



October 22, 2008

Dear Shareholder:

The third quarter of 2008 has presented some unusual and challenging issues for the Banking industry. As this letter is written, capital markets are in disarray and, as we're sure you've read, the entire landscape in the financial services industry is changing. Time-honored institutions have ceased to exist; large, nationwide banks have gotten larger, and the government is involved in the industry to an extent never before seen.

While the ultimate outcome of all this turmoil remains to be seen, we are pleased to report that your Bank continues to progress and to succeed through very difficult times. As reported to you in our last update, the Bank has adjusted its strategy both in terms of expense control as well as asset growth. In order to leverage our capital base in the most effective way, we have limited our growth over the past three months, allowed some high-rate deposits to run off and successfully reduced our cost of funds. These strategies have combined to result in continued reduction of our loss levels, to the point where our September, 2008 monthly net loss was only \$(36,000). We expect these improvements to continue, as we maintain our conservative growth strategy.


We continue to pursue sources of additional capital in order to further improve our capital ratios, which have remained within acceptable ranges (as opposed to many other institutions). Excess capital is the key to future growth and, as announced recently, we intend to raise up to \$20 million in additional capital through a combination of common and preferred stock. A special meeting of shareholders has been called for October 28, 2008 at which we hope our shareholders will approve those organizational changes which are required to move forward with this new stock issue.

We believe that the unrest in the economy, and the financial services sector in particular, will present some unique opportunities for First State Bank in the months to come. There will be, no doubt, continuing concern for the health of many financial institutions and there may well be additional bank failures and consolidations going forward. The fallout from these unfortunate developments will allow First State Bank to attract new customers as well as talented staff. Together, these factors should present synergies to benefit your bank in terms of quality, profitable growth.

Attached you will find unaudited financial reports for results through September 30, 2008. We trust you will take note of the progress to date and recognize that the trends reflected are positive, especially considering the state of the industry. As always, management and the Board of Directors stand ready to answer any questions you may have.

Again, we thank you for your continued support and look forward to being able to report additional progress as of year end.

Sincerely,

  
Joseph D. Natale  
Chairman & CEO

  
Theodore M. Kest  
President & CFO

# First State Bank

## Balance Sheets

(In Thousands)

	<u>Sep 30, 2008</u> <u>(unaudited)</u>	<u>Dec 31, 2007</u>
<b>Assets</b>		
Cash and Due From Banks	5,251	1,818
Fed Funds Sold	4,901	12,451
Short-term Investments	-	6,200
Cash and Equivalents	<u>10,152</u>	<u>20,469</u>
Investment Securities, HTM	2,704	2,748
Commercial Loans	114,044	72,622
Indirect Auto Loans	77,987	40,387
All other loans	18,959	17,881
Total Loans	<u>210,990</u>	<u>130,890</u>
Allowance for Loan Losses	<u>(2,295)</u>	<u>(1,312)</u>
Net Loans	<u>208,695</u>	<u>129,578</u>
Premise & Equipment, Net	1,864	1,970
Other Assets	1,391	937
<b>Total Assets</b>	<b><u>\$ 224,806</u></b>	<b><u>\$ 155,702</u></b>
<b>Liabilities</b>		
Non-Interest Bearing Deposits	10,758	6,926
Interest Bearing Deposits	194,654	135,112
Total Deposits	<u>205,412</u>	<u>142,038</u>
Borrowings & Other Debt	-	-
Other Liabilities	1,224	1,105
<b>Total Liabilities</b>	<b><u>206,636</u></b>	<b><u>143,143</u></b>
<b>Stockholders' Equity</b>		
Common Stock, \$5 Par Value	16,977	10,615
Surplus	7,931	7,022
Accumulated Deficit	(6,738)	(5,078)
<b>Total Stockholders' Equity</b>	<b><u>18,170</u></b>	<b><u>12,559</u></b>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$ 224,806</u></b>	<b><u>\$ 155,702</u></b>

**First State Bank**  
**Income Statements (unaudited)**

(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Interest Income</b>				
Loans Recievable	3,699	1,476	9,869	3,333
Investments, Held to Maturity	30	31	134	79
Fed Funds Sold	45	191	218	677
Other	1	1	3	-
Total Interest Income	<u>3,775</u>	<u>1,699</u>	<u>10,224</u>	<u>4,089</u>
<b>Interest Expense</b>				
Deposits	2,124	1,019	5,982	2,472
Borrowings & Other Debt	-	-	-	-
Total Interest Expense	<u>2,124</u>	<u>1,019</u>	<u>5,982</u>	<u>2,472</u>
<b>Net Interest Income</b>	<u>1,651</u>	<u>680</u>	<u>4,242</u>	<u>1,617</u>
Provision for Loan Losses	593	250	1,522	521
<b>Net Interest Income after Provision</b>	<u>1,058</u>	<u>430</u>	<u>2,720</u>	<u>1,096</u>
<b>Non-Interest Income</b>				
Deposit Service Fees	20	5	49	20
Other Fees	108	51	330	70
Total Non-Interest Income	<u>128</u>	<u>56</u>	<u>379</u>	<u>90</u>
<b>Non-Interest Expense</b>				
Salaries & Employee Benefits	782	882	2,553	1,911
Occupancy	171	130	496	297
Furniture & Equipment	55	39	153	87
Legal & Professional Fees	234	54	421	183
Advertising & Promotion	26	28	88	47
Data Processing	96	55	314	117
FDIC Insurance	58	15	145	28
Other	187	113	585	303
Total Non-Interest Expense	<u>1,609</u>	<u>1,316</u>	<u>4,755</u>	<u>2,973</u>
<b>Net Loss before taxes</b>	<u>(423)</u>	<u>(830)</u>	<u>(1,656)</u>	<u>(1,787)</u>
Income Taxes	4	2	4	3
<b>Net Loss</b>	<u>\$ (427)</u>	<u>\$ (832)</u>	<u>\$ (1,660)</u>	<u>\$ (1,790)</u>