



July 31, 2008

Dear Shareholder

We are pleased to provide our investors with an update on your bank's progress through June 30, 2008.

A review of the unaudited financial statements enclosed will disclose remarkable growth since the end of 2007. Total assets have increased by some 47%, with growth in the loan portfolio equaling 60%. This growth was accomplished during a period when most banks were struggling to show even modest growth. We have been blessed with a loyal following, which provides leads on new business on a consistent basis. Commercial lending opportunities remain strong. Today's market conditions allow us to attract great loan-to-value ratios and excellent yields on credits to financially strong, credit-worthy borrowers.

First State reported a loss for the Second Quarter, but excluding the cost of building our loan loss reserves for new loans, we are nearing break-even levels.

Our challenge has been, and continues to be, achieving profitability with a prudent pace of loan expansion, all while maintaining strong statutory capital ratios. We have been successful in raising additional capital during a time when the financial sector has suffered an exodus of investors, due to the well-publicized credit crunch and fear over unconventional lending products and practices. We are pleased to report that your bank is not involved in any of that type of lending.

Our capital-raising efforts have been bolstered by significant investments by some very well-known institutional investors. Most recently, your Board of Directors infused \$3.1 million in additional capital and now represents approximately 40% of outstanding shares.

Last summer we embarked on a new line of business, indirect auto lending. We were fortunate to acquire an outstanding staff, with many years of experience in this discipline, who helped us build a portfolio of over \$80 million, a major contribution to our growth. This growth was achieved without sacrificing credit quality and we have been pleased on the low level of losses, and delinquencies on par with our expectations. However, this business depended on the external capital markets to move loans as necessary in order to manage our retained asset growth. Due to the extreme conditions in the capital markets which have limited the external interest in this lending type, your Board has elected to discontinue this line of business. We have retained a staff

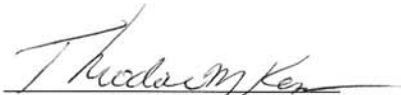
sufficient to manage the existing portfolio, and we will further build our successful efforts in the commercial lending arena. Further, this decision should have a positive impact on Third Quarter 2008 expenses which enables First State Bank to approach profitability sooner than we expected.

Our efforts to acquire additional capital for future growth continue, with the help of our financial advisers and partners, FIG Partners LLC. FIG has enabled us to attract many of the institutional investors mentioned above, and continue to be supportive of your bank with regards to attracting prospective new investors.

While many of the major banks in the country have struggled in this economy, we continue to experience strong demand for our services and are confident that we will successfully navigate the next several quarters, with continued improvement in our fundamentals. With the reduction in overhead expense resulting from the de-emphasis on auto lending and the corresponding reduction in required loan loss provisions, we expect our earnings performance to improve dramatically. We appreciate your continued support and stand ready to answer any questions you may have.



Joseph D. Natale
Chairman & CEO



Theodore M. Kest
President & CFO

First State Bank

Balance Sheets

(In Thousands)

	Dec 31, 2007	(unaudited) Mar 31, 2008	(unaudited) Jun 30, 2008
Assets			
Cash and Due From Banks	1,818	1,668	1,750
Fed Funds Sold	12,451	12,560	13,620
Short-term Investments	6,200	1,000	-
Cash and Equivalents	<u>20,469</u>	<u>15,228</u>	<u>15,370</u>
Investment Securities	2,748	2,499	2,501
Commercial Loans	72,622	82,356	106,835
Indirect Auto Loans	40,387	64,918	84,823
All other loans	16,569	16,639	15,679
Total Loans	<u>129,578</u>	<u>163,913</u>	<u>207,337</u>
Premise & Equipment, Net	1,970	1,975	1,913
Other Assets	937	1,045	1,387
Total Assets	<u>\$ 155,702</u>	<u>\$ 184,660</u>	<u>\$ 228,508</u>
Liabilities			
Non-Interest Bearing Deposits	6,926	7,050	4,674
Interest Bearing Deposits	135,112	163,292	205,301
Total Deposits	<u>142,038</u>	<u>170,342</u>	<u>209,975</u>
Borrowings & Other Debt	-	-	-
Other Liabilities	1,105	680	1,043
Total Liabilities	<u>143,143</u>	<u>171,022</u>	<u>211,018</u>
Stockholders' Equity			
Common Stock, \$5 Par Value	10,615	11,990	15,874
Surplus	7,022	7,321	7,931
Accumulated Deficit	(5,078)	(5,673)	(6,315)
Total Stockholders' Equity	<u>12,559</u>	<u>13,638</u>	<u>17,490</u>
Total Liabilities and Stockholders' Equity	<u>\$ 155,702</u>	<u>\$ 184,660</u>	<u>\$ 228,508</u>

First State Bank

Income Statements

(In Thousands)

	Year Ending Dec 31, 2007	(unaudited) Quarter Ending Mar 31, 2008	(unaudited) Quarter Ending Jun 30, 2008
Interest Income			
Loans Recievable	5,406	2,766	3,406
Securities	109	31	26
Fed Funds Sold	979	94	79
Other	30	41	6
Total Interest Income	<u>6,524</u>	<u>2,932</u>	<u>3,517</u>
Interest Expense			
Deposits	4,161	1,789	2,069
Borrowings & Other Debt	-	-	-
Total Interest Expense	<u>4,161</u>	<u>1,789</u>	<u>2,069</u>
Net Interest Income	<u>2,363</u>	<u>1,143</u>	<u>1,448</u>
Provision for Loan Loss	893	352	577
Net Interest Income after Provision	<u>1,470</u>	<u>791</u>	<u>871</u>
Non-Interest Income			
Customer Service Fees	54	16	13
Other Fees	139	100	123
Total Non-Interest Income	<u>193</u>	<u>116</u>	<u>136</u>
Non-Interest Expense			
Salaries & Employee Benefits	2,667	892	879
Occupancy	451	162	163
Furniture & Equipment	147	53	45
Professional Fees	244	81	106
Advertising & Promotion	93	30	33
Data Processing	256	87	109
Other	591	197	314
Total Non-Interest Expense	<u>4,449</u>	<u>1,502</u>	<u>1,649</u>
Net Loss	<u>\$ (2,786)</u>	<u>\$ (595)</u>	<u>\$ (642)</u>