

FIRST RELIANCE BANCSHARES INC
Form 10-Q
May 15, 2009

FIRST RELIANCE BANCSHARES, INC.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

(Mark One)

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

OR

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

For the Transition Period from _____ to _____

Commission File Number 000-49757

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

South Carolina
(State or other jurisdiction of
incorporation or organization)

80-0030931
(I.R.S. Employer
Identification No.)

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

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

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

3,587,426 shares of common stock, par value \$0.01 per share, as of April 30, 2009

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

Yes No.

Edgar Filing: FIRST RELIANCE BANCSHARES INC - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

FIRST RELIANCE BANCSHARES, INC.

INDEX

| | Page No. |
|--------------------------------------|---|
| PART I. FINANCIAL INFORMATION | |
| Item 1. | Financial Statements (Unaudited) |
| | Condensed Consolidated Balance Sheets - March 31, 2009 and December 31, 2008 |
| | 3 |
| | Condensed Consolidated Statements of Income - Three months ended March 31, 2009 and 2008 |
| | 4 |
| | Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income - Three months ended March 31, 2009 and 2008 |
| | 5 |
| | Condensed Consolidated Statements of Cash Flows - Three months ended March 31, 2009 and 2008 |
| | 6 |
| | Notes to Condensed Consolidated Financial Statements |
| | 7-12 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations |
| | 13-28 |
| Item 3. | Quantitative and Qualitative Disclosure About Market Risk |
| | 29 |
| Item 4. | Controls and Procedures |
| | 29 |
| PART II. OTHER INFORMATION | |
| Item 1. | Legal Proceedings |
| | 30 |
| Item 1A. | Risk Factors |
| | 30 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds |
| | 30 |
| Item 3. | Defaults Upon Senior Securities |
| | 30 |
| Item 4. | Submission of Matters to a Vote of Security Holders |
| | 31 |
| Item 5. | Other Information |
| | 31 |
| Item 6. | Exhibits |
| | 31 |

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Balance Sheets

| | March 31, 2009 (Unaudited) | December 31, 2008 (Audited) |
|---|----------------------------------|-----------------------------------|
| Assets | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | \$ 31,683,883 | \$ 5,451,607 |
| Federal funds sold | - | 257,000 |
| Total cash and cash equivalents | 31,683,883 | 5,708,607 |
| Investment securities: | | |
| Securities available-for-sale | 73,593,711 | 76,310,816 |
| Nonmarketable equity securities | 5,284,600 | 4,574,700 |
| Total investment securities | 78,878,311 | 80,885,516 |
| Mortgage loans held for sale | 24,250,382 | 9,589,081 |
| Loans receivable | 464,124,999 | 468,990,202 |
| Less allowance for loan losses | (7,331,051) | (8,223,899) |
| Loans, net | 456,793,948 | 460,766,303 |
| Premises and equipment, net | 26,462,326 | 28,612,022 |
| Accrued interest receivable | 2,462,465 | 2,653,260 |
| Other real estate owned | 1,423,582 | 379,950 |
| Cash surrender value life insurance | 11,091,634 | 10,986,484 |
| Other assets | 4,354,994 | 3,852,660 |
| Total assets | \$ 637,401,525 | \$ 603,433,883 |
| Liabilities and Shareholders' Equity | | |
| Liabilities | | |
| Deposits | | |
| Noninterest-bearing transaction accounts | \$ 48,085,212 | \$ 39,467,609 |
| Interest-bearing transaction accounts | 34,414,993 | 34,708,951 |
| Savings | 85,396,666 | 110,629,005 |
| Time deposits \$100,000 and over | 190,458,083 | 137,444,867 |
| Other time deposits | 143,596,606 | 138,884,952 |
| Total deposits | 501,951,560 | 461,135,384 |
| Securities sold under agreement to repurchase | 864,994 | 8,197,451 |
| Advances from Federal Home Loan Bank | 69,500,000 | 78,000,000 |
| Note payable | - | 6,950,000 |
| Junior subordinated debentures | 10,310,000 | 10,310,000 |
| Accrued interest payable | 610,924 | 623,330 |
| Other liabilities | 1,205,844 | 791,960 |
| Total liabilities | 584,443,322 | 566,008,125 |
| Shareholders' Equity | | |

Edgar Filing: FIRST RELIANCE BANCSHARES INC - Form 10-Q

| | | |
|---|----------------|----------------|
| Preferred stock, no par value, authorized 10,000,000 shares: | | |
| Series A cumulative perpetual preferred stock 15,349 and 0 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively | 14,389,600 | - |
| Series B cumulative perpetual preferred stock 767 and 0 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively | 848,396 | - |
| Common stock, \$0.01 par value; 20,000,000 shares authorized, 3,587,226 and 3,525,004 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively | 35,872 | 35,250 |
| Nonvested restricted stock | (312,580) | (207,653) |
| Capital surplus | 26,259,837 | 26,120,460 |
| Treasury stock at cost at 11,454 and 10,829 shares at at March 31, 2009 and December 31, 2008, respectively | (163,433) | (159,777) |
| Retained earnings | 11,840,186 | 11,839,005 |
| Accumulated other comprehensive income (loss) | 60,325 | (201,527) |
| Total shareholders' equity | 52,958,203 | 37,425,758 |
| Total liabilities and shareholders' equity | \$ 637,401,525 | \$ 603,433,883 |

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Income
(Unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|--------------|
| | 2009 | 2008 |
| Interest income | | |
| Loans, including fees | \$ 6,967,737 | \$ 9,099,475 |
| Investment securities | | |
| Taxable | 531,316 | 346,384 |
| Nontaxable | 313,418 | 327,610 |
| Federal funds sold | 983 | 1,893 |
| Other interest income | 9,599 | 51,290 |
| Total | 7,823,053 | 9,826,652 |
| Interest expense | | |
| Time deposits over \$100,000 | 1,192,567 | 2,037,053 |
| Other deposits | 1,622,844 | 1,902,095 |
| Other interest expense | 854,549 | 919,520 |
| Total | 3,669,960 | 4,858,668 |
| Net interest income | 4,153,093 | 4,967,984 |
| Provision for loan losses | 1,300,380 | 501,603 |
| Net interest income after provision for loan losses | 2,852,713 | 4,466,381 |
| Noninterest income | | |
| Service charges on deposit accounts | 460,608 | 437,135 |
| Gain on sale of mortgage loans | 660,499 | 559,384 |
| Brokerage fees | 3,922 | 50,330 |
| Income from bank owned life insurance | 105,150 | 121,754 |
| Other charges, commissions and fees | 126,999 | 113,272 |
| Loss on sale of other real estate owned | (15,892) | - |
| Gain on sale of fixed assets | 86,810 | - |
| Other non-interest income | 265,021 | 49,919 |
| Total | 1,693,117 | 1,331,794 |
| Noninterest expenses | | |
| Salaries and benefits | 2,808,915 | 2,944,751 |
| Occupancy expense | 355,857 | 339,703 |
| Furniture and equipment expense | 285,865 | 212,959 |
| Other operating expenses | 1,274,242 | 1,236,983 |
| Total | 4,724,879 | 4,734,396 |
| Income (loss) before taxes | (179,049) | 1,063,779 |
| Income tax expense (benefit) | (192,914) | 237,656 |
| Net income | 13,865 | 826,123 |
| Preferred stock dividends | 59,584 | - |
| Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium | 12,684 | - |
| Net Income (loss) available to common shareholders | \$ (58,403) | \$ 826,123 |
| Average common shares outstanding, basic | 3,525,004 | 3,494,862 |
| Average common shares outstanding, diluted | 3,525,004 | 3,536,861 |

| | | | | |
|-----------------------------------|----|--------|----|------|
| Basic earnings (loss) per share | \$ | (0.02) | \$ | 0.24 |
| Diluted earnings (loss) per share | \$ | (0.02) | \$ | 0.23 |

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income
For the Three Months Ended March 31, 2009 and 2008
(Unaudited)

| | Preferred Stock | Common Stock | Capital Surplus | Treasury Stock | Nonvested Restricted Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|--------------------|-----------------|--------------------|-------------------|----------------------------------|----------------------|---|---------------|
| Balance, December 31, 2007 | \$ - | \$ 34,946 | \$ 25,875,012 | \$ (145,198) | \$ (152,762) | \$ 11,417,275 | \$ (1,369) | \$ 37,027,904 |
| Adjustment to reflect the cumulative-effect of change in accounting for life insurance arrangements | | | | | | (203,902) | | (203,902) |
| Net income | | | | | | 826,123 | | 826,123 |
| Other comprehensive gain, net of tax expense of \$49,275 | | | | | | | 95,651 | 95,651 |
| Comprehensive income | | | | | | | | 921,774 |
| Non-vested restricted stock | | 141 | 22,455 | | (120,582) | | | (97,986) |
| Purchase of treasury stock | | | | (11,777) | | | | (11,777) |
| Exercise of stock options | | 45 | 150,457 | | | | | 150,502 |
| Balance, March 31, 2008 | \$ - | \$ 35,132 | \$ 26,047,924 | \$ (156,975) | \$ (273,344) | \$ 12,039,496 | \$ 94,282 | \$ 37,786,515 |
| Balance, December 31, | \$ - | \$ 35,250 | \$ 26,120,460 | \$ (159,777) | \$ (207,653) | \$ 11,839,005 | \$ (201,527) | \$ 37,425,758 |

2008

| | | | | | | | | | |
|---|---------------|-----------|---------------|--------------|--------------|---------------|-----------|---------------|------------|
| Issuance of Series A preferred stock, net of issuance cost of \$116,786 | 14,375,740 | | | | | | | | 14,375,740 |
| Issuance of Series B preferred stock, net of issuance cost \$6,902 | 849,572 | | | | | | | | 849,572 |
| Net income | | | | | 13,865 | | | | 13,865 |
| Other comprehensive gain, net of tax expense of \$134,894 | | | | | | 261,852 | | | 261,852 |
| Comprehensive income | | | | | | | | | 275,717 |
| Accretion of Series A Preferred stock discount | 13,860 | | | | (13,860) | | | | - |
| Amortization of Series B Preferred stock premium | (1,176) | | | | 1,176 | | | | - |
| Non-vested restricted stock | | 622 | 139,377 | | (104,927) | | | | 35,072 |
| Purchase of treasury stock | | | | | (3,656) | | | | (3,656) |
| Balance, March 31, 2009 | \$ 15,237,996 | \$ 35,872 | \$ 26,259,837 | \$ (163,433) | \$ (312,580) | \$ 11,840,186 | \$ 60,325 | \$ 52,958,203 | |

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|--------------|
| | 2009 | 2008 |
| Cash flows from operating activities: | | |
| Net income | \$ 13,865 | \$ 826,123 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Provision for loan losses | 1,300,380 | 501,603 |
| Depreciation and amortization expense | 269,374 | 287,706 |
| Gain on sale of premises and equipment | (86,810) | - |
| Loss on sale of other real estate owned | 15,892 | - |
| Discount accretion and premium amortization | 44,471 | 7,274 |
| Disbursements for mortgage loans held for sale | (51,727,574) | (36,572,893) |
| Proceeds from mortgage loans held for sale | 37,066,273 | 37,770,606 |
| Decrease in interest receivable | 190,795 | 115,207 |
| Decrease in interest payable | (12,406) | (83,510) |
| Increase for cash surrender value of life insurance | (105,150) | (121,754) |
| Amortization of deferred compensation on restricted stock | 35,072 | (97,986) |
| Decrease (increase) in other assets | (562,383) | (609,713) |
| Increase in other liabilities | 278,990 | 1,892,946 |
| Net cash provided (used) by operating activities | (13,279,211) | 3,915,609 |
| Cash flows from investing activities: | | |
| Net (increase) decrease in loans receivable | 1,605,843 | (5,365,863) |
| Maturities of securities available-for-sale | 3,069,380 | 1,087,846 |
| Sales of other real estate owned | 6,608 | 0 |
| Purchase of non marketable equity securities | (709,900) | (441,800) |
| Proceeds from disposal of premises and equipment | 2,286,810 | 0 |
| Purchases of premises and equipment | (259,629) | (1,636,950) |
| Net cash provided (used) by investing activities | 5,999,112 | (6,356,767) |
| Cash flows from financing activities: | | |
| Net decrease in demand deposits, interest-bearing transaction accounts and savings accounts | (16,908,694) | (2,346,309) |
| Net increase in certificates of deposit and other time deposits | 57,724,870 | 2,859,685 |
| Net decrease in securities sold under agreements to repurchase | (7,332,457) | (68,909) |
| Net increase (decrease) in advances from the Federal Home Loan Bank | (8,500,000) | 4,500,000 |
| Net decrease in federal funds purchased | - | (1,877,000) |
| Repayment of note payable | (6,950,000) | - |
| Net proceeds from issuance of preferred stock | 15,225,312 | - |
| Purchase of treasury stock | (3,656) | (11,777) |
| Proceeds from the exercise of stock options | - | 150,502 |
| Net cash provided by financing activities | 33,255,375 | 3,206,192 |
| Net increase in cash and cash equivalents | 25,975,276 | 765,034 |
| Cash and cash equivalents, beginning | 5,708,607 | 7,164,650 |
| Cash and cash equivalents, end | \$ 31,683,883 | \$ 7,929,684 |
| Cash paid during the period for: | | |

| | | |
|--------------|--------------|--------------|
| Income taxes | \$ 4,257 | \$ 403,499 |
| Interest | \$ 3,682,366 | \$ 4,942,178 |

Supplemental noncash investing and financing activities:

| | | |
|-----------------------|--------------|------------|
| Foreclosures on loans | \$ 1,066,132 | \$ 201,750 |
|-----------------------|--------------|------------|

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures, which would appear in audited annual consolidated financial statements. The consolidated financial statements as of March 31, 2009 and for the interim periods ended March 31, 2009 and 2008 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The consolidated financial information as of December 31, 2008 has been derived from the audited consolidated financial statements as of that date. For further information, refer to the consolidated financial statements and the notes included in First Reliance Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2008.

Note 2 - Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and / or disclosure of financial information by the Company.

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

FSP EITF 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20," ("FSP EITF 99-20-1") was issued in January 2009. Prior to the FSP, other-than-temporary impairment was determined by using either Emerging Issues Task Force ("EITF") Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transferor in Securitized Financial Assets," ("EITF 99-20") or SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," ("SFAS 115") depending on the type of security. EITF 99-20 required the use of market participant assumptions regarding future cash flows regarding the probability of collecting all cash flows previously projected. SFAS 115 determined impairment to be other than temporary if it was probable that the holder would be unable to collect all amounts due according to the contractual terms. To achieve a more consistent determination of other-than-temporary impairment, the FSP amends EITF 99-20 to determine any other-than-temporary impairment based on the guidance in SFAS 115, allowing management to use more judgment in determining any other-than-temporary impairment. The FSP was effective for reporting periods ending after December 15, 2008. Management has reviewed the Company's security portfolio and evaluated the portfolio for any other-than-temporary impairments.

On April 9, 2009, the FASB issued three staff positions related to fair value which are discussed below.

FSP SFAS 115-2 and SFAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments," ("FSP SFAS 115-2 and SFAS 124-2") categorize losses on debt securities available-for-sale or held-to-maturity determined by management to be other-than-temporarily impaired into losses due to credit issues and losses related to all other factors. Other-than-temporary impairment ("OTTI") exists when it is more likely than not that the security will mature or be sold before its amortized cost basis can be recovered. An OTTI related to credit losses should be recognized through earnings. An OTTI related to other factors should be recognized in other comprehensive income. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. Annual disclosures required in SFAS 115 and FSP SFAS 115-1 and SFAS 124-1 are also required for interim periods (including the aging of securities with unrealized losses).

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 2 - Recently Issued Accounting Pronouncements – (continued)

FSP SFAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That are Not Orderly” recognizes that quoted prices may not be determinative of fair value when the volume and level of trading activity has significantly decreased. The evaluation of certain factors may necessitate that fair value be determined using a different valuation technique. Fair value should be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction, not a forced liquidation or distressed sale. If a transaction is considered to not be orderly, little, if any, weight should be placed on the transaction price. If there is not sufficient information to conclude as to whether or not the transaction is orderly, the transaction price should be considered when estimating fair value. An entity’s intention to hold an asset or liability is not relevant in determining fair value. Quoted prices provided by pricing services may still be used when estimating fair value in accordance with SFAS 157; however, the entity should evaluate whether the quoted prices are based on current information and orderly transactions. Inputs and valuation techniques are required to be disclosed in addition to any changes in valuation techniques.

FSP SFAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments” requires disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements and also requires those disclosures in summarized financial information at interim reporting periods. A publicly traded company includes any company whose securities trade in a public market on either a stock exchange or in the over-the-counter market, or any company that is a conduit bond obligor. Additionally, when a company makes a filing with a regulatory agency in preparation for sale of its securities in a public market it is considered a publicly traded company for this purpose.

The three staff positions are effective for periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, in which case all three must be adopted. The Company will adopt the staff positions for its second quarter 10-Q but does not expect the staff positions to have a material impact on the consolidated financial statements.

Also on April 1, 2009, the FASB issued FSP SFAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.” The FSP requires that assets acquired and liabilities assumed in a business combination that arise from a contingency be recognized at fair value. If fair value cannot be determined during the measurement period as determined in SFAS 141 (R), the asset or liability can still be recognized if it can be determined that it is probable that the asset existed or the liability had been incurred as of the measurement date and if the amount of the asset or liability can be reasonably estimated. If it is not determined to be probable that the asset/liability existed/was incurred or no reasonable amount can be determined, no asset or liability is recognized. The entity should determine a rational basis for subsequently measuring the acquired assets and assumed liabilities. Contingent consideration agreements should be recognized initially at fair value and subsequently reevaluated in accordance with guidance found in paragraph 65 of SFAS 141 (R). The FSP is effective for business combinations with an acquisition date on or after the beginning of the Company’s first annual reporting period beginning on or after December 15, 2008. The Company will assess the impact of the FSP if and when a future acquisition occurs.

The Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) No. 111 on April 9, 2009 to amend Topic 5.M., “Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities” and to supplement FSP SFAS 115-2 and SFAS 124-2. SAB 111 maintains the staff’s previous views related to equity

securities; however debt securities are excluded from its scope. The SAB provides that “other-than-temporary” impairment is not necessarily the same as “permanent” impairment and unless evidence exists to support a value equal to or greater than the carrying value of the equity security investment, a write-down to fair value should be recorded and accounted for as a realized loss. The SAB was effective upon issuance and had no impact on the Company’s financial position.

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

Note 3 - Reclassifications

Certain captions and amounts in the financial statements in the Company’s Form 10-Q for the quarter ended March 31, 2008 were reclassified to conform to the March 31, 2009 presentation.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 4 - Comprehensive Income

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

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

| | Pre-tax Amount | Tax Expense | Net-of-tax Amount |
|---|-------------------|----------------|----------------------|
| For the Quarter Ended March 31, 2009: | | | |
| Unrealized gains on securities available-for-sale | \$ 396,746 | \$ 134,894 | \$ 261,852 |
| Reclassification adjustment for gains (losses) realized in net income | - | - | - |
| | \$ 396,746 | \$ 134,894 | \$ 261,852 |
| For the Quarter Ended March 31, 2008: | | | |
| Unrealized gains on securities available-for-sale | \$ 144,926 | \$ 49,275 | \$ 95,651 |
| Reclassification adjustment for gains (losses) realized in net income | - | - | - |
| | \$ 144,926 | \$ 49,275 | \$ 95,651 |

Note 5 – Shareholders’ Equity

Common Stock – The following is a summary of the changes in common shares outstanding for the three months ended March 31, 2009 and 2008.

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2009 | 2008 |
| Common shares outstanding at beginning of the period | 3,525,004 | 3,494,646 |
| Issuance of non-vested restricted shares | 62,222 | 14,009 |
| Exercise of stock options | - | 4,500 |
| Common shares outstanding at end of the period | 3,587,226 | 3,513,155 |

Preferred Stock - On February 24, 2009, the Company’s Articles of Incorporation was amended to authorize the issuance of a class of 10,000,000 shares of preferred stock, having no par value. Subject to certain conditions, the amendment authorizes the Company’s Board of Directors to issue preferred stock without shareholders’ approval. Under this amendment, the Board is authorized to determine the terms of one or more series of preferred stock, including the preferences, rights, and limitations of each series.

On March 6, 2009, the Company completed a transaction with the United States Treasury (“Treasury”) under the Troubled Asset Relief Program Capital Purchase Program (“TARP CPP”), which was amended by the enactment of the

American Recovery and Reinvestment Act of 2009 on February 17, 2009. Under the TARP CPP, the Company sold 15,349 shares of its Series A Cumulative Perpetual Preferred Stock. In addition, the Treasury received a warrant to purchase 767 shares of the Company's Series B Cumulative Perpetual Preferred Stock, which was immediately exercised by the Treasury for a nominal exercise price. The preferred shares issued to the Treasury qualify as tier 1 capital for regulatory purposes.

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

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 – Shareholders' Equity – (continued)

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

The proceeds from the issuance of the Series A and Series B were allocated based on the relative fair value of each series based on a discounted cash flow model. As a result of the valuations, \$14,492,526 and \$856,474 was allocated to the Series A Preferred Stock and Series B Preferred Stock, respectively. This resulted in a discount of \$973,260 for the Series A stock and a premium of \$82,572 for the Series B stock. The discount and premium will be accreted and amortized, respectively, through retained earnings over a five-year estimated life using the effective interest method. For the quarter ended March 31, 2009, accretion of the Series A Preferred Stock discount totaled \$13,860 and the amortization of the Series B Preferred Stock premium totaled \$1,176. The net amount of the accretion and amortization was treated as a deemed dividend to preferred shareholders in the computation of earnings per share.

Note 6 - Earnings Per Share

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

The following is a summary of the earnings (loss) per share calculations for the three months ended March 31, 2009 and 2008.

| | March 31, | |
|--|-------------|------------|
| | 2009 | 2008 |
| Earnings (loss) available to common shareholders | | |
| Net income | \$ 13,865 | \$ 826,123 |
| Preferred stock dividends | 59,584 | - |
| Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium | 12,684 | - |
| Net income (loss) available to common shareholders | \$ (58,403) | \$ 826,123 |
| Basic earnings per share: | | |
| Net income (loss) available to common shareholders | \$ (58,403) | \$ 826,123 |
| Average common shares outstanding - basic | 3,525,004 | 3,494,862 |
| Basic earnings (loss) per share | \$ (0.02) | \$ 0.24 |
| Diluted earnings per share: | | |
| Net income (loss) available to common shareholders | \$ (58,403) | \$ 826,123 |
| Average common shares outstanding - basic | 3,525,004 | 3,494,862 |
| Dilutive potential common shares | - | 41,999 |
| Average common shares outstanding - diluted | 3,525,004 | 3,536,861 |
| Diluted earnings (loss) per share | \$ (0.02) | \$ 0.24 |

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 7 - Equity Incentive Plan

On January 19, 2006, the Company adopted the 2006 Equity Incentive Plan, which provides for the granting of dividend equivalent rights options, performance unit awards, phantom shares, stock appreciation rights and stock awards, each of which shall be subject to such conditions based upon continued employment, passage of time or satisfaction of performance criteria or other criteria as permitted by the plan. The plan allows granting up to 350,000 shares of stock, to officers, employees, and directors, consultants and service providers of the Company or its affiliates. Awards may be granted for a term of up to ten years from the effective date of grant. Under this Plan, our Board of Directors has sole discretion as to the exercise date of any awards granted. The per-share exercise price of incentive stock awards may not be less than the market value of a share of common stock on the date the award is granted. Any awards that expire unexercised or are canceled become available for re-issuance.

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

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

During three months ended March 31, 2009 the Company issued 62,222 of restricted stock pursuant to the 2006 Equity Incentive Plan. The shares cliff vest in three years and are fully vested in 2012. The weighted-average fair value of restricted stock issued during the three months ended March 31, 2009 was \$2.25 per share. Compensation cost associated with the issuance was \$139,998. There were no restricted stock forfeitures during the first quarter of 2009. Deferred compensation expense of \$35,072, relating to restricted stock, was amortized to income during three months ended March 31, 2009.

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

There were no SARs awarded, exercised or forfeited during the quarter ended March 31, 2009 and 2008. The SARs compensation expense for the quarter ended March 31, 2009 and 2008 was \$18,356 and \$18,560, respectively.

As of March 31, 2009 and 2008, there were 93,981 SARs outstanding with a weighted average exercise price of \$14.95.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 8 – STOCK-BASED COMPENSATION

The Company terminated its 2003 Employee Stock Option Plan and replaced it with the 2006 Equity Incentive Plan. Outstanding options issued under any former stock option plans will be honored in accordance with the terms and conditions in effect at the time they were granted, except that they are not subject to reissuance. At March 31, 2009, 269,447 options were outstanding and exercisable. No stock options have been granted since June 2005.

A summary of the status of the Company's 2003 stock option plan as of March 31, 2009 and 2008, and changes during the period is presented below:

| | 2009 | | 2008 | |
|----------------------------------|---------|---------------------------------|---------|---------------------------------|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 269,447 | \$ 8.36 | 278,847 | \$ 8.32 |
| Exercised | | | (4,500) | 5.00 |
| Forfeited | | | (2,500) | 11.00 |
| Outstanding at end of period | 269,447 | \$ 8.36 | 271,846 | \$ 8.35 |

Note 9 – FAIR VALUE MEASUREMENTS

The Company adopted Statement No. 157 effective January 1, 2008, which did not have a material impact on the financial statements. Statement No. 157 applies to all assets and liabilities that are being measured and reported on a fair value basis. Statement No. 157 requires new disclosure that establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. This statement enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to Statement No. 157. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

| | March 31, 2009 | | |
|-------|----------------|---------|---------|
| Total | Level 1 | Level 2 | Level 3 |

Edgar Filing: FIRST RELIANCE BANCSHARES INC - Form 10-Q

| | | | | |
|-------------------------------|---------------|------|---------------|------|
| Available for sale securities | \$ 73,593,711 | \$ - | \$ 73,593,711 | \$ - |
| Mortgage loans held for sale | 24,250,382 | - | 24,250,382 | - |

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis.

The Company is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. Loans that are deemed impaired are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be level 2 inputs. The aggregate carrying amount of impaired loans at March 31, 2009 was \$47,752,613.

FIRST RELIANCE BANCSHARES, INC.

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

The following discussion of financial condition as of March 31, 2009 compared to December 31, 2008, and the results of operations for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 should be read in conjunction with the condensed financial statements and accompanying footnotes appearing elsewhere in this report.

Advisory Note Regarding Forward-Looking Statements

The statements contained in this report on Form 10-Q that are not historical facts are forward-looking statements subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. We caution readers of this report that such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of us to be materially different from those expressed or implied by such forward-looking statements. Although we believe that our expectations of future performance are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations.

Factors which could cause actual results to differ from expectations include, among other things:

- the challenges, costs and complications associated with the continued development of our branches;
- the potential that loan charge-offs may exceed the allowance for loan losses or that such allowance will be increased as a result of factors beyond the control of us;
 - our dependence on senior management;
- competition from existing financial institutions operating in our market areas as well as the entry into such areas of new competitors with greater resources, broader branch networks and more comprehensive services;
- adverse conditions in the stock market, the public debt market, and other capital markets (including changes in interest rate conditions);
 - changes in deposit rates, the net interest margin, and funding sources;
 - inflation, interest rate, market, and monetary fluctuations;
 - risks inherent in making loans including repayment risks and value of collateral;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations may be different than expected resulting in, among other things, a deterioration in credit quality or a reduced demand for credit, including the resultant effect on our loan portfolio and allowance for loan losses;
 - fluctuations in consumer spending and saving habits;
 - the demand for our products and services;
 - technological changes;
- the challenges and uncertainties in the implementation of our expansion and development strategies;
 - the ability to increase market share;
 - the adequacy of expense projections and estimates of impairment loss;
- the impact of changes in accounting policies by the Securities and Exchange Commission;
 - unanticipated regulatory or judicial proceedings;
- the potential negative effects of future legislation affecting financial institutions (including without limitation laws concerning taxes, banking, securities, and insurance);
- the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- the timely development and acceptance of products and services, including products and services offered through alternative delivery channels such as the Internet;

- the impact on our business, as well as on the risks set forth above, of various domestic or international military or terrorist activities or conflicts;
- other factors described in this report and in other reports we have filed with the Securities and Exchange Commission; and
 - our success at managing the risks involved in the foregoing.

Forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made to reflect the occurrence of unanticipated events.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Overview

The following discussion describes our results of operation for the quarter ended March 31, 2009 as compared to the quarter ended March 31, 2008 and also analyzes our financial condition as of March 31, 2009 as compared to December 31, 2008.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this non-interest income, as well as of our non-interest expense.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with our financial statements and the other statistical information included in our filings with the Securities and Exchange Commission.

Critical Accounting Policies

We have adopted various accounting policies which govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements at December 31, 2008 as filed on our annual report on Form 10-K. Certain accounting policies involve significant judgments and assumptions by us which have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on the historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a major impact on our carrying values of assets and liabilities and our results of operations.

We believe the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for description of our processes and methodology for determining our allowance for loan losses.

Regulatory Matters

We are not aware of any current recommendations by regulatory authorities which, if they were to be implemented, would have a material effect on liquidity, capital resources or operations.

Effect of Economic Trends

Economic conditions, competition and federal monetary and fiscal policies also affect financial institutions. Lending activities are also influenced by regional and local economic factors, such as housing supply and demand, competition among lenders, customer preferences and levels of personal income and savings in our primary market area.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Results of Operations

Three months ended March 31, 2009, compared with the three months ended March 31, 2008

Net income was \$13,865 for the first quarter of 2009, compared to \$826,123 for the first quarter of 2008. The decrease in net income can be attributed to the \$798,777 increase in our provision for loan losses, lost income on nonaccruing loans, and net interest margin compression due to declining interest rate movements, which is the result of the depressed economy.

Net Interest Income

The largest component of our net income is its net interest income, which is the difference between the income earned on assets and interest paid on deposits and on borrowings used to support such assets. Net interest income is determined by the yields earned on our interest-earning assets and the rates paid on its interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities. Total interest earning assets yield less total interest bearing liabilities rate represents our net interest rate spread.

Net interest income decreased \$814,891 or 16.40%, to \$4,153,093 for the quarter ended March 31, 2009, from \$4,967,984 for the comparable period of 2008. The decrease in the net interest income was partially attributable to the numerous declines in the prime interest rate that occurred during 2008. These declines negatively impacted interest income, since approximately 55% of the average volume of our loan portfolio included variable interest rate loans. Also, the decrease in net interest income was significantly impacted by the increase in our nonaccruing loans, which were \$17,344,313 higher at March 31, 2009, compared to nonaccruing loans at March 31, 2008. For the first quarter of 2009 and 2008, the primary components of interest income were interest on loans, including fees, of \$6,967,737 and \$9,099,475 and interest on investment securities of \$844,734 and \$673,994, respectively.

Average earning assets increased \$22,039,801 or 4.01%, mainly due to growth in the investment portfolio. The average balance of our taxable and nontaxable securities increased \$17,475,089, or 30.04%. Our average interest bearing liabilities increased \$31,958,087, or 6.33% from 2008 to \$536,833,143. This increase was mainly due to the increase in the average balance of interest bearing deposits, which increased \$30,843,198, or 7.68%.

Our net interest spread was 2.86% for the three months ended March 31, 2009, compared to 3.41% for the three months ended March 31, 2008. This represents a decrease of 55 basis points. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

Our net interest margin is calculated as net interest income divided by average interest-earning assets. Our net interest margin for the first quarter of 2009 was 3.03%, which is 68 basis points lower than our net interest margin of 3.71% for the first quarter of 2008.

The annualized yield on our loans was 5.79% and 7.53% for the three months ended March 31, 2009 and 2008, respectively, which is a 174 basis points decline. Average loans represented 85.43% and 88.53% of average interest-earning assets for the three months ended March 31, 2009 and 2008, respectively.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The following table sets forth, for the period indicated, certain information related to our average balance sheet and our average yields on assets and average costs of liabilities. Such yields are derived by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been derived from the daily balances throughout the periods indicated.

| | Average Balances, Income and Expenses, and Rates | | | Average Balances, Income and Expenses, and Rates | | |
|---|--|--------------------|----------------|--|--------------------|----------------|
| | For the three months ended | | | For the three months ended | | |
| | March 31, 2009 | | | March 31, 2008 | | |
| | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate |
| Assets | | | | | | |
| Loans (2) | \$ 487,878,971 | \$ 6,967,737 | 5.79% | \$ 486,026,665 | \$ 9,099,475 | 7.53% |
| Securities, taxable | 46,574,800 | 531,316 | 4.63 | 27,214,400 | 346,384 | 5.12 |
| Securities, nontaxable (1) | 29,066,978 | 419,980 | 5.86 | 30,952,289 | 438,997 | 5.70 |
| Federal funds sold | 2,076,767 | 983 | 0.19 | 146,604 | 1,893 | 5.18 |
| Other | 5,455,670 | 9,599 | 0.71 | 4,673,427 | 51,290 | 4.37 |
| Total earning assets | 571,053,186 | 7,929,615 | 5.63 | 549,013,385 | 9,938,039 | 7.28 |
| Non-earning assets | 54,764,507 | | | 39,926,555 | | |
| Total assets | \$ 625,817,693 | | | \$ 588,939,940 | | |
| Liabilities and Stockholders' equity | | | | | | |
| Interest bearing transaction accounts | \$ 34,087,269 | \$ 49,578 | 0.59% | \$ 31,527,448 | \$ 58,985 | 0.75% |
| Savings and money market accounts | 99,193,160 | 369,611 | 1.51 | 89,629,482 | 633,267 | 2.84 |
| Time deposits | 299,383,198 | 2,396,222 | 3.25 | 280,663,499 | 3,246,896 | 4.65 |
| Total interest bearing deposits | 432,663,627 | 2,815,411 | 2.64 | 401,820,429 | 3,939,148 | 3.94 |
| Securities sold under agreement to repurchase | 5,708,517 | 1,162 | 0.08 | 7,999,902 | 47,832 | 2.40 |
| Federal funds purchased | 83,222 | 157 | 0.77 | 8,952,637 | 57,601 | 2.58 |
| Federal Home Loan Borrowings | 82,044,444 | 665,984 | 3.29 | 72,792,088 | 620,980 | 3.42 |
| Junior Subordinated Debentures | 10,310,000 | 152,352 | 5.99 | 10,310,000 | 154,607 | 6.01 |
| Note payable | 6,023,333 | 34,894 | 2.35 | 3,000,000 | 38,500 | 5.15 |
| Total other interest bearing liabilities | 104,169,516 | 854,549 | 3.33 | 103,054,627 | 919,520 | 3.59 |
| Total interest bearing liabilities | 536,833,143 | 3,669,960 | 2.77 | 504,875,056 | 4,858,668 | 3.87 |
| Non-interest bearing deposits | 47,575,206 | | | 43,665,972 | | |
| Other liabilities | 1,506,646 | | | 2,755,176 | | |
| Stockholders' equity | 39,902,698 | | | 37,643,736 | | |

Edgar Filing: FIRST RELIANCE BANCSHARES INC - Form 10-Q

| | | | | |
|-------------------------------------|----------------|--------------|----------------|--------------------|
| Total liabilities and equity | \$ 625,817,693 | | \$ 588,939,940 | |
| Net interest income/interest spread | | \$ 4,259,655 | 2.86% | \$ 5,079,371 3.41% |
| Net yield on earning assets | | | 3.03% | 3.71% |

- (1) Fully tax - equivalent basis at 34% tax rate for non-taxable securities.
- (2) Includes mortgage loans held for sale.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following table sets forth the effect which the varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented.

| | Three Months Ended March 31, 2009 compared to 2008 | | |
|---|---|--------------------|---------------------|
| | Rate | Volume | Total |
| Interest-Earning Assets | | | |
| Loans | \$ (2,164,818) | \$ 33,080 | \$ (2,131,738) |
| Securities, taxable | (36,036) | 220,968 | 184,932 |
| Securities, nontaxable | 10,719 | (29,736) | (19,017) |
| Federal funds sold and other | (3,424) | 2,514 | (910) |
| Other | (48,797) | 7,106 | (41,691) |
| Total interest-earning assets | (2,242,356) | 233,932 | (2,008,424) |
| Interest bearing liabilities | | | |
| Interest bearing deposits | | | |
| Interest bearing transaction accounts | (13,672) | 4,265 | (9,407) |
| Savings and money market accounts | (323,819) | 60,163 | (263,656) |
| Time deposits | (1,047,818) | 197,144 | (850,674) |
| Total interest bearing deposits | (1,385,309) | 261,572 | (1,123,737) |
| Other interest bearing liabilities | | | |
| Securities under agreement to repurchase | (36,002) | (10,668) | (46,670) |
| Federal funds purchased | (23,814) | (33,630) | (57,444) |
| Federal Home Loan Bank borrowings | (25,563) | 70,567 | 45,004 |
| Junior Subordinated Debentures | (2,255) | - | (2,255) |
| Note payable | (28,171) | 24,565 | (3,606) |
| Total other interest bearing liabilities | (115,805) | 50,834 | (64,971) |
| Total interest bearing liabilities | (1,501,114) | 312,406 | (1,188,708) |
| Net interest income | \$ (741,242) | \$ (78,474) | \$ (819,716) |

Provision and Allowance for Loan Losses

The Company has developed policies and procedures for evaluating the overall quality of its credit portfolio and the timely identification of potential problem credits. On a quarterly basis, the Company's Board of Directors reviews and approves the appropriate level for the Company's allowance for loan losses based upon management's recommendations, the results of the internal monitoring and reporting system, and an analysis of economic conditions in its market. The objective of management has been to fund the allowance for loan losses at a level greater or equal to the Company's internal risk measurement system for loan risk.

Additions to the allowance for loan losses, which are expensed as the provision for loan losses on the Company's income statement, are made periodically to maintain the allowance at an appropriate level based on management's analysis of the potential risk in the loan portfolio. Loan losses and recoveries are charged or credited directly to the allowance. The amount of the provision is a function of the level of loans outstanding, the level of nonperforming

loans, historical loan loss experience, the amount of loan losses actually charged against the reserve during a given period, and current and anticipated economic conditions.

-17-

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The allowance represents an amount which management believes will be adequate to absorb inherent losses on existing loans that may become uncollectible. Our judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans; the quality, mix and size of our overall loan portfolio; economic conditions that may affect the borrower's ability to repay the amount and quality of collateral securing the loans; our limited historical loan loss experience and a review of specific problem loans.

The Company adjusts the amount of the allowance periodically based on changing circumstances as a component of the provision for loan losses. We charge recognized losses against the allowance and add subsequent recoveries back to the allowance. Under the Company's policy, it evaluates the allowance for loan losses using three categories; specific reserves, historical losses based on loan category, and environmental factors. Detailed calculations are documented on a monthly basis and submitted through appropriate areas for approval to ensure adequate levels for the allowance for loan losses. Management and the Board believe that the current methodology meets regulatory requirements and industry standards.

Our various regulatory agencies review the Company's allowance for loan losses through their periodic examinations, and they may require additions to the allowance for loan losses based on their judgment about information available to them at the time of their examinations. The Company's losses will undoubtedly vary from our estimates, and it is possible that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time.

As of March 31, 2009 and 2008, the allowance for loan losses was \$7,331,051 and \$5,539,601, respectively, an increase of \$1,791,450 over the 2008 allowance. As a percentage of total loans, the allowance for loan losses was 1.58% and 1.17% at March 31, 2009 and 2008, respectively. The increase in the allowance for loan losses was driven primarily by a higher level of required reserves for all categories of loans due to depressed economic conditions in our market areas. The categories and concentrations of loans have been generally consistent between the past two years.

We believe the allowance for loan losses at March 31, 2009, is adequate to meet potential loan losses inherent in the loan portfolio.

The provision for loan losses was \$1,300,380 for the first quarter of 2009 compared to \$501,603 for the first quarter of 2008. The \$798,777 increase in the provision for loan losses was necessitated by the depressed economic conditions in our market areas, which has resulted in a significantly higher volume of nonperforming loans included in our loan portfolio.

Noninterest Income

The following table sets forth information related to our noninterest income.

| | Three Months Ended March 31, | |
|----------------------------------|---------------------------------|--------------|
| | 2009 | 2008 |
| Service fees on deposit accounts | \$ 460,608 | 437,135 |
| Gain on sale of mortgage loans | 660,499 | 559,384 |
| Other income | 572,010 | 335,275 |
| Total noninterest income | \$ 1,693,117 | \$ 1,331,794 |

Noninterest income increased \$361,323, or 27.13%, to \$1,693,117 for the first quarter of 2009 from \$1,331,794 for the first quarter of 2008. The increase is primarily attributable to the increase in income relating to the sale of mortgage loans. During the first quarter of 2009, we experienced an increase in the volume mortgage loans that were refinanced because of lower market interest rates.

-18-

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Service fees on deposits consist primarily of income from NSF fees and service charges on transaction accounts. Service fees on deposits were \$460,608 and \$437,135 for the three months ended March 31, 2009 and 2008, respectively. NSF income was \$423,139 and \$413,316 for the three months ended March 31, 2009 and 2008, respectively, representing 91.87% of total service fees on deposits in the 2009 period compared to 94.56% of total service fees on deposits in the 2008 period. In addition, service charges on deposit accounts increased to \$23,473 for the three months ended March 31, 2009 compared to \$23,819 for the same period ended March 31, 2008.

Other income consisted primarily of other service fees and commissions, income from bank owned life insurance and other miscellaneous types of income.

Noninterest Expense

Total noninterest expense for the three months ended March 31, 2009 was \$4,724,879, a decrease of \$9,517, or 0.20% from the three months ended March 31, 2008. The primarily reason for this decline is our continual emphasis on expense management. For the quarter ended March 31, 2009, compared to the quarter ended March 31, 2008, salaries and employee benefits decreased \$135,836, while all other major categories of noninterest expense increased \$126,319.

Our income tax provision for the three months ended March 31, 2009 compared to the same period in 2008 decreased \$430,570, which is mainly attributable to the amount of tax exempt income included in our income.

Balance Sheet Review

General

At March 31, 2009, we had total assets of \$637.4 million, consisting principally of \$464.1 million in loans, \$78.9 million in investments, and \$31.7 million in cash and due from banks. Our liabilities at March 31, 2009 totaled \$584.4 million, which consisted principally of \$502.0 million in deposits, \$69.5 million in FHLB advances, and \$11.2 million in other borrowings. Since December 31, 2009, we improved our capital position by issuing \$15.3 million of preferred stock to the United States Treasury under the Troubled Asset Relief Program Capital Program. At March 31, 2009, our shareholders' equity was \$53.0 million.

At December 31, 2008, we had total assets of \$603.4 million, consisting principally of \$469.0 million in loans, \$80.9 million in investments, and \$5.5 million in cash and due from banks. Our liabilities at December 31, 2008 totaled \$566.0 million, consisting principally of \$461.1 million in deposits, \$78.0 million in FHLB advances, and \$25.5 million in other borrowings. At December 31, 2008, our shareholders' equity was \$37.4 million.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Investments Securities

The investment securities portfolio, which is also a component of our total earning assets, consists of securities available-for-sale and nonmarketable equity securities.

At March 31, 2009 and December 31, 2008, we had investment securities totaling \$78,878,311 and \$80,885,516, respectively, which represented 12.38% and 13.40% of our total assets, respectively.

Nonmarketable equity securities consist of Federal Home Loan Bank stock, which is recorded at its original cost of \$5,284,600 and \$4,574,700 at March 31, 2009 and 2008, respectively.

The amortized costs and the fair value of our securities available-for-sale at March 31, 2009 and December 31, 2008 are shown in the following table.

| | March 31, 2009 | | December 31, 2008 | |
|----------------------------------|-----------------------------------|-------------------------|-----------------------------------|-------------------------|
| | Amortized Cost (Book Value) | Estimated Fair Value | Amortized Cost (Book Value) | Estimated Fair Value |
| Government sponsored enterprises | 24,650 | 24,638 | 88,013 | 87,997 |
| Mortgage-backed securities | 43,422,533 | 44,920,792 | 46,465,667 | 47,574,021 |
| Municipal securities | 29,836,377 | 28,556,781 | 29,843,730 | 28,524,498 |
| Other | 218,750 | 91,500 | 218,750 | 124,300 |
| | \$ 73,502,310 | \$ 73,593,711 | \$ 76,616,160 | \$ 76,310,816 |

At March 31, 2009, there were no unrealized losses in our government sponsored enterprises and mortgage-backed securities. We believe, based on industry analyst reports and credit ratings that the unrealized losses included in our municipal and other securities are attributed to changes in market interest rates and not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary. We have the ability and intent to hold these securities until such time as the value recovers or the securities mature.

Securities Available-for-sale Maturity Distribution and Yields

Contractual maturities and yields on our available for sale securities at March 31, 2009 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| March 31, 2009 (Dollars in thousands) | After One But Within Five Years | | After Five But Within Ten Years | | After Ten Years | | Total | |
|---|------------------------------------|-------|------------------------------------|-------|-----------------|-------|-----------|-------|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| U.S. government agencies and corporations | \$ 25 | 6.32% | \$ - | % | \$ - | -% | \$ 25 | 6.32% |
| Municipals (2) | 1,099 | 5.50 | 2,056 | 5.71 | 25,402 | 6.19 | 28,557 | 6.13 |
| Total securities(1) | \$ 1,124 | 5.52% | \$ 2,056 | 5.71% | \$ 25,402 | 6.19% | \$ 28,612 | 6.19% |

(1) Excludes mortgage-backed securities totaling \$44,920,793 with a yield of 4.79 % and other equity securities totaling \$91,500.

(2) Yields are based on a tax equivalent basis of 34%.

Loans

Since loans typically provide higher interest yields than other types of interest earning assets, a substantial percentage of our earning assets are invested in our loan portfolio. For the three months ended March 31, 2009 and 2008, average loans, including mortgage loans held for sale, were \$487,878,971 and \$486,026,665, respectively. Before the allowance for loan losses, total loans outstanding, excluding mortgage loans held for sale, at March 31, 2009 and December 31, 2008, were \$464,124,999 and \$468,990,202, respectively.

-20-

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The following table summarizes the composition of our loan portfolio March 31, 2009 and December 31, 2008.

| | March 31, 2009 | % of Total | December 31, 2008 | % of Total |
|--------------------------------------|-------------------|---------------|----------------------|---------------|
| Mortgage loans on real estate | | | | |
| Residential 1-4 family | \$ 65,605,518 | 14.14% | 72,245,289 | 15.40% |
| Multifamily | 7,458,472 | 1.61 | 7,104,889 | 1.51 |
| Commercial | 172,695,276 | 37.21 | 201,318,345 | 42.94 |
| Construction | 109,362,755 | 23.56 | 60,744,432 | 12.95 |
| Second mortgages | 5,107,623 | 1.10 | 4,989,538 | 1.06 |
| Equity lines of credit | 34,203,068 | 7.37 | 37,792,852 | 8.06 |
| Total mortgage loans | 394,432,712 | 84.99 | 384,195,345 | 81.92 |
| Commercial and industrial | 58,084,130 | 12.51 | 70,877,890 | 15.12 |
| Consumer | 8,604,075 | 1.85 | 8,974,448 | 1.91 |
| Other, net | 3,004,082 | 0.65 | 4,942,519 | 1.05 |
| Total loans | \$ 464,124,999 | 100.00% | \$ 468,990,202 | 100.00% |

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following tables is based on the contractual maturities of individual loans, including loans, which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below because borrowers have the right to prepay obligations with or without prepayment penalties.

The following table summarizes the loan maturity distribution by type and related interest rate characteristics at March 31, 2009.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

March 31, 2009

(Dollars in thousands)

| | One Year or Less | Over One Year Through Five Years | Over Five Years | Total |
|-------------------------------------|---------------------|---|--------------------|------------|
| Commercial and industrial | \$ 33,000 | \$ 22,675 | \$ 2,409 | \$ 58,084 |
| Real estate | 145,215 | 193,208 | 56,010 | 394,433 |
| Consumer and other | 4,558 | 6,400 | 650 | 11,608 |
| | \$ 182,773 | \$ 222,283 | \$ 59,069 | \$ 464,125 |
| Loans maturing after one year with: | | | | |
| Fixed interest rates | | | | \$ 156,606 |
| Floating interest rates | | | | 124,746 |
| | | | | \$ 281,352 |

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The following table summarizes the activity related to our allowance for loan losses for the three months ended March 31, 2009 and 2008:

| | March 31, | |
|--|----------------|----------------|
| | 2009 | 2008 |
| Balance, January 1, | \$ 8,223,899 | \$ 5,270,607 |
| Provision for loan losses for the period | 1,300,380 | 501,603 |
| Net loans (charged-off) recovered for the period | (2,193,228) | (232,609) |
| Balance, end of period | \$ 7,331,051 | \$ 5,539,601 |
| Total loans outstanding, end of period | \$ 464,124,999 | \$ 473,069,194 |
| Allowance for loan losses to loans outstanding | 1.58% | 1.17% |

Risk Elements in the Loan Portfolio

The following is a summary of risk elements in the loan portfolio:

| | March 31, 2009 | March 31, 2008 |
|--|-------------------|-------------------|
| Nonperforming Loans | | |
| Nonaccrual loans | \$ 20,952,510 | \$ 3,608,197 |
| Accruing loans more than 90 days past due | 1,983,307 | 2,360,585 |
| Percentage of nonperforming loans to total loans | 4.94% | 1.26% |
| Allowance for loan losses as a percentage of nonperforming loans | 31.96% | 92.81% |

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or we deem the collectibility of the principal and/or interest to be doubtful. Once a loan is placed in nonaccrual status, all previously accrued and uncollected interest is reversed against interest income. Interest income on nonaccrual loans is recognized on a cash basis when the ultimate collectability is no longer considered doubtful. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. All nonaccruing loans at March 31, 2009, were included in our impaired loans.

Impaired Loans

At March 31, 2009, we had impaired loans totaling \$47,752,613 as compared to \$3,608,197 at March 31, 2008. Included in the impaired loans at March 31, 2009, were 31 borrowers that accounted for approximately 84.02% of the total amount of the impaired loans at that date. These loans were primarily commercial real estate loans isolated to the coastal regions of South Carolina. Impaired loans, as a percentage of total loans, were 10.29% at March 31, 2009 as compared to 0.76% at March 31, 2008.

The recent downturn in the real estate market has resulted in an increase in loan delinquencies, defaults and foreclosures, and management believes these trends are likely to continue. In some cases, this downturn has resulted in a significant impairment to the value of the Company's collateral and ability to sell the collateral upon foreclosure at its appraised value, and there is a risk that this trend will continue. If real estate values continue to decline, it is also more likely that the Company would be required to increase its allowance for loan losses.

At March 31, 2009, nonaccrual loans were \$20,952,510 and total recorded investments in impaired loans were \$47,752,613 versus \$3,608,197 at March 31, 2008. During the quarter ended March 31, 2009, the average investments in impaired loans were \$36,968,107 as compared to \$2,742,209 during the quarter ended March 31, 2008. Impaired loans with a specific allocation of the allowance for loan losses totaled \$26,427,132 at March 31, 2009. The amount of the specific allocation was \$3,860,741. There was no specific allocation of the allowance for loan losses at March 31, 2008.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Monthly, management analyzes each loan that is classified as impaired to determine the potential for possible loan losses. This analysis is focused upon determining the then current estimated value of the collateral, local market condition and estimated costs to foreclose, repair and resell the property. The net realizable value of the property is then computed and compared to the loan balance to determine the appropriate amount of specific reserve for each loan.

Interest income recognized on impaired loans for the first quarter of 2009 was \$748,154.

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities increased \$31,958,087 or 6.33%, to \$536,833,143 for the first quarter of 2009, from \$504,875,076 for the first quarter of 2008. The increase is primarily a result of the continued growth of the Company.

Deposits. For the quarter ended March 31, 2009 and 2008, average total deposits were \$480,238,833 and \$445,486,401, respectively, which is an increase of \$34,752,432, or 7.80%. At March 31, 2009 and December 31, 2008, total deposits were \$501,951,560 and \$461,135,384, respectively, an increase of \$40,816,176, or 8.85%.

Average interest-bearing deposits increased \$30,843,198, or 7.68%, to \$432,663,627 for the quarter ended March 31, 2009, from \$401,820,429 for the quarter ended March 31, 2008.

The average balance of non-interest bearing deposits increased \$3,909,234, or 8.95%, to \$47,575,206 for the three months ended March 31, 2009, from \$43,665,972 for the three months ended March 31, 2008.

The following table shows the average balance amounts and the average rates paid on deposits held by us for the three months ended March 31, 2009 and 2008.

| | 2009 | | 2008 | |
|-------------------------------------|----------------|--------------|----------------|--------------|
| | Average Amount | Average Rate | Average Amount | Average Rate |
| Noninterest bearing demand deposits | \$ 47,575,206 | 0.0% | \$ 43,665,972 | 0.0% |
| Interest bearing demand deposits | 34,087,269 | 0.59 | 31,527,448 | 0.75 |
| Savings accounts | 99,193,160 | 1.51 | 89,629,482 | 2.84 |
| Time deposits | 299,383,198 | 3.25 | 280,663,499 | 4.65 |
| | \$ 480,238,833 | 2.37% | \$ 445,486,401 | 3.56% |

Core deposits, which exclude time deposits of \$100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits were \$311,493,477 and \$323,690,517 at March 31, 2009 and December 31, 2008, respectively. Included in time deposits \$100,000 and over, at March 31, 2009 and December 31, 2008 are brokered time deposits of \$144,258,000 and \$96,652,000, respectively.

Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet successfully both its short-term and long-term liquidity needs. Management anticipates that such deposits will continue to be the Company's primary source of funding in the future. However, advances from the Federal Home Loan Bank are being used as an alternative source of funds. The Company's loan-to-deposit ratio was

92.46% and 101.70% at March 31, 2009 and December 31, 2008, respectively.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of \$100,000 or more at March 31, 2009 was as follows:

| | March 31, 2009 |
|-----------------------------------|-------------------|
| Three months or less | \$ 64,541,991 |
| Over three through twelve months | 54,111,616 |
| Over one year through three years | 43,563,302 |
| Over three years | 28,241,174 |
| Total | \$ 190,458,083 |

Borrowings

The following table outlines our various sources of borrowed funds during the three months ended March 31, 2009 and the year ended December 31, 2008, the amounts outstanding at the end of each period, at the maximum point for each component during the periods and on average for each period, and the average interest rate that we paid for each borrowing source. The maximum month-end balance represents the high indebtedness for each component of borrowed funds at any time during each of the periods shown.

| (Dollars in thousands) | Maximum Outstanding at any Month End | Weighted Average Balance | Average Interest Rate | Ending Balance | Period End Rate |
|--|---|--------------------------------|--------------------------|-------------------|--------------------|
| At or for the three months ended March 31, 2009 | | | | | |
| Securities sold under agreement to repurchase | \$ 7,664 | \$ 5,709 | 0.08% | \$ 865 | 0.54% |
| Advances from Federal Home Loan Bank | | | | | |
| | 93,500 | 82,044 | 3.29 | 69,500 | 3.90 |
| Federal funds purchased | 243 | 83 | 0.77 | - | - |
| Note payable | 6,950 | 6,023 | 2.35 | - | - |
| Junior subordinated debentures | 10,310 | 10,310 | 5.99 | 10,310 | 5.93 |
| At or for the year ended December 31, 2008 | | | | | |
| Securities sold under agreement to repurchase | \$ 9,291 | \$ 7,845 | 1.54% | \$ 8,198 | 0.25% |
| Advances from Federal Home Loan Bank | | | | | |
| | 83,500 | 72,617 | 3.77 | 78,000 | 3.43 |
| Federal funds purchased | 11,482 | 4,359 | 2.99 | - | - |
| Note payable | 6,950 | 3,389 | 4.01 | 6,950 | 2.00 |
| Junior subordinated debentures | 10,310 | 10,310 | 5.97 | 10,310 | 5.93 |

Capital Resources

Total shareholders' equity at March 31, 2009 and December 31, 2008 was \$52,958,203 and \$37,425,758, respectively. The \$15,532,445 increase during the first three months of 2009 resulted primarily from the issuance of \$15,349,000 of preferred stock to the United States Treasury under the Troubled Asset Relief Program Capital Purchase Program. See Note 8 of the condensed consolidated financial statements, which described the terms of the preferred stock issued to the treasury.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio (average equity divided by average total assets) for the three months ended March 31, 2009 and 2008. Since our inception, we have not paid cash dividends.

| | March 31, 2009 | March 31, 2008 |
|--|-------------------|-------------------|
| Return on average assets | 0.01% | 0.56% |
| Return on average equity | 0.13 | 8.78 |
| Average equity to average assets ratio | 6.38 | 6.39 |

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the bank must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum ratios of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk weights ranging from 0% to 100%. Tier 1 capital of the Company consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. The Company's Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital. The regulatory minimum requirements are 4% for Tier 1 capital and 8% for total risk-based capital.

The Company and the bank are also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

The following table sets forth the holding company's and the bank's various capital ratios at March 31, 2009 and at December 31, 2008. For all periods, the bank was considered "well capitalized" and the holding company met or exceeded its applicable regulatory capital requirements.

| | March 31, 2009 | | December 31, 2008 | |
|--|--------------------|--------|--------------------|--------|
| | Holding Company | Bank | Holding Company | Bank |
| Tier 1 capital (to risk-weighted assets) | 12.26% | 11.01% | 10.73% | 9.60% |
| Total capital (to risk-weighted assets) | 13.51% | 12.26% | 11.97% | 10.86% |
| Leverage or Tier 1 capital (to total average assets) | 10.16% | 9.11% | 9.28% | 8.18% |

Effect of Inflation and Changing Prices

The effect of relative purchasing power over time due to inflation has not been taken into account in our consolidated financial statements. Rather, our financial statements have been prepared on an historical cost basis in accordance with generally accepted accounting principles.

Unlike most industrial companies, our assets and liabilities are primarily monetary in nature. Therefore, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. In addition, interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude. As discussed previously, we seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide rate fluctuations, including those resulting from inflation.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Off-Balance Sheet Risk

Through our operations, we have made contractual commitments to extend credit in the ordinary course of its business activities. These commitments are legally binding agreements to lend money to our customers at predetermined interest rates for a specified period of time. At March 31, 2009 we had issued commitments to extend credit of \$46.5 million and standby letters of credit of \$3.0 million through various types of commercial lending arrangements. Approximately \$37.0 million of these commitments to extend credit had variable rates.

The following table sets forth the length of time until maturity for unused commitments to extend credit and standby letters of credit at March 31, 2009:

| (Dollars in thousands) | Within One Month | After One Through Three Months | After Three Through Twelve Months | Within One Year | Greater Than One Year | Total |
|-------------------------------------|---------------------|---|---|--------------------|-----------------------------|-----------|
| Unused commitments to extend credit | \$ 7,935 | \$ 3,330 | \$ 14,132 | \$ 25,397 | \$ 21,079 | \$ 46,476 |
| Standby letters of credit | | 367 | 986 | 1,353 | 1,598 | 2,951 |
| Totals | \$ 7,935 | \$ 3,697 | \$ 15,118 | \$ 26,750 | \$ 22,677 | \$ 49,427 |

We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on its credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates, which principally arises from interest rate risk inherent in our lending, investing, deposit gathering, and borrowing activities. Other types of market risks, such as foreign currency exchange rate risk and commodity price risk, do not generally arise in the normal course of our business. Our finance committee monitors and considers methods of managing exposure to interest rate risk. We have both an internal finance committee consisting of senior management that meets at various times during each quarter and a management finance committee that meets weekly as needed. The finance committees are responsible for maintaining the level of interest rate sensitivity of our interest sensitive assets and liabilities within board-approved limits.

We actively monitor and manage our interest rate risk exposure principally by measuring our interest sensitivity "gap," which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available for sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. We generally would benefit from increasing market rates of interest when we have an asset-sensitive gap position and generally would benefit from decreasing market rates of interest when we are liability-sensitive.

We were asset sensitive during most of the year ended December 31, 2008 and during the three months ended March 31, 2009. As of March 31, 2009, we expect to be liability sensitive for the next nine months because a majority of our deposits reprice over a 12-month period. Approximately 55% of our loans were variable rate loans at March 31, 2009. The ratio of cumulative gap to total earning assets after 12 months was (29.17%) because \$165.1 million more assets will reprice in a 12 month period than liabilities. However, our gap analysis is not a precise indicator of our interest sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by us as significantly less interest-sensitive than market-based rates such as those paid on noncore deposits. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

Liquidity and Interest Rate Sensitivity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

At March 31, 2009, our liquid assets, consisting of cash and due from banks, amounted to \$31.7 million, or 4.97% of total assets. Our investment securities, excluding nonmarketable securities, at March 31, 2009 amounted to \$73.6 million, or 11.55% of total assets. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, \$68.4 million of these securities are pledged against unused FHLB borrowing lines, the Federal Reserve line of credit, and other required deposit accounts. At December 31, 2008, our liquid assets amounted to \$5.7 million, or 0.95% of total assets. Our investment securities, excluding nonmarketable securities, at December 31, 2008 amounted to \$76.3 million, or 12.65% of total assets. However, \$73.2 million of these securities were pledged.

Our ability to maintain and expand our deposit base and borrowing capabilities serves as our primary source of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. During most of 2008 and the first three months of 2009, as a result of historically low rates that were being earned on short-term liquidity investments, we maintained a lower than normal level of short-term liquidity securities. In addition, we maintain five federal funds purchased lines of credit with correspondent banks giving us credit availability totaling approximately \$22.0 million for which there were no borrowings against the lines at March 31, 2009. We are also a member of the Federal Home Loan Bank of Atlanta, from which applications for borrowings can be made for leverage purposes. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the bank be pledged to secure any advances from the FHLB. The Company has an available line to borrow funds from the Federal Home Loan Bank up to 30% of the Bank's total assets which provide additional available funds of \$92.5 million at March 31, 2009. At March 31, 2009 the bank had \$69.5 million outstanding in FHLB advances. Additionally, the Company has an available line of credit at the Federal Reserve of \$23.2 million. At March 31, 2009, there were no borrowings against this line. We believe that sources described above will be sufficient to meet our future liquidity needs.

Asset/liability management is the process by which we monitor and control the mix and maturities of our assets and liabilities. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets and liabilities in order to minimize potentially adverse impacts on earnings from changes in market interest rates. We have both an internal finance committee consisting of senior management that meets at various times during each quarter and a management finance committee that meets weekly as needed. The finance committees are responsible for maintaining the level of interest rate sensitivity of our interest sensitive assets and liabilities within board-approved limits.

FIRST RELIANCE BANCSHARES, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - continued

The following table sets forth information regarding our rate sensitivity as of March 31, 2009 for each of the time intervals indicated. The information in the table may not be indicative of our rate sensitivity position at other points in time. In addition, the maturity distribution indicated in the table may differ from the contractual maturities of the earning assets and interest-bearing liabilities presented due to consideration of prepayment speeds under various interest rate change scenarios in the application of the interest rate sensitivity methods described above.

Interest Sensitivity Analysis

March 31, 2009

| (Dollars in thousands) | Within One Month | After One Through Three Months | Three Through Twelve Months | Within One Year | Greater Than One Year or Non- Sensitive | Total |
|--|------------------------|---|--------------------------------------|-----------------------|--|------------|
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Loans(1) | \$ 73,408 | \$ 32,974 | \$ 95,577 | \$ 201,959 | \$ 286,416 | \$ 488,375 |
| Securities, taxable | 92 | - | - | 92 | 44,945 | 45,037 |
| Securities, nontaxable | - | - | - | - | 28,557 | 28,557 |
| Nonmarketable securities | 5,285 | - | - | 5,285 | - | 5,285 |
| Investment in trust | - | - | - | - | 310 | 310 |
| Total earning assets | 78,785 | 32,974 | 95,577 | 207,336 | 360,228 | 567,564 |
| Liabilities | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Demand deposits | 34,415 | - | - | 34,415 | - | 34,415 |
| Savings deposits | 85,397 | - | - | 85,397 | - | 85,397 |
| Time deposits | 4 | 89,248 | 120,501 | 209,753 | 124,302 | 334,055 |
| Total interest-bearing deposits | 119,816 | 89,248 | 120,501 | 329,565 | 124,302 | 453,867 |
| Federal Home Loan Bank Advances | | | | | | |
| | - | 13,000 | 29,500 | 42,500 | 27,000 | 69,500 |
| Junior subordinated debentures | | | | | | |
| | - | - | - | - | 10,310 | 10,310 |
| Repurchase agreements | 865 | - | - | 865 | - | 865 |
| Total interest-bearing liabilities | 120,681 | 102,248 | 150,001 | 372,930 | 161,612 | 534,542 |
| Period gap | \$ (41,896) | \$ (69,274) | \$ (54,424) | \$ (165,594) | \$ 198,616 | |
| Cumulative gap | \$ (41,896) | \$ (111,170) | \$ (165,594) | \$ (165,594) | \$ 32,022 | |

| | | | | | |
|--|---------|----------|----------|----------|-------|
| Ratio of cumulative gap to total earning assets | (7.38)% | (19.58)% | (29.17)% | (29.17)% | 5.82% |
|--|---------|----------|----------|----------|-------|

(1) Including mortgage loans held for sale.

FIRST RELIANCE BANCSHARES, INC.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

See "Market Risk" and "Liquidity and Interest Rate Sensitivity" in Item 2, Management Discussion and Analysis of Financial Condition and Results of Operations for quantitative and qualitative disclosures about market risk, which information is incorporated herein by reference.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer have evaluated the effectiveness of our "disclosure controls and procedures" ("Disclosure Controls"). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Our management, including the CEO and CFO, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our CEO and CFO have concluded that our Disclosure Controls are effective at a reasonable assurance level.

There have been no changes in our internal controls over financial reporting during our first fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FIRST RELIANCE BANCSHARES, INC.

Part II - Other Information

Item 1. Legal Proceedings

There are no material, pending legal proceedings to which the Company or its subsidiary is a party or of which any of their property is the subject.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1. Business" under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

(a) On March 6, 2009, the Company completed a transaction with the United States Treasury Department (the "Treasury") under the Troubled Asset Relief Program Capital Purchase Program (the "TARP CPP"). The Company sold 15,349 shares of its Series A Cumulative Perpetual Preferred Stock. In addition, the Treasury received a warrant to purchase 767 shares of the Company's Series B Cumulative Perpetual Preferred Stock, which was immediately exercised by the Treasury for a nominal exercise price. The Series A Preferred Stock is a senior cumulative perpetual preferred stock that has a liquidation preference of \$1,000 per share, pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. Dividends are payable quarterly. The Series A Preferred Stock is generally non-voting. The Series B Preferred Stock is a cumulative perpetual preferred stock that has the same rights, preferences, privileges, voting rights and other terms as the Series A Preferred Stock, except that dividends will be paid at the rate of 9% per year. The aggregate sales price of the Series A Preferred Stock and warrant to purchase Series B Preferred Stock was \$15,349,000. The securities offered and sold in the TARP CPP transaction were not registered under the Securities Act of 1933 in reliance upon the exemption provided under Section 4(2) of that Act for transactions not involving any public offering.

(b) Not applicable.

(c) The following stock repurchases were made during the period covered by this report in connection with administration of the Company's employee stock ownership plan.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------------|----------------------------------|------------------------------|--|--|
| January 1, 2009 – January 31, 2009 | - | \$ - | - | - |
| February 1, 2009 - February 28, 2009 | 622 | \$ 5.85 | - | - |

| | | | | | |
|--------------------------------|-----|----|------|---|---|
| March 1, 2009 – March 31, 2009 | 3 | \$ | 5.85 | - | - |
| | 625 | \$ | 5.85 | - | - |

Item 3. Defaults Upon Senior Securities

Not applicable.

-30-

FIRST RELIANCE BANCSHARES, INC.

Item 4. Submission of Matters to a Vote of Security Holders

On February 24, 2009, a special meeting of shareholders was held to (1) approve an amendment to the Company's articles of incorporation to authorize the issuance of preferred stock and vest in the board of directors the authority to determine the terms of one or more series of preferred stock, including the preferences, rights, and limitations of each series (the "Amendment Proposal") and (2) authorize management to adjourn the special meeting to another time and date in order to allow the board of directors to solicit additional proxies or attendance at the Special Meeting (the "Adjournment Proposal"). Both proposals were approved by the shareholders.

With respect to the Amendment Proposal, 2,427,790 votes were cast for the proposal and 122,134 votes were cast against it. There were 19,851 abstentions and no broker non-votes. With respect to the Adjournment Proposal, 2,437,861 votes were cast for the proposal and 107,490 were cast against it. There were 17,882 abstentions and no broker non-votes.

Item 5. Other Information

None.

Item 6. Exhibits

| Exhibit Number | Exhibit |
|----------------|--|
| 3.1 | Articles of Amendment to the Articles of Incorporation authorizing a class of preferred stock * |
| 3.2 | Articles of Amendment to the Articles of Incorporation establishing the terms of the Series A Preferred Stock and the Series B Preferred Stock * |
| 4.1 | Form of Certificate for the Series A Preferred Stock * |
| 4.2 | Form of Certificate for the Series B Preferred Stock * |
| 4.3 | Warrant to Purchase up to 767.00767 shares of Series B Preferred Stock, dated March 6, 2009 * |
| 10.1 | Letter Agreement, dated March 6, 2009, including Securities Purchase Agreement – Standard Terms, incorporated by reference therein, between the Company and the United States Department of the Treasury * |
| 10.2 | Side Letter Agreement, dated March 6, 2009 * |
| 10.3 | Form of Waiver * |
| 10.4 | Form of Senior Executive Officer Agreement * |
| 31.1 | Certification pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. |

- 31.2 Certification pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference from the Company's Current Report on Form 8-K filed on March 10, 2009.

FIRST RELIANCE BANCSHARES, INC.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST RELIANCE BANCSHARES, INC.

By: /s/ F.R. SAUNDERS, JR.
F. R. Saunders, Jr.
President & Chief Executive Officer

Date: May 15, 2009

By: /s/ JEFFERY A. PAOLUCCI
Jeffery A. Paolucci
Senior Vice President and Chief Financial
Officer