

FIRST RELIANCE BANCSHARES INC
Form 10-Q
May 14, 2010

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, 2010

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:

4,048,520 shares of common stock, par value \$0.01 per share, as of April 30, 2010

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, 2010 and December 31, 2009	3
	Condensed Consolidated Statements of Income - Three months ended March 31, 2010 and 2009	4
	Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income - Three months ended March 31, 2010 and 2009	5
	Condensed Consolidated Statements of Cash Flows - Three months ended March 31, 2010 and 2009	6
	Notes to Condensed Consolidated Financial Statements	7-16
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	17-34
Item 3.	Quantitative and Qualitative Disclosure About Market Risk	35
Item 4.	Controls and Procedures	35
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	35
Item 1A.	Risk Factors	35
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 6.	Exhibits	37

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Balance Sheets

	March 31, 2010 (Unaudited)	December 31, 2009 (Audited)
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 2,029,201	\$ 2,942,295
Interest-bearing deposits with other banks	40,658,139	50,356,191
Total cash and cash equivalents	42,687,340	53,298,486
Time deposits in other banks	503,107	502,089
Securities available-for-sale	121,633,494	121,948,744
Nonmarketable equity securities	4,812,100	4,812,100
Total investment securities	126,445,594	126,760,844
Mortgage loans held for sale	583,952	5,100,609
Loans receivable	392,192,736	406,627,401
Less allowance for loan losses	(6,725,174)	(9,800,746)
Loans, net	385,467,562	396,826,655
Premises and equipment, net	26,327,343	26,469,436
Accrued interest receivable	2,446,595	2,661,030
Other real estate owned	7,249,401	8,954,214
Cash surrender value life insurance	11,514,595	11,409,937
Other assets	12,939,322	13,525,073
Total assets	\$ 616,164,811	\$ 645,508,373
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	\$ 44,229,115	\$ 44,298,626
Interest-bearing transaction accounts	39,366,420	47,733,229
Savings	104,310,169	103,604,793
Time deposits \$100,000 and over	190,977,782	195,346,191
Other time deposits	147,795,709	161,780,140
Total deposits	526,679,195	552,762,979
Securities sold under agreement to repurchase	603,062	598,342
Advances from Federal Home Loan Bank	27,000,000	34,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	654,082	680,880
Other liabilities	4,773,096	1,932,345
Total liabilities	570,019,435	600,284,546

Shareholders' Equity

Preferred stock, no par value, authorized 10,000,000 shares: Series A cumulative perpetual preferred stock 15,349 issued and outstanding at March 31, 2010 and December 31, 2009	14,584,146	14,536,176
Series B cumulative perpetual preferred stock 767 shares issue and outstanding at March 31, 2010 and December 31, 2009	831,890	835,960
Common stock, \$0.01 par value; 20,000,000 shares authorized, 3,703,375 and 3,582,691 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	37,034	35,827
Capital surplus	26,602,763	26,181,576
Treasury stock at cost at 12,090 and 11,535 shares at at March 31, 2010 and December 31, 2009, respectively	(166,322)	(163,936)
Nonvested restricted stock	(597,925)	(206,004)
Retained earnings	5,546,577	5,269,463
Accumulated other comprehensive income (loss)	(692,787)	(1,265,235)
Total shareholders' equity	46,145,376	45,223,827
Total liabilities and shareholders' equity	\$ 616,164,811	\$ 645,508,373

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended	
	March 31,	
	2010	2009
Interest income		
Loans, including fees	\$ 6,213,086	\$ 6,967,737
Investment securities		
Taxable	609,994	531,316
Nontaxable	652,898	313,418
Federal funds sold	-	983
Other interest income	28,873	9,599
Total	7,504,851	7,823,053
Interest expense		
Time deposits over \$100,000	1,455,703	1,192,567
Other deposits	1,352,809	1,622,844
Other interest expense	388,799	854,549
Total	3,197,311	3,669,960
Net interest income	4,307,540	4,153,093
Provision for loan losses	186,089	1,300,380
Net interest income after provision for loan losses	4,121,451	2,852,713
Noninterest income		
Service charges on deposit accounts	468,220	460,608
Gain on sale of mortgage loans	210,043	660,499
Income from bank owned life insurance	104,658	105,150
Other charges, commissions and fees	152,984	126,999
Gain on sale of securities available-for-sale	1,602	-
Gain (loss) on sale of other real estate owned	242,122	(15,892)
Gain on sale of fixed assets	-	86,810
Other non-interest income	104,778	268,943
Total	1,284,407	1,693,117
Noninterest expenses		
Salaries and benefits	2,396,066	2,727,150
Occupancy expense	399,534	355,857
Furniture and equipment expense	310,225	285,865
Other operating expenses	1,836,131	1,356,007
Total	4,941,956	4,724,879
Income (loss) before taxes	463,902	(179,049)

Income tax benefit	(66,232)	(192,914)
Net income	530,134	13,865
Preferred stock dividends	204,574	59,584
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	43,900	12,684
Net Income (loss) available to common shareholders	\$ 281,660	\$ (58,403)
Average common shares outstanding, basic	3,584,032	3,525,004
Average common shares outstanding, diluted	3,584,032	3,525,004
Basic earnings (loss) per share	\$ 0.08	\$ (0.02)
Diluted earnings (loss) per share	\$ 0.08	\$ (0.02)

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, 2010 and 2009
(Unaudited)

	Preferred Stock	Common Stock	Capital Surplus	Treasury Stock	Nonvested Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	\$ -	\$ 35,250	\$ 26,120,460	\$ (159,777)	\$ (207,653)	\$ 11,839,005	\$ (201,527)	\$ 37,425,758
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		-

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

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
Balance, December 31, 2009	\$ 15,372,136	\$ 35,827	\$ 26,181,576	\$ (163,936) \$ (206,004) \$ 5,269,463 \$ (1,265,235) \$ 45,223,827
Net income			530,134	530,134
Other comprehensive gain, net of tax expense of \$294,897				572,448 572,448
Other comprehensive income				1,102,582
Preferrd Stock Dividend			(209,120)	(209,120)
Accretion of Series A Preferred stock discount	47,970		(47,970)	-
Amortization of Series B Preferred stock premium	(4,070)		4,070	-
Issuance Restricted Stock	1,207	421,187	(391,921)	30,473
Purchase of treasury stock			(2,386)	(2,386)
Balance, March 31, 2010	\$ 15,416,036	\$ 37,034	\$ 26,602,763	\$ (166,322) \$ (597,925) \$ 5,546,577 \$ (692,787) \$ 46,145,376

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 530,134	\$ 13,865
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan losses	186,089	1,300,380
Depreciation and amortization expense	274,165	269,374
Gain on sale of securities available-for-sale	(1,602)	-
Gain on sale of premises and equipment	-	(86,810)
(Gain) loss on sale of other real estate owned	(242,122)	15,892
Write down of other real estate owned	187,582	-
Discount accretion and premium amortization	62,220	44,471
Disbursements for mortgage loans held for sale	(7,343,801)	(51,727,574)
Proceeds from sale of mortgage loans held for sale	11,860,458	37,066,273
Decrease in interest receivable	214,435	190,795
Decrease in interest payable	(26,798)	(12,406)
Increase for cash surrender value of life insurance	(104,658)	(105,150)
Amortization of deferred compensation on restricted stock	30,473	35,072
Decrease (increase) in other assets	239,289	(562,383)
Increase in other liabilities	2,840,751	278,990
Net cash provided (used) by operating activities	8,706,615	(13,279,211)
Cash flows from investing activities:		
Net decrease in loans receivable	10,826,774	1,605,843
Purchases of securities available-for-sale	(2,888,381)	-
Maturities of securities available-for-sale	892,813	3,069,380
Sales of securities available-for-sale	3,117,545	-
Sales of other real estate owned	2,105,583	6,608
Increase in time deposits in other banks	(1,018)	-
Purchase of non marketable equity securities	-	(709,900)
Proceeds from disposal of premises and equipment	-	2,286,810
Purchases of premises and equipment	(80,507)	(259,629)
Net cash provided by investing activities	13,972,809	5,999,112
Cash flows from financing activities:		
Net decrease in demand deposits, interest-bearing transaction accounts and savings accounts	(7,730,944)	(16,908,694)
Net increase (decrease) in certificates of deposit and other time deposits	(18,352,840)	57,724,870
Net increase (decrease) in securities sold under agreements to repurchase	4,720	(7,332,457)
Net decrease in advances from the Federal Home Loan Bank	(7,000,000)	(8,500,000)

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

Repayment of note payable	-	(6,950,000)
Net proceeds from issuance of preferred stock	-	15,225,312
Purchase of treasury stock	(2,386)	(3,656)
Payment of preferred stock dividends	(209,120)	-
Net cash provided (used) by financing activities	(33,290,570)	33,255,375
Net increase (decrease) in cash and cash equivalents	(10,611,146)	25,975,276
Cash and cash equivalents, beginning	53,298,486	5,708,607
Cash and cash equivalents, end	\$ 42,687,340	\$ 31,683,883
Cash paid during the period for:		
Income taxes	\$ -	\$ 4,257
Interest	\$ 3,224,109	\$ 3,682,366
Supplemental noncash investing and financing activities:		
Foreclosures on loans	\$ 346,230	\$ 1,066,132

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying condensed 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, 2010 and for the interim periods ended March 31, 2010 and 2009 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, 2009 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, 2009.

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 January 2010, compensation guidance was updated to reflect the Securities and Exchange Commission's (the "SEC") views of when escrowed share arrangements are considered to be compensatory. Historically the SEC staff has expressed the view that an escrowed share arrangement involving the release of shares to certain shareholders based on performance-related criteria is presumed to be compensatory. Facts and circumstances may indicate that the arrangement is an incentive made to facilitate a transaction on behalf of the company if the escrowed shares will be released or canceled without regard to continued employment. In such cases, the SEC staff generally believes that the arrangement should be recognized and measured according to its nature and reflected as a reduction of the proceeds allocated to the newly issued securities. The SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation. The guidance is effective upon issuance and had no impact on the Company's financial statements.

In January 2010, fair value guidance was amended to require disclosures for significant amounts transferred in and out of Levels 1 and 2 and the reasons for such transfers and to require that gross amounts of purchases, sales, issuances and settlements be provided in the Level 3 reconciliation. The new disclosures are effective for the Company for the current quarter and have been reflected in Note 10, Fair Value measurements.

Guidance related to subsequent events was amended in February 2010 to remove the requirement for an SEC filer to disclose the date through which subsequent events were evaluated. The amendments were effective upon issuance and had no significant impact on the Company's financial statements.

Consolidation guidance was amended in February 2010 to defer guidance regarding the analysis of interests in variable interest entities issued in June 2009 for entities having attributes of investment companies or that apply investment company measurement principles. Disclosure requirements provided in the June 2009 guidance were not deferred. The amendments were effective January 1, 2010 and had no effective on the Company's financial statements.

In March 2010, guidance related to derivatives and hedging was amended to exempt embedded credit derivative features related to the transfer of credit risk from potential bifurcation and separate accounting. Embedded features related to other types of risk and other embedded credit derivative features were not exempt from potential bifurcation

and separate accounting. The amendments will be effective for the Company on July 1, 2010 although early adoption is permitted. The Company does not expect these amendments to have any impact on the financial statements.

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

-7-

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 3 - Reclassifications

Certain captions and amounts in the financial statements in the Company's Form 10-Q for the quarter ended March 31, 2009 were reclassified to conform to the March 31, 2010 presentation.

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, 2010:			
Unrealized gains on securities available-for-sale	\$ 868,947	\$ (295,442)	\$ 573,505
Reclassification adjustment for gains (losses) realized in net income	1,602	(545)	1,057
	\$ 867,345	\$ (294,897)	\$ 572,448
For the Quarter Ended March 31, 2009:			
Unrealized gains on securities available-for-sale	\$ 396,746	\$ 134,894	\$ 261,852
	\$ 396,746	\$ 134,894	\$ 261,852

Note 5 - Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2010				
U.S. Government agencies	\$ 3,009,668	\$ 25,766	\$ -	\$ 3,035,434
Mortgage-backed securities	58,402,107	19,488	489,986	57,931,609
Municipals	61,052,646	522,749	962,799	60,612,596
Other	218,750	-	164,895	53,855
	\$ 122,683,171	\$ 568,003	\$ 1,617,680	\$ 121,633,494
December 31, 2009				
U.S. Government agencies	\$ 3,021,782	\$ 751	\$ 11,167	\$ 3,011,366
Mortgage-backed securities	59,324,978	-	1,192,307	58,132,671
Municipals	61,300,256	460,262	1,023,326	60,737,192

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

Other	218,750	-	151,235	67,515
	\$ 123,865,766	\$ 461,013	\$ 2,378,035	\$ 121,948,744

The following is a summary of maturities of securities available-for-sale as of March 31, 2010. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 - Investment Securities –(continued)

	Securities	
	Available-For-Sale	
	Amortized Cost	Estimated Fair Value
Due after one year but within five years	\$ 3,441,501	\$ 3,399,029
Due after five years but with ten years	29,752,335	29,418,256
Due after ten years	30,868,478	30,830,745
	64,062,314	63,648,030
Mortgage-backed securities	58,402,107	57,931,609
Other	218,750	53,855
Total	\$ 122,683,171	\$ 121,633,494

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2010 and December 31, 2009.

	March 31, 2010		December 31, 2009	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Less Than 12 Months				
U.S. government agencies and corporations	\$ -	\$ -	\$ 2,995,629	\$ 11,167
Mortgage-backed securities	45,523,829	489,985	58,132,671	1,192,307
Municipals	26,112,244	623,505	27,850,269	688,885
	71,636,073	1,113,490	88,978,569	1,892,359
12 Months or More				
Municipals	4,307,603	339,295	4,314,797	334,441
Other	53,855	164,895	67,515	151,235
	4,361,458	504,190	4,382,312	485,676
Total securities available-for-sale	\$ 75,997,532	\$ 1,617,680	\$ 93,360,881	\$ 2,378,035

At March 31, 2010, securities classified as available-for-sale are recorded at fair market value. Approximately 31.17% of the unrealized losses, or 10 individual securities, consisted of securities in a continuous loss position for twelve months or more. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

During the first quarter of 2010 and 2009, gross proceeds from the sale of available-for-sale securities were \$3,117,545 and \$0, respectively. Gains on available-for-sale securities totaled \$1,602 and \$0 for the first quarter 2010 and 2009, respectively.

Note 6 – Shareholders' Equity

Common Stock – The following is a summary of the changes in common shares outstanding for the three months ended March 31, 2010 and 2009.

	Three Months Ended March 31,	
	2010	2009
Common shares outstanding at beginning of the period	3,582,691	3,525,004
Issuance of non-vested restricted shares	120,684	62,222
Common shares outstanding at end of the period	3,703,375	3,587,226

-9-

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 6 – Shareholders' Equity – (continued)

Preferred Stock - On February 24, 2009, the Company's Articles of Incorporation were 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.

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 are being accreted and amortized, respectively, through retained earnings over a five-year estimated life using the effective interest method. For the quarter ended March 31, 2010 and 2009, accretion of the Series A Preferred Stock discount totaled \$47,970 and \$13,860, respectively. Amortization of the Series B Preferred Stock premium totaled \$4,070 and \$1,176 for the first quarter of 2010 and 2009, respectively. 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 7 - 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, 2010 and 2009.

	March 31,	
	2010	2009
Earnings (loss) available to common shareholders		
Net income	\$ 530,134	\$ 13,865
Preferred stock dividends	204,574	59,584
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	43,900	12,684
Net income (loss) available to common shareholders	\$ 281,660	\$ (58,403)

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 7 - Earnings Per Share – (continued)

	March 31,	
	2010	2009
Basic earnings per share:		
Net income (loss) available to common shareholders	\$ 281,660	\$ (58,403)
Average common shares outstanding - basic	3,584,032	3,525,004
Basic earnings (loss) per share	\$ 0.08	\$ (0.02)
Diluted earnings per share:		
Net income (loss) available to common shareholders	\$ 281,660	\$ (58,403)
Average common shares outstanding – basic	3,584,032	3,525,004
Dilutive potential common shares	-	-
Average common shares outstanding - diluted	3,584,032	3,525,004
Diluted earnings (loss) per share	\$ 0.08	\$ (0.02)

Note 8 - 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 the three months ended March 31, 2010 and 2009 the Company issued 120,684 and 62,222, respectively, of restricted stock pursuant to the 2006 Equity Incentive Plan. The shares cliff vest in three years and are fully vested in 2012 and 2011, respectively. The weighted-average fair value of restricted stock issued during the three months ended

March 31, 2010 and 2009 was \$3.50 and \$2.25 per share, respectively. Compensation cost associated with the issuance for 2010 and 2009 was \$422,394 and \$139,999, respectively. There were no restricted stock forfeitures during the first quarter of 2010 or 2009. Deferred compensation expense of \$30,473 and \$35,072, relating to restricted stock, was amortized to income during three months ended March 31, 2010 and 2009, respectively.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 8 - Equity Incentive Plan - (continued)

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.

The SARs compensation expense for both the quarters ended March 31, 2010 and 2009 was \$18,356.

A summary of the status of the Company's SARs as of March 31, 2010 and 2009 and changes during the period then ended is presented below.

	2010		2009	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	89,293	\$ 14.95	93,981	\$ 14.95
Forfeited	(794)	15.00	-	-
Outstanding at end of year	88,499	\$ 14.95	93,981	\$ 14.95

Note 9 – 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, 2010, 203,746 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, 2010 and 2009, and changes during the period is presented below:

	2010		2009	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	206,547	\$ 9.38	269,447	\$ 8.36
Forfeited	(2,800)	6.96	-	-
Outstanding at end of period	203,747	\$ 9.42	269,447	\$ 8.36

Note 10 – Fair Value Measurements

The current accounting literature requires the disclosure of fair value information for financial instruments, whether or not they are recognized in the consolidated balance sheets, when it is practical to estimate the fair value. The guidance defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash, or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment, accrued interest receivable and payable, and other assets and liabilities.

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts, which could be realized, in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair values presented.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks and Interest-bearing Deposits with Other Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Time Deposits in other Banks - The carrying amount is a reasonable estimate of fair value.

Securities Available-for-Sale - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable- The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2010, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, The Company records the impaired loan as nonrecurring Level 3.

Other Real Estate Owned - Other real estate owned (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the OREO as nonrecurring Level 3.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company's current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures and Note Payable - The carrying value of the junior subordinated debentures and note payable approximates their fair value since they were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance Sheet Financial Instruments - Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The carrying values and estimated fair values of the Company's financial instruments were as follows:

	March 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	\$ 2,029,201	2,029,201	\$ 2,942,295	2,942,295
Interest-bearing deposits with other banks	40,658,139	40,658,139	50,356,191	50,356,191
Time deposits in other banks	503,107	503,107	502,089	502,089
Securities available-for-sale	121,633,494	121,633,494	121,948,744	121,948,744
Nonmarketable equity securities	4,812,100	4,812,100	4,812,100	4,812,100
Loans, including loans held for sale	392,776,688	392,135,000	411,728,010	410,265,000
Accrued interest receivable	2,446,595	2,446,595	2,661,030	2,661,030
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	187,905,704	187,905,704	\$ 195,636,648	195,636,648
Certificates of deposit	338,773,491	340,483,000	357,126,331	352,318,000
Securities sold under agreements to repurchase	603,602	603,602	598,342	598,342
	27,000,000	27,163,000	34,000,000	33,992,000

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

Advances from Federal Home
Loan Bank

Junior subordinated debentures	10,310,000	10,310,000	10,310,000	10,310,000
Accrued interest payable	654,082	654,082	680,880	680,880

	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:				
Commitments to extend credit	\$ 38,229,146	-	39,873,440	\$ -
Standby letters of credit	2,112,497	-	2,583,466	-

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

In determining appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to fair value disclosures. 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.

Assets and liabilities that are carried at fair value are classified in one of the following three categories based on a hierarchy for ranking the quality and reliability of the information used to determine fair value:

- Level 1 — Quoted 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.

The table below presents the balances of assets measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Total	Level 1	Level 2	Level 3
March 31, 2010				
Available for- sale- securities:				
U.S. Government agencies	\$ 3,035,434	\$ -	\$ 3,035,434	\$ -
Mortgage-backed securities	57,931,609	-	57,931,609	-
Municipals	60,612,596	-	60,612,596	-
Other	53,855	-	53,855	-
	121,633,494	-	121,633,494	\$ -
Mortgage loans held for sale (1)	583,952	-	583,952	-
	\$ 122,217,446	\$ -	\$ 122,217,446	\$ -
December 31, 2009				
Available for- sale- securities				
U.S. Government agencies	\$ 3,011,366	\$ -	\$ 3,011,366	\$ -
Mortgage-backed securities	58,132,671	-	58,132,671	-
Municipals	60,737,192	-	60,737,192	-
Other	67,515	-	67,515	-
	\$ 121,948,744	\$ -	\$ 121,948,744	\$ -
Mortgage loans held for sale (1)	5,100,609	-	5,100,609	-
	\$ 127,049,353	\$ -	\$ 127,049,353	\$ -

(1) Carried at the lower of cost or market.

There were no liabilities carried at fair value at March 31, 2010 and December 31, 2009.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 10 – Fair Value Measurements – (continued)

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of March 31, 2010 and 2009, for which a nonrecurring change in fair value has been recorded during the three months and the year ended March 31, 2010 and December 31, 2009, respectively.

	Total	Level 1	Level 2	Level 3
March 31, 2010				
Impaired loans receivable	\$ 24,565,466	\$ -	24,565,466	\$ -
Other real estate owned	7,249,401	-	7,249,401	-
Total assets at fair value	\$ 31,814,867	\$ -	\$ 31,814,867	\$ -
December 31, 2009				
Impaired loans receivable	\$ 44,937,157	\$ -	44,937,157	\$ -
Other real estate owned	8,954,214	-	8,954,214	-
Total assets at fair value	\$ 53,891,371	\$ -	\$ 53,891,371	\$ -

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis at March 31, 2010 and December 31, 2009.

Note 11 – Subsequent Events

In preparing these financial statements, subsequent events were evaluated through the time the financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC.

On April 9, 2010, the Company issued 345,145 shares of its common stock at \$4.50 for a total of \$1,530,653 and 2,293 shares of its Series C preferred stock at \$1,000 per share for a total of \$2,293,000. Of the shares issued, 119,179 and 335 shares of common stock and Series C preferred stock, respectively, were issued to related parties.

The Series C preferred stock consists of 7% cumulative mandatory convertible preferred stock, which will be convertible into common shares for up to three years at the lesser of \$6.50 per share or tangible common equity per share as of the calendar quarter ending on or before the conversion date.

The total stock offering fees associated with the above stock issuances are approximately \$315,000. These securities were offered and sold in a private offering exempt from the registration requirements of the Securities Act of 1933, as amended, and applicable state securities laws.

In conjunction with applicable accounting standards, there were no other subsequent material events which should have been either recognized in the financial statements or disclosed in the notes to the financial statements.

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, 2010 compared to December 31, 2009, and the results of operations for the three months ended March 31, 2010 compared to the three months ended March 31, 2009 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 SEC;
 - 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 SEC; 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, 2010 as compared to the quarter ended March 31, 2009 and also analyzes our financial condition as of March 31, 2010 as compared to December 31, 2009.

Like most community bank holding companies, 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 SEC.

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, 2009 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.

-18-

FIRST RELIANCE BANCSHARES, INC.

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

Results of Operations

We realized net income available to common shareholders for the first quarter of 2010 of \$281,660, or \$0.08 per basic and diluted share, compared to a net loss available to common shareholders for the first quarter of 2009 of \$58,403, or \$0.02 per basic and diluted share.

Our operating results for the first quarter of 2010 were favorably impacted by the stabilization of the credit quality of our loan portfolio, which resulted in a provision for loan losses of \$186,089 for the first quarter of 2010 compared to \$1,300,380 for the first quarter of 2009. We believe this stabilization is attributed to the implementation of a loss mitigation and recovery division staffed with experienced bankers, who specifically handle nonperforming and deteriorating assets. Additionally, we have strengthened our credit review process by being proactive in making conservative lending decisions.

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 the 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 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 increased \$154,447, or 3.72%, to \$4,307,540 for the quarter ended March 31, 2010, from \$4,153,093 for the comparable period of 2009. We were able to improve our net interest income mainly by lowering the rates paid for interest-bearing deposits. The annualized yield on average earning assets decreased 9 basis points for 2010 compared to 2009, while our annualized average cost of our interest-bearing liabilities decreased 31 basis points for 2010 compared to 2009. See "Rate/Volume Analysis" below for a more detailed discussion.

For the first quarter of 2010, average-earning assets totaled \$565,972,425 with an annualized average yield of 5.55% compared to \$571,053,186, and 5.63%, respectively, for the first quarter of 2009. Average interest-bearing liabilities totaled \$527,745,383 with an annualized average cost of 2.46% for first quarter of 2010 compared to \$536,833,143 and 2.77%, respectively, for the first quarter of 2009.

Our net interest margin and net interest spread were 3.25% and 3.08%, respectively, for the first quarter of 2010 compared to 3.03% and 2.86%, respectively, for the first quarter of 2009.

Because loans often provide a higher yield than other types of earning assets, one of our goals is to maintain our loan portfolio as the largest component of total earning assets. Loans comprised 71.24% and 85.43% of average earning assets for at March 31, 2010 and 2009, respectively. Loan interest income for the three months ended March 31, 2010 and 2009 was \$6,213,086 and \$6,967,737, respectively. The annualized average yield on loans was 6.25% and 5.79% for the first quarter of 2010 and 2009, respectively. Average balances of loans decreased to \$403,233,736 during the first quarter of 2010, a decrease of \$84,645,235 from the average of \$487,878,971 during first quarter of 2009. Our loan income for the first of 2010 was significantly impacted by the depressed real estate market, the significant increase in charged off loans, and the average volume of nonperforming loans. The decrease in the average volume of loans had a significant impact on our net interest income. Because of the economic downturn in our markets that

caused the volume of new loan customers to decrease, we began shifting our asset mix toward securities after the first quarter of 2009.

-19-

FIRST RELIANCE BANCSHARES, INC.

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

Available-for-sale investment securities averaged \$121,661,899, or 21.50% of average earning assets, for the first quarter of 2010 compared to \$75,641,778, or 13.25% of average earning assets for the first quarter of 2009. Interest earned on these securities amounted to \$1,262,892 for the first quarter of 2010, compared to \$844,734 for the same period last year. Our fully tax-equivalent yield was 4.95% and 5.10% for the three months ended March 31, 2010 and 2009, respectively.

Our total average interest-bearing deposits were \$488,882,534 and \$432,663,627 for quarters ended March 31, 2010 and 2009, respectively, which represented an increase of \$56,218,907, or 12.99%. The increase in deposits resulted from successful pricing and marketing promotions, a key strategic initiative for our Company. Total interest paid on deposits for the quarters ended March 31, 2010 and 2009 was \$2,808,512 and \$2,815,411, respectively. The annualized average cost of deposits was 2.33% and 2.64% for the first quarter of 2010 and 2009, respectively. The decline in average rate paid for deposits is mainly due to our decision to lower the overall cost of our interest-bearing liabilities by lowering the rates we paid for deposits.

The average balance of other interest-bearing liabilities was \$38,862,848 and \$104,169,516 for the first quarter of 2010 and 2009, respectively. This represented a decrease of \$65,306,668, or 62.69%. The decrease is partially attributable to the decrease of \$54,263,655 in our average borrowings from the Federal Home Loan Bank. With the availability of interest-bearing deposits at lower cost, we became less reliant on using borrowings from the Federal Home Loan Bank to fund loan demands. The low market interest rates that existed during 2009 and continuing into 2010 for federal funds purchased and securities sold under agreements to repurchase resulted in an average decrease of \$5,019,676 in the use of these types of financial instruments.

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

Three Months Ended March, 31, (Dollars in thousands)(3)	2010			2009			2008		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets									
Earning assets:									
Loans (2)	\$ 403,234	\$ 6,213	6.25%	\$ 487,879	\$ 6,968	5.79%	\$ 486,027	\$ 9,099	7.53%
Securities, taxable	61,135	610	4.05	46,575	531	5.63	27,214	347	5.12
Securities, nontaxable (1)	60,526	875	5.86	29,067	420	5.86	30,952	439	5.70
Federal funds sold	-	-	-	2,076	1	0.19	147	2	5.18
Other earning assets	41,077	29	0.29	5,456	10	0.71	4,673	51	4.37
Total earning assets	565,972	7,727	5.55	571,053	7,930	5.63	549,013	9,938	7.28
Non earning assets	54,180			54,765			39,927		
Total assets	\$ 620,152			\$ 625,818			\$ 588,940		
Liabilities and Shareholders' Equity									
Interest-bearing deposits:									
Transaction accounts	\$ 41,354	\$ 44	0.43%	\$ 34,086	\$ 50	0.59%	\$ 31,527	\$ 59	0.75%
Savings and money market accounts									
	101,138	337	1.35	99,194	370	1.51	89,629	633	2.84
Time deposits	346,391	2,428	2.84	299,383	2,395	3.25	280,664	3,247	4.65
Total interest-bearing deposits	488,883	2,809	2.33	432,663	2,815	2.64	401,820	3,939	3.94
Other interest-bearing liabilities:									
Securities sold under agreement to repurchase									
	770	-	0.25	5,709	1	0.08	8,000	48	2.40
Federal funds purchased	2	-	0.77	83	-	0.77	8,953	58	2.58
Federal Home Loan Bank borrowing									
	27,780	236	3.44	82,045	667	3.29	72,792	621	3.42
Junior subordinated debentures	10,310	153	6.01	10,310	152	5.99	10,310	155	6.01
Note payable	-	-	-	6,023	35	2.35	3,000	38	5.15
Total other interest-bearing liabilities	38,862	389	4.06	104,170	855	3.33	103,055	920	3.59
Total interest-bearing liabilities	527,745	3,198	2.46	536,833	3,670	2.77	504,875	4,859	3.87
Noninterest-bearing deposits	43,367			47,575			43,667		

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

Other liabilities	3,412	1,507	2,754			
Shareholders' equity	45,628	39,903	37,644			
Total liabilities and equity	\$ 620,152	\$ 625,818	\$ 588,940			
Net interest income/interest spread	\$ 4,529	3.09%	\$ 4,260	2.86%	\$ 5,079	3.41%
Net yield on earning assets		3.25%		3.03%		3.71%

(1) Fully tax-equivalent basis at 34% tax rate for nontaxable securities

(2) Includes mortgage loans held for sale and nonaccruing loans

(3) Prior year percentages based on actual dollar amounts

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.

(Dollars in thousands)	2010 Compared to 2009 Due to increase (decrease) in			2009 Compared to 2008 Due to increase (decrease) in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans	\$ (1,277)	\$ 522	\$ (755)	\$ 33	\$ (2,165)	\$ (2,132)
Securities, taxable	152	(73)	79	221	(36)	185
Securities, tax exempt	455	-	455	(30)	11	(19)
Federal funds sold	-	(1)	(1)	3	(3)	-
Other earning assets	28	(9)	19	7	(49)	(42)
Total interest income	(642)	439	(203)	234	(2,242)	(2,008)
Interest expense:						
Interest-bearing deposits						
Interest-bearing transaction accounts	9	(15)	(6)	4	(14)	(10)
Savings and money market accounts	7	(40)	(33)	60	(324)	(264)
Time deposits	353	(321)	32	197	(1,048)	(851)
Total interest-bearing deposits	369	(376)	(7)	261	(1,386)	(1,125)
Other interest-bearing liabilities						
Securities sold under agreement to repurchase	(2)	1	(1)	(11)	(36)	(47)
Federal funds purchased	(1)	-	(1)	(34)	(24)	(58)
Federal Home Loan Bank borrowings	(460)	29	(431)	71	(25)	46
Junior subordinated debentures	1	-	1	-	(2)	(2)
Note payable	(17)	(17)	(34)	25	(28)	(3)
Total other interest-bearing liabilities	(479)	13	(466)	51	(115)	(64)
Total interest expense	(110)	(363)	(473)	312	(1,501)	(1,189)

Net interest income	\$	(532)	\$	802	\$	270	\$	(78)	\$	(741)	\$	(819)
---------------------	----	-------	----	-----	----	-----	----	------	----	-------	----	-------

Provision and Allowance for Loan Losses

We have developed policies and procedures for evaluating the overall quality of our credit portfolio and the timely identification of potential problem credits. On a quarterly basis, our Board of Directors reviews and approves the appropriate level for the 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 our market. The objective of management has been to fund the allowance for loan losses at a level greater than or equal to our internal risk measurement system for loan risk.

Additions to the allowance for loan losses, which are expensed as the provision for loan losses on our statement of income, 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.

The allowance represents an amount which management believes will be adequate to absorb inherent losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses 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 historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local and national economy, changes in volume or type of credits, changes in the volume or severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons.

FIRST RELIANCE BANCSHARES, INC.

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

More specifically, in determining our allowance for loan loss, we review loans for specific and impaired reserves based on current appraisals less estimated closing costs. General and unallocated reserves are determined using historical loss trends applied to risk rated loans grouped by loan type. The general and unallocated reserves are calculated by applying the appropriate historical loss ratio to the loan categories. Impaired loans are excluded from this analysis. The sum of all such amounts determines our general and unallocated reserves.

We also track our portfolio and analyze loans grouped by loan type categories. The first step in this process is to risk grade each and every loan in the portfolio based on one common set of parameters. These parameters include items like debt-to-worth ratio, liquidity of the borrower, net worth, experience in a particular field and other factors such as underwriting exceptions. Weight is also given to the relative strength of any guarantors on the loan. We anticipate, however, that this analysis will eventually provide us with historical behavioral indications by credit grading as we develop sufficient history to analyze the general allowance related to non-impaired loans.

After risk grading each loan, we then use 15 qualitative factors to analyze the trends in the portfolio. These 15 factors include both internal and external factors. The internal factors include the concentration of credit across the portfolio, current delinquency ratios and trends, the experience level of management and staff, our adherence to lending policies and procedures, current loss and recovery trends, the nature and volume of the portfolio's categories, current non-accrual and problem loan trends, the quality of our loan review system, and other factors which include collateral, loan to value ratio, and policy exceptions. The external factors include the current economic and business environment, which includes indicators such as national GDP, pricing indicators, employment statistics, housing statistics, market indicators, financial regulatory economic analysis, and economic forecasts from reputable sources. A quantitative value is assigned to each of the 15 internal and external factors, which, when added together, creates a net qualitative weight. The net qualitative weight is then added to the minimum loss ratio. Negative trends in the loan portfolio increase the quantitative values assigned to each of the qualitative factors and, therefore, increase the loss ratio. As a result, an increased loss ratio will result in a higher allowance for loan loss. For example, as general economic and business conditions decline, this qualitative factor's quantitative value will increase, which will increase the net qualitative weight and the loss ratio (assuming all other qualitative factors remain constant). Similarly, positive trends in the loan portfolio, such as an improvement in general economic and business conditions, will decrease the quantitative value assigned to this qualitative factor, thereby decreasing the net qualitative weight (assuming all other qualitative factors remain constant). These factors are reviewed and updated by our risk management committee on a quarterly basis to arrive at a consensus for our qualitative adjustments.

We then create a loss range by applying average historical industry loss rates for the last 10 years to determine the level of the allowance for loan and lease losses on the non-impaired loans in the portfolio. We utilize a 10 year time frame, as we believe it includes numerous complete economic cycles. As such, we consider the time frame long enough to include both favorable and problematic industry trends relevant in determining historical loss rates. The resulting unadjusted historical loss factor is used as a beginning point upon which we add our quantitative adjustments based on the qualitative factors discussed above. Once the qualitative adjustments are made, we refer to the final amount as the historical loss factor. The historical loss factor is then multiplied by the loans outstanding for the period ended, except for any loans classified as non-performing, which are addressed specifically as discussed below.

Separately, we review all impaired loans individually to determine a specific allocation for each. In our assessment of impaired loans, we consider the primary source of repayment when determining whether loans are collateral dependent or not.

Periodically, we adjust the amount of the allowance based on changing circumstances. We recognize loan losses to the allowance and add subsequent recoveries back to the allowance for loan losses. In addition, on a quarterly basis we informally compare our allowance for loan losses to various peer institutions; however, we recognize that allowances will vary as financial institutions are unique in the make-up of their loan portfolios and customers, which necessarily creates different risk profiles for the institutions. We would only consider further adjustments to our allowance for loan losses based on this peer review if our allowance was significantly different from our peer group. To date, we have not made any such adjustment. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period, especially considering the overall weakness in the commercial real estate market in our market areas.

FIRST RELIANCE BANCSHARES, INC.

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

Various regulatory agencies review our 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. Our 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, 2010 and 2009, the allowance for loan losses was \$6,725,174 and \$7,331,051, respectively, a decrease of \$605,877, or 8.26%, from the 2009 allowance. As a percentage of total loans, the allowance for loan losses 1.71% and 1.58% at March 31, 2010 and 2009, respectively. The decrease in the allowance for loan losses was driven by the significant increase in net loans charged off during the first quarter of 2010 compared to the first quarter of 2009. During the first quarter of 2010, net loans charged off totaled \$3,261,661 compared to \$2,193,228 for the quarter ended March 31, 2009, an increase of \$1,068,433. Additionally, our loan portfolio at March 31, 2010 compared to March 31, 2009, was \$71,932,263 or 15.50% lower. See "Loans" below for additional information regarding our asset quality and loan portfolio.

For the first quarter of 2010 and 2009, the provision for loan losses was \$186,089 and \$1,300,380, respectively. This represents a decrease of \$1,114,291, which is primarily attributable to the stabilization of the credit quality of our loan portfolio.

We believe the allowance for loan losses at March 31, 2010, is adequate to meet potential loan losses inherent in the loan portfolio.

Noninterest Income

The following is a summary of noninterest income for the three months ended March 31, 2010 and 2009.

	Three Months Ended March 31,	
	2010	2009
Service fees on deposit accounts	\$ 468,220	\$ 460,608
Gain on sale of mortgage loans	210,043	660,499
Gain (loss) on sale of other real estate owned	242,122	(15,892)
Gain on sale of fixed assets	-	86,810
Other income	364,022	501,092
Total noninterest income	\$ 1,284,407	\$ 1,693,117

Noninterest income decreased \$408,710, or 24.14%, to \$1,284,407 for the first quarter of 2010 from \$1,693,117 for the first quarter of 2009. The decrease is primarily attributable to the decrease in the gain on the sale of mortgage loans, which decrease due to the weak demand for mortgage loan and the bottoming out of residential mortgages being refinanced because of low interest rates.

Noninterest Expense

Total noninterest expense increased by \$217,077, or 4.59%, to \$4,941,956 for the first quarter of 2010 from \$4,724,879 for the first quarter of 2009. The increase is largely attributable to the increase in the expenses relating to

our foreclosed properties, which were \$511,094 higher for the first quarter of 2010 compared to the first quarter of 2009. This increase was offset by the reduction of \$331,084 in our salaries and employee benefits, resulting from a reduction in our staff.

For the first quarter of 2010 and 2009 salary and employee benefits expense was \$2,396,066 and \$2,727,150, respectively. Other operating expenses for the quarter ended March 31, 2010 and 2009 was \$1,836,131 and \$1,356,007, respectively

Our income tax provision for the three months ended March 31, 2010, compared to the same period in 2009, decreased \$126,682, which is mainly attributable to increase in pretax income.

FIRST RELIANCE BANCSHARES, INC.

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

Balance Sheet Review

General

At March 31, 2010, we had total assets of \$616.1 million, consisting principally of \$392.2 million in loans, \$126.4 million in investments, and \$42.7 million in cash and due from banks. Our liabilities at March 31, 2010 totaled \$570.0 million, which consisted principally of \$526.7 million in deposits, \$27.05 million in FHLB advances, and \$10.9 million in other borrowings. At March 31, 2010, our shareholders' equity was \$46.1 million.

At December 31, 2009, we had total assets of \$645.5 million, consisting principally of \$406.6 million in loans, \$126.7 million in investments, and \$53.3 million in cash and due from banks. Our liabilities at December 31, 2009 totaled \$560.3 million, consisting principally of \$552.7 million in deposits, \$34.0 million in FHLB advances, and \$10.9 million in other borrowings. At December 31, 2009, our shareholders' equity was \$45.2 million.

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, 2010 and December 31, 2009, we had investment securities totaling \$126,445,594 and \$126,760,844, respectively, which represented 20.52% and 19.63% of our total assets, respectively.

Nonmarketable equity securities consist of Federal Home Loan Bank stock, which is recorded at its original cost of \$4,812,100 and \$5,284,600 at March 31, 2010 and 2009, respectively.

The amortized costs and the fair value of our securities available-for-sale at March 31, 2010 and December 31, 2009 are shown in the following table.

	March 31, 2010		December 31, 2009	
	Amortized Cost (Book Value)	Estimated Fair Value	Amortized Cost (Book Value)	Estimated Fair Value
Government sponsored enterprises	3,009,668	3,035,434	3,021,782	3,011,366
Mortgage-backed securities	58,402,107	57,931,609	59,324,978	58,132,671
Municipal securities	61,052,646	60,612,596	61,300,256	60,737,192
Other	218,750	53,855	218,750	67,515
	\$ 122,683,171	\$ 121,633,494	\$ 123,865,766	\$ 121,948,744

At March 31, 2010, securities classified as available-for-sale are recorded at fair market value. Approximately 31.17% of the unrealized losses, or 10 individual securities, consisted of securities in a continuous loss position for twelve months or more. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market

interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

During the first quarter of 2010 and 2009, gross proceeds from the sale of available-for-sale securities were \$3,117,545 and \$0, respectively. Gains on available-for-sale securities totaled \$1,602 and \$0 for the first quarter 2010 and 2009, respectively.

-25-

FIRST RELIANCE BANCSHARES, INC.

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

Securities Available-for-Sale Maturity Distribution and Yields

Contractual maturities and yields on our available for sale securities at March 31, 2010 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, 2010 (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	\$ 9	6.32%	\$ 3,026	4.18%	\$ -	-%	\$ 3,035	4.19%
Municipals(2)	3,390	6.29	26,392	6.52	30,831	6.88	60,613	6.69
Total securities(1)	\$ 3,399	6.29%	\$ 29,418	6.29%	\$ 30,831	6.19%	\$ 63,648	6.58%

(1) Excludes mortgage-backed securities totaling \$57,931,609 with a yield of 4.256% and other equity securities totaling \$53,835.

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

Loans

Loans, including loans held for sale, are the largest category of earning assets and typically provide higher yields than the other types of earning assets. Associated with the higher loan yields are the inherent credit and liquidity risks which management attempts to control and counterbalance. Loans averaged \$403,233,736 during the first quarter of 2010 compared to \$487,878,971 during the first quarter of 2009, a decrease of \$84,645,235, or 17.35%. At March 31, 2010, total loans were \$392,776,688 compared to \$411,728,010 at December 31, 2009, a decrease of \$18,951,322, or 4.60%. Excluding loans held for sale, loans were \$392,192,736 at March 31, 2010, compared to \$406,627,401 at December 31, 2009, which equated to a decrease of \$14,434,665, or 3.55%. This decrease is the result of the economic downturn in our markets that caused the volume of new loan customers to decrease.

The following table sets forth the composition of the loan portfolio, excluding loans held for sale, by category at the dates indicated and highlights the Company's general emphasis on all types of lending.

The following table summarizes the composition of our loan portfolio March 31, 2010 and December 31, 2009.

	March 31, 2010	% of Total	December 31, 2009	% of Total
Mortgage loans on real estate				
Residential 1-4 family	\$ 56,206,272	14.33%	57,539,371	14.15%
Multifamily	10,644,714	2.71	9,962,625	2.45
Commercial	164,908,332	42.05	169,933,348	41.79
Construction	72,663,156	18.53	77,566,504	19.08
Second mortgages	4,601,939	1.17	4,746,686	1.17
Equity lines of credit	30,499,086	7.78	31,596,471	7.77
Total mortgage loans	339,523,499	86.57	351,345,005	86.40

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

Commercial and industrial	44,297,408	11.29	45,887,237	11.28
Consumer	7,398,528	1.89	7,942,668	1.95
Other, net	973,301	0.25	1,452,491	0.36
Total loans	\$392,192,736	100.00%	\$406,627,401	100.00%

In the context of this discussion, a “real estate mortgage loan” is defined as any loan, other than a loan for construction purposes, secured by real estate, regardless of the purpose of the loan. It is common practice for financial institutions in our market area to obtain a mortgage on real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase management’s willingness to make real estate loans and, to that extent, also tends to increase the magnitude of the real estate loan portfolio component.

FIRST RELIANCE BANCSHARES, INC.

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

The largest component of our loan portfolio is real estate mortgage loans. At March 31, 2010, real estate mortgage loans totaled \$266,860,343 and represented 68.04% of the total loan portfolio, compared to \$273,778,501, or 67.33%, at December 31, 2009.

Residential mortgage loans totaled \$101,952,010 at March 31, 2010, and represented 25.99% of the total loan portfolio, compared to \$103,845,154 and 25.54%, respectively, at December 31, 2009. Residential real estate loans consist of first and second mortgages on single or multi-family residential dwellings. Nonresidential mortgage loans, which include commercial loans and other loans secured by multi-family properties and farmland, totaled \$164,908,332 at March 31, 2010, compared to \$169,933,348 at December 31, 2009. This represents a decrease of \$5,025,016, or 2.96%, from the December 31, 2009 balance. Real estate construction loans were \$72,663,156 and \$77,566,504 at March 31, 2010 and December 31, 2009, respectively, and represented 18.53% and 19.08% of the total loan portfolio, respectively. Currently, the demand for all types of real estate mortgage loans in our market area is very weak.

Commercial and industrial loans decreased \$1,589,829, or 3.46%, to \$44,297,408 at March 31, 2010, from \$45,887,237 at December 31, 2009. The decrease is mainly due to the economic downturn in our markets that caused the demand for these types of loans to decrease and to the reclassification of certain loans to real estate construction loans.

Our loan portfolio is also comprised of consumer loans. Consumer loans decreased \$544,140, or 6.85%, to \$7,398,528 at March 31, 2010, from \$7,942,668 at December 31, 2009.

Our loan portfolio reflects the diversity of our markets. The economies of our markets contain elements of medium and light manufacturing, higher education, regional health care, and distribution facilities. We expect the area to remain stable; however due to the current depressed economies of our markets, we do not expect any material growth in the near future. The diversity of the economy creates opportunities for all types of lending. We do not engage in foreign lending.

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, 2010.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

March 31, 2010 (Dollars in thousands)	Over			Total
	One Year or Less	One Year Through Five Years	Over Five Years	
Commercial and industrial	\$ 59	\$ 40,680	\$ 3,558	\$ 44,297

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

Real estate	17,133	257,454	64,937	339,524
Consumer and other	516	6,476	1,380	8,372
	\$ 17,708	\$ 304,610	\$ 69,875	\$ 392,193
Loans maturing after one year with:				
Fixed interest rates				\$ 187,979
Floating interest rates				186,506
				\$ 374,485

-27-

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, 2010 and 2009:

	March 31,	
	2010	2009
Balance, January 1,	\$ 9,800,746	\$ 8,223,899
Provision for loan losses for the period	186,089	1,300,380
Net loans (charged-off) recovered for the period	(3,261,661)	(2,193,228)
Balance, end of period	\$ 6,725,174	\$ 7,331,051
Total loans outstanding, end of period	\$ 392,192,736	\$ 464,124,999
Allowance for loan losses to loans outstanding	1.71%	1.58%

Risk Elements in the Loan Portfolio

Nonperforming Assets - At March 31, 2010 and 2009, loans totaling \$24,787,204 and \$20,952,510, respectively, were in nonaccrual status, total loans of \$635 and \$1,983,307, respectively, were 90 days or more overdue and still accruing interest.

The following table shows the nonperforming assets, percentages of net charge-offs, and the related percentage of allowance for loan losses for the three months ended March 31, 2010 and 2009.

(Dollars in thousands)	2010		2009	
Loans over 90 days past due and still accruing	\$	1	\$	1,983
Loans on nonaccrual:				
Real Estate Construction		15,103		11,767
Real Estate Mortgage		8,668		8,728
Commercial		1,004		399
Consumer		12		59
Total nonaccrual loans		24,787		20,953
Total of nonperforming loans		24,788		22,936
Other nonperforming assets		7,249		1,983
Total nonperforming assets	\$	32,037	\$	24,919
Percentage of nonperforming assets to total assets		5.20%		3.86%
Percentage of nonperforming loans to total loans		6.32%		4.94%
Allowance for loan losses as a percentage of non-performing loans		27.13%		31.96%

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or we deem the collectability 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, 2010 and 2009 were included in our classification of impaired loans at those dates.

FIRST RELIANCE BANCSHARES, INC.

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

Impaired loans – We consider all loans in nonaccrual status to be impaired. At March 31, 2010, we had impaired loans totaling \$24,787,204, as compared to \$47,752,613 at March 31, 2009. The significant reduction in impaired loans is due mainly to the removal of approximately \$20,000,000 of loans from the impaired loan classification. As a result of external loan reviews, we have modified the manner in which we apply the definition of an impaired loan in the evaluation of the adequacy of our allowance for loan losses. Additionally, during the first quarter of 2010 we charged off approximately \$3,200,000 in impaired loans. Included in the impaired loans at March 31, 2010, were 12 borrowers that accounted for approximately 70.69% 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 6.32% at March 31, 2010.

During the first quarter of 2010, the average investment in impaired loans was \$34,862,181 as compared to \$36,968,107 for the first quarter of 2009. Impaired loans with a specific allocation of the allowance for loan losses totaled \$2,817,993 and \$26,427,132 at March 31, 2010 and 2009, respectively. The amount of the specific allocation at March 31, 2010 and 2009 was \$221,738 and \$3,860,741, respectively.

The recent downturn in the real estate market has resulted in an increase in loan delinquencies, defaults and foreclosures; however, we believe these trends are stabilizing. In some cases, this downturn has resulted in a significant impairment to the value of our collateral and ability to sell the collateral upon foreclosure at its appraised value. However, there is a risk that these trends could continue at a higher pace. If real estate values continue to decline, it is also more likely that we would be required to increase our allowance for loan losses.

On a monthly basis, we analyze 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.

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities decreased \$9,087,760 or 1.69%, to \$527,745,383 for the first quarter of 2010, from \$536,833,143 on December 31, 2009.

Deposits - For the quarter ended March 31, 2010 and 2009, average total deposits were \$532,249,647 and 480,238,833, respectively, which is an increase of \$52,010,814, or 10.83%. At March 31, 2010 and December 31, 2009, total deposits were \$526,679,195 and \$552,762,979, respectively, a decrease of \$26,083,784, or 4.72%.

Average interest-bearing deposits increased \$56,218,907, or 12.99%, to \$488,882,534 for the quarter ended March 31, 2010, from \$432,663,627 for the quarter ended March 31, 2009.

The average balance of non-interest bearing deposits decreased \$4,208,093, or 8.85%, to \$43,637,113 for the three months ended March 31, 2010, from \$47,575,206 for the three months ended March 31, 2009.

FIRST RELIANCE BANCSHARES, INC.

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

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, 2010 and 2009.

	2010		2009	
	Average Amount	Average Rate	Average Amount	Average Rate
Noninterest bearing demand deposits	\$ 43,367,113	0.0%	\$ 47,575,206	0.00%
Interest bearing demand deposits	41,354,002	0.43	34,087,269	0.59
Savings accounts	101,137,758	1.35	99,193,160	1.51
Time deposits	346,390,774	2.84	299,383,198	3.25
	\$ 532,249,647	2.14%	\$ 480,238,833	2.37%

Core deposits, which exclude time deposits of \$100,000 or more, provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were \$335,701,413 and \$357,416,788 at March 31, 2010 and December 31, 2009, respectively. This equates to a decrease in core deposits of \$21,715,375, or 6.08%.

Included in time deposits \$100,000 and over, at March 31, 2010 and 2009 are brokered time deposits of \$117,468,000 and \$144,258,000, respectively. We anticipate being able to either renew or replace brokered deposits when they mature, although we may not be able to replace them with deposits with the same terms or rates.

Deposits, and particularly core deposits, have been our primary source of funding and have enabled us to meet successfully both our short-term and long-term liquidity needs. We anticipate that such deposits will continue to be our primary source of funding in the future. However, advances from the Federal Home Loan Bank are being used as an alternative source of funds. Our loan-to-deposit ratio was 74.46% on March 31, 2010, and 73.56% at December 31, 2009.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of \$100,000 or more at March 31, 2010 was as follows:

	March 31, 2010
Three months or less	\$ 16,895,535
Over three through twelve months	62,815,841
Over one year through three years	59,986,578
Over three years	51,279,828
Total	\$ 190,977,782

Borrowings

The following table outlines our various sources of borrowed funds during the three months ended March 31, 2010 and the year ended December 31, 2009, 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.

-30-

FIRST RELIANCE BANCSHARES, INC.

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

(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, 2010					
Securities sold under agreement to repurchase	\$ 818	\$ 770	0.25%	\$ 603	0.25%
Advances from Federal					
Home Loan Bank	27,010	27,780	3.44	27,000	3.17
Junior subordinated debentures	10,310	10,310	6.01	10,310	5.93
At or for the year ended December 31, 2009					
Securities sold under agreement to repurchase	\$ 7,664	\$ 2,262	0.05%	\$ 598	0.25%
Advances from Federal Home Loan					
Bank	93,500	59,800	3.57	34,000	3.17
Federal funds purchased	11,482	21	0.82	-	-
Note payable	6,950	1,485	2.01	-	-
Junior subordinated debentures	10,310	10,310	5.95	10,310	5.93

Capital Resources

Total shareholders' equity at March 31, 2010 and December 31, 2009 was \$46,145,376 and \$45,223,827, respectively. The \$921,549 increase during the first three months of 2010 resulted primarily from the increase in accumulated other comprehensive income of \$572,448 and the net income of \$530,134 for the first quarter of 2010.

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, 2010 and 2009. Since our inception, we have not paid cash dividends on our common stock.

	March 31, 2010	March 31, 2009
Return on average assets	0.35%	0.01%
Return on average equity	4.71	0.13
Average equity to average assets ratio	7.36	6.38

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.

FIRST RELIANCE BANCSHARES, INC.

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

The following table sets forth the holding company's and the bank's various capital ratios at March 31, 2010 and at December 31, 2009. For all periods, the bank was considered "well capitalized" and the holding company met or exceeded its applicable regulatory capital requirements.

	March 31, 2010		December 31, 2009	
	Holding Company	Bank	Holding Company	Bank
Tier 1 capital (to risk-weighted assets)	12.00%	11.27%	12.78%	12.01%
Total capital (to risk-weighted assets)	13.25%	12.52%	11.52%	10.75%
Leverage or Tier 1 capital (to total average assets)	8.84%	8.29%	8.25%	7.69%

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.

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, 2010 we had issued commitments to extend credit of \$38.2 million and standby letters of credit of \$2.1 million through various types of commercial lending arrangements. Approximately \$31.76 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, 2010:

(Dollars in thousands)	Within	After One	After Three	Within	Greater	Total
	One Month	Through Three Months	Through Twelve Months	One Year	Than One Year	
	\$ 6,233	\$ 2,864	\$ 10,339	\$ 19,436	\$ 18,793	\$ 38,229

Unused commitments to extend credit						
Standby letters of credit	10		2,005	2,015	97	2,112
Totals	\$ 6,243	\$ 2,864	\$ 12,344	\$ 21,451	\$ 18,890	\$ 40,341

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.

FIRST RELIANCE BANCSHARES, INC.

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

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, 2009 and during the three months ended March 31, 2010. As of March 31, 2010, 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, 2010. The ratio of cumulative gap to total earning assets after 12 months was (28.07%) because \$157.3 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.

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, 2010, our liquid assets, consisting of cash and cash equivalents due from banks amounted to \$42.7 million, or 6.93% of total assets. Our investment securities, excluding nonmarketable securities, at March 31, 2010 amounted to \$121.6 million, or 19.74% of total assets. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, \$115.6 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, 2009, our liquid assets amounted to \$53.3 million, or 8.26% of total assets. Our investment securities, excluding nonmarketable securities, at December 31, 2009 amounted to \$121.9 million, or 18.89% of total assets. However, \$115.3 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 2009 and the first three months of 2010, 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 \$17.0 million for which there were no borrowings against the lines at March 31, 2010. 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 \$102.7 million at March 31, 2010. At March 31, 2010 the bank had \$27 million outstanding in FHLB advances. Additionally, the Company has an available line of credit at the Federal Reserve of \$52.5 million. At March 31, 2010, there were no borrowings against this line. We believe that sources described above will be sufficient to meet our future liquidity needs.

FIRST RELIANCE BANCSHARES, INC.

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

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.

The following table sets forth information regarding our rate sensitivity as of March 31, 2010 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, 2010

(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						
Interest-bearing deposits						
in other banks	\$ 40,658	\$ -	\$ -	\$ 40,658	\$ -	\$ 40,658
Loans (1)	48,336	29,528	78,849	156,713	236,064	392,777
Securities, taxable	54	-	-	54	60,967	61,021
Securities, nontaxable	-	-	-	-	60,612	60,612
Nonmarketable securities	4,812	-	-	4,812	-	4,812
Time Deposits in other banks			503	503		503
Total earning assets	93,860	29,528	79,352	202,740	357,643	560,383
Liabilities						
Interest-bearing liabilities						
Interest-bearing deposits:						
Demand deposits	39,366	-	-	39,366	-	39,366
Savings deposits	104,310	-	-	104,310	-	104,310
Time deposits	24,974	30,697	146,082	201,753	137,020	338,773
Total interest-bearing deposits	168,650	30,697	146,082	345,429	137,020	482,449
	1,000	-	13,000	14,000	13,000	27,000

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

Federal Home Loan Bank
Advances

Junior subordinated debentures	-	-	-	-	10,310	10,310
Repurchase agreements	603	-	-	603	-	603
Total interest-bearing liabilities	170,253	30,697	159,082	360,032	160,330	520,362
Period gap	\$ (76,393)	\$ (1,169)	\$ (79,730)	\$ (157,292)	\$ 197,313	
Cumulative gap	\$ (76,393)	\$ (77,562)	\$ (157,292)	\$ (157,292)	\$ 40,021	
Ratio of cumulative gap to total earning assets	(13.63)%	(13.84)%	(28.07)%	(28.07)%	7.14%	

(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.

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, 2009, 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.

-35-

FIRST RELIANCE BANCSHARES, INC.

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

(a) Not applicable.

(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 Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2010 – January 31, 2010	217	\$ 4.30	-	-
February 1, 2010 - February 28, 2010	338	\$ 4.30	-	-
March 1, 2010 – March 31, 2010	-	\$ -	-	-
	555	\$ 4.30	-	-

Item 6. Exhibits

Exhibit Number	Exhibit
10.1	Form of Director Retirement Agreement.
10.2	Form of Amendment to Director Retirement 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.

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.

Date: May 14, 2010

By

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

Date: May 14, 2010

By:

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