (to risk-weighted assets) | **$ 33,586** | **11.78%** | **$ 22,804** | **8.00%** | **$ 28,505** | **10.00%** |
| Tier 1 capital (to risk-weighted assets) | **30,016** | **10.53** | **11,402** | **4.00** | **17,103** | **6.00** |
| Tier 1 capital (to average assets) | **30,016** | **8.89** | **13,501** | **4.00** | **16,876** | **5.00** |
| December 31, 2011: | | | | | | |
| Total capital (to risk-weighted assets) | $ 26,123 | 11.56% | $ 18,073 | 8.00% | $ 22,591 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 23,293 | 10.31 | 9,036 | 4.00 | 13,554 | 6.00 |
| Tier 1 capital (to average assets) | 23,293 | 9.29 | 10,034 | 4.00 | 12,543 | 5.00 |

First Bank is considered "well-capitalized" under the FDIC's Prompt Corrective Action Capital Provisions.

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations. The New Jersey Banking Act of 1948 provides that cash dividends may be declared and paid out of accumulated net earnings or out of surplus, provided that the Bank's surplus may not be less than 50% of the Bank's capital account. In addition, as a policy, the FDIC and NJ DOBI will not permit a de novo bank to pay cash dividends until it has earned back its pre-opening costs and initial operating losses.

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Bank's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Bank could have realized in a sales transaction on the dates indicated. The fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

The Bank follows FASB ASC 820-10-5 which establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

*Level 2:* Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

*Level 3:* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

| **Description** | **December 31, 2012** | **(Level 1) Quoted Prices in Active Markets for Identical Assets** | **(Level 2) Significant Other Observable Inputs** | **(Level 3) Significant Unobservable Inputs** |
|---|---|---|---|---|
| (In thousands) | | | | |
| Securities available for sale: | | | | |
| Mortgage-backed securities | **$ 38,890** | **$ –** | **$ 38,890** | **$ –** |
| Corporate obligations | **4,375** | **–** | **4,375** | **–** |
| Total | **$ 43,265** | **$ –** | **$ 43,265** | **$ –** |

| Description | December 31, 2011 | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|---|---|---|---|
| (In thousands) | | | | |
| Securities available for sale: | | | | |
| U.S. Government sponsored agencies | $ 3,001 | $ – | $ 3,001 | $ – |
| Mortgage-backed securities | 10,673 | – | 10,673 | – |
| Corporate obligations | 2,877 | – | 2,877 | – |
| Total | $ 16,551 | $ – | $ 16,551 | $ – |

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

| **Description** | **December 31, 2012** | **(Level 1) Quoted Prices in Active Markets for Identical Assets** | **(Level 2) Significant Other Observable Inputs** | **(Level 3) Significant Unobservable Inputs** |
|---|---|---|---|---|
| (In thousands) | | | | |
| Impaired loans | **$ 4,231** | **$ –** | **$ –** | **$ 4,231** |
| Other real estate owned | **1,634** | **–** | **–** | **1,634** |
| Total | **$ 5,865** | **$ –** | **$ –** | **$ 5,865** |

| Description | December 31, 2011 | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|---|---|---|---|
| (In thousands) | | | | |
| Impaired loans | $ 7,421 | $ – | $ – | $ 7,421 |

The table below presents additional information about Level 3 assets measured at fair value on a nonrecurring basis:

**Quantitative information about Level 3 Fair Value Measurements December 31, 2012**

| **Asset Description** | **Fair Value** | **Valuation Method** | **Unobservable Input** | **Range (3)** | **Weighted Average (3)** |
|---|---|---|---|---|---|
| (In thousands) | | | | | |
| Impaired loans | **$ 4,231** | **Fair value of collateral (1)** | **Appraised Value (2)** | **0% – 42%** | **15%** |
| Other real estate owned | **$ 1,634** | **Fair value of collateral (1)** | **Appraised Value (2) Sales Price** | **5% – 11%** | **7%** |

Quantitative information about Level 3 Fair Value Measurements December 31, 2011

| Asset Description | Fair Value | Valuation Method | Unobservable Input | Range (3) | Weighted Average (3) |
|---|---|---|---|---|---|
| (In thousands) | | | | | |
| Impaired loans | $ 7,421 | Fair value of collateral (1) | Appraised Value (2) | 0% – 42% | 15% |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include level 3 inputs that are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.
(3) The range and weighted average of qualitative factors such as economic conditions and estimated liquidation expenses are presented as a percent of the appraised value.

The significant unobservable inputs for impaired loans and other real estate owned are the appraised value or an agreed upon sales price. These values are adjusted for estimated costs to sell which are incremental direct costs to transact a sale such as broker commissions, legal fees and title transfer fees. The costs must be considered essential to the sale and would not have been incurred if the decision to sell had not been made.

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

The following information should not be interpreted as an estimate of the fair value of the entire Bank since a fair value calculation is only provided for a limited portion of the Bank's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Bank's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Bank's financial instruments at December 31, 2012 and 2011.

### Cash and Cash Equivalents (Carried at Cost)

The carrying amounts for cash and cash equivalents approximate those assets' fair values.

### Interest Bearing Time Deposits with Banks (Carried at Cost)

The fair value of CDs with other banks is estimated using a discounted cash flow analysis and rate that approximates CDs with comparable remaining terms.

### Securities

The fair value of securities is determined by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices.

### Restricted Investment in Bank Stocks (Carried at Cost)

The carrying amount of restricted investment in bank stocks, which includes stocks of the Federal Home Loan Bank of New York and Atlantic Central Bankers Bank, approximates fair value, and considers the limited marketability of such securities.

### Other Investments (Carried at Cost)

The Solomon Hess SBA Loan Fund operates as a private fund. Shares in the Fund are not publicly traded and therefore have no readily determinable market value. Therefore, this investment's carrying value approximates fair value.

### Loans (Carried at Cost)

The fair value of loans is estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair value is based on carrying value.

### Impaired Loans (Generally Carried at Fair Value)

Impaired loans are generally measured based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. Impaired loans, which are measured for impairment using the fair value of the collateral, for collateral dependent loans, consisted of impaired loans with an unpaid principal balance of $5,379,000 less partial charge offs of $1,148,000 and no related allowance at December 31, 2012. Impaired loans with a related allowance, carried at fair value at December 31, 2011, include $1,107,000 in loans with specific reserves of $69,000 with unpaid principal balances of $1,142,000 less partial charge offs of $35,000. Impaired loans with no related allowance, carried at fair value at December 31, 2011, include loans with unpaid principal balances of $7,161,000 less partial charge offs of $778,000.

### Other Real Estate Owned (Carried at Fair Value)

Other real estate owned ("OREO") and other repossessed assets are measured at fair value less costs to sell. Fair value of OREO is determined by sales agreements or appraisals by qualified licensed appraisers. Costs to sell associated with OREO are based on estimation per the terms and conditions of the sales agreements or appraisals.

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

### Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair value.

### Deposits (Carried at Cost)

The fair value of nonmaturity deposits (e.g., interest and non-interest checking, savings and money market accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e., carrying amount). Fair value for time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on time deposits to a schedule of aggregated expected monthly maturities on time deposits.

### Long-term Borrowings (Carried at Cost)

Long-term borrowings consist of FHLB advances. The fair value of FHLB advances is estimated using a discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

### Off-Balance Sheet Financial Instruments

Fair value for off-balance sheet financial instruments (lending commitments and letters of credit are disclosed in Note 14) is based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing. The fair value of these instruments is considered immaterial.

The fair values of the Bank's financial instruments are as follows:

| | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | | | Fair Value Measurements Using: | | |
| (In thousands) | Carrying Amount | Estimated Fair Value | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 6,180 | $ 6,180 | $ 6,180 | $ – | $ – |
| Interest bearing deposits with banks | 17,686 | 17,686 | – | 17,686 | – |
| Interest bearing time deposits with banks | 1,469 | 1,472 | – | 1,472 | – |
| Securities available for sale | 43,265 | 43,265 | – | 43,265 | – |
| Securities held to maturity | 6,693 | 7,052 | – | 7,052 | – |
| Restricted investment in bank stocks | 824 | 824 | – | 824 | – |
| Other investments | 5,000 | 5,000 | – | 5,000 | – |
| Net loans | 255,955 | 261,622 | – | – | 261,622 |
| Accrued interest receivable | 1,033 | 1,033 | – | 1,033 | – |
| Financial Liabilities: | | | | | |
| Demand, savings and money market deposits | 184,003 | 184,003 | – | 184,003 | – |
| Time deposits | 124,983 | 126,783 | – | 126,783 | – |
| Long-term borrowings | 10,219 | 10,483 | – | 10,483 | – |
| Accrued interest payable | 139 | 139 | – | 139 | – |

## Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (Continued)

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | | | Fair Value Measurements Using: | | |
| (In thousands) | Carrying Amount | Estimated Fair Value | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 6,311 | $ 6,311 | $ 6,311 | $ – | $ – |
| Federal funds sold | 1,053 | 1,053 | 1,053 | – | – |
| Interest bearing deposits with banks | 14,465 | 14,465 | – | 14,465 | – |
| Interest bearing time deposits with banks | 3,584 | 3,591 | – | 3,591 | – |
| Securities available for sale | 16,551 | 16,551 | – | 16,551 | – |
| Securities held to maturity | 2,000 | 2,267 | – | 2,267 | – |
| Restricted investment in bank stocks | 542 | 542 | – | 542 | – |
| Other investments | 5,000 | 5,000 | – | 5,000 | – |
| Net loans | 203,717 | 205,389 | – | – | 205,389 |
| Accrued interest receivable | 743 | 743 | – | 743 | – |
| Financial Liabilities: | | | | | |
| Demand, savings and money market deposits | 128,282 | 128,282 | – | 128,282 | – |
| Time deposits | 106,379 | 108,073 | – | 108,073 | – |
| Long-term borrowings | 5,428 | 5,660 | – | 5,660 | – |
| Accrued interest payable | 135 | 135 | – | 135 | – |

FIRSTBANK

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Paul E. Fitzgerald

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Chief Lending Officer

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Treasurer/Chief Financial Officer

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Marian Sorrentino
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Elizabeth F. Camishion
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Kimberly Cerasi
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Commercial Lending Relationship Manager

Michael B. Cook
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Certified Public Accountant

# WELCOME HOME to First Bank…

**Pictured from left to right:** **Kim Dargay**, *Hamilton Branch Manager*; **John Pettit**, *Williamstown Branch Manager*; **Susan Paglione**, *Senior Business Development Officer*; **Kristin Bachik**, *Ewing Branch Manager* and **Kathy Rowley**, *Lawrence Branch Manager*

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