BKOR 10-Q 9/30/2008

Section 1: 10-Q (FORM 10-Q)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2008
Commission File No. 000-52640

OAK RIDGE FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

North Carolina **(State or other jurisdiction of incorporation or organization)**	**20-8550086** **(I.R.S. Employer Identification No.)**
Post Office Box 2 **2211 Oak Ridge Road** **Oak Ridge, North Carolina** **(Address of principal executive offices)**	**27310** **(Zip Code)**

(336) 644-9944
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) 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

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 ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☒

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

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, no par value	1,791,474 shares
Class	Outstanding at November 3, 2008

Oak Ridge Financial Services, Inc.
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This form contains certain forward-looking statements with respect to the financial condition, results of operations and business of the Company. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on the information available to management at the time that these disclosures were prepared. These statements can be identified by the use of words like "expect," "anticipate," "estimate" and "believe," variations of these words and other similar expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, (1) competition in the Company's markets, (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environment and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in the Company's other filings with the Securities Exchange Commission. The Company undertakes no obligation to update any forward-looking statements.

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Consolidated Balance Sheets
September 30, 2008 (Unaudited) and December 31, 2007
(Dollars in thousands – except share data)

	2008	2007
Assets		
Cash and due from banks	$ 2,750	$ 6,125
Interest-bearing deposits with banks	2,158	3,983
Total cash and cash equivalents	4,908	10,108
Federal funds sold	8,035	8,493
Trading assets	801	802
Securities available-for-sale	29,089	17,353
Securities held-to-maturity (fair values of $10,787 in 2008)	13,520	—
Federal Home Loan Bank Stock, at cost	1,461	1,093
Loans, net of allowance for loan losses of $2,379 in 2008 and $2,120 in 2007	236,237	210,701
Property and equipment, net	8,257	6,755
Accrued interest receivable	1,301	1,219
Bank owned life insurance	4,390	4,269
Other real estate owned	65	—
Other assets	1,666	1,415
Total assets	$ 309,730	$ 262,208
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 19,155	$ 14,771
Interest-bearing	240,486	203,745
Total deposits	259,641	218,516
Long-term debt	22,000	16,000
Junior subordinated notes related to trust preferred securities	8,248	8,248
Accrued interest payable	498	553
Other liabilities	1,149	1,207
Total liabilities	291,536	244,524
Commitments and contingencies	—	—
Stockholders' equity		
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, no par value; 50,000,000 shares authorized; 1,791,474 issued and outstanding in 2008 and 2007	15,831	15,831
Retained earnings	2,151	1,590
Accumulated other comprehensive income	212	263
Total stockholders' equity	18,194	17,684
Total liabilities and stockholders' equity	$ 309,730	$ 262,208

See Notes to Unaudited Consolidated Financial Statements

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Consolidated Statements of Operations (Unaudited)
For the three and nine months ended September 30, 2008 and 2007
(Dollars in thousands – except share data)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Interest income				
Loans and fees on loans	$ 3,920	$ 3,832	$ 11,793	$ 10,797
Federal funds sold	27	131	136	232
Interest on deposits in banks	27	28	98	41
Federal Home Loan Bank stock dividends	10	17	48	52
Taxable investment securities	473	260	1,283	768
Total interest income	4,457	4,268	13,358	11,890
Interest expense				
Deposits	1,930	1,978	6,146	5,483
Federal funds purchased	2	—	2	4
Short-term and long-term debt	249	370	799	849
Total interest expense	2,181	2,348	6,947	6,336
Net interest income	2,276	1,920	6,411	5,554
Provision for loan losses	74	110	337	273
Net interest income after provision for loan losses	2,202	1,810	6,074	5,281
Noninterest income				
Service charges on deposit accounts	222	160	575	405
Trading income (loss)	(2)	11	1	(135)
Mortgage loan origination fees	98	94	330	316
Investment and insurance commissions	237	246	687	626
Fee income from accounts receivable financing	209	113	561	236
Income earned on bank owned life insurance	41	40	121	118
Other service charges and fees	93	71	274	181
Total noninterest income	898	735	2,549	1,747
Noninterest expense				
Salaries and employee benefits	1,339	1,103	3,885	3,356
Occupancy expense	171	121	434	367
Equipment expense	158	145	438	407
Data and items processing	122	89	334	223
Professional and advertising	259	269	850	717
Stationary and supplies	81	50	192	158
Telecommunications expense	56	55	194	164
Other expense	315	250	1,005	724
Total noninterest expense	2,501	2,082	7,332	6,116
Income before income taxes	599	463	1,291	912
Income tax expense	224	164	471	305
Net income	$ 375	$ 299	$ 820	$ 607
Basic earnings per share	$ 0.21	$ 0.17	$ 0.46	$ 0.34
Diluted earnings per share	$ 0.21	$ 0.17	$ 0.45	$ 0.33
Basic weighted average shares outstanding	1,791,474	1,790,224	1,791,474	1,790,208
Diluted weighted average shares outstanding	1,791,474	1,809,057	1,809,404	1,837,396

See Notes to Unaudited Consolidated Financial Statements

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Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income (Unaudited)
For the nine months ended September 30, 2008 and 2007
(In thousands except shares of common stock)

	Common Stock			Retained Earnings	Accumulated Other Comprehensive	
	Shares	Amount	Surplus	(Deficit)	Income (Loss)	Total
Balance, December 31, 2006	1,790,174	$ 5,370	$ 10,450	$ 978	$ (345)	$16,453
Comprehensive income						
Net income	—	—	—	607	—	607
Net change in unrealized gain on investment securities available-for-sale, net of tax liability of $68	—	—	—	—	110	110
Total comprehensive income						717
Recapitalization to no par stock	—	10,450	(10,450)	—	—	—
Cumulative effect of a change in accounting principle	—	—	—	(393)	345	(48)
Issuance of common stock	50	—	—	—	—	—
Balance, September 30, 2007	1,790,224	$15,820	$ —	$ 1,192	$ 110	$17,122
Balance, December 31, 2007	1,791,474	$15,831	$ —	$ 1,590	$ 263	$17,684
Comprehensive income						
Net income	—	—	—	820	—	820
Net change in unrealized gain on investment securities available-for-sale, net of tax benefit of $29	—	—	—	—	(51)	(51)
Total comprehensive income						769
Cumulative effect of a change in accounting principle	—	—	—	(259)	—	(259)
Balance, September 30, 2008	1,791,474	$15,831	$ —	$ 2,151	$ 212	$18,194

See Notes to Unaudited Consolidated Financial Statements

Consolidated Statements of Cash Flows (Unaudited)
For the nine months ended September 30, 2008 and 2007
(In thousands)

	2008	2007
Cash flows from operating activities		
Net income	$ 820	$ 607
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	455	398
Provision for loan losses	337	273
Income earned on bank owned life insurance	(121)	(118)
Net change in trading assets	(1)	24,157
Deferred income tax (benefit) expense	(63)	123
Income taxes payable	(479)	—
Net accretion of discounts and premiums on securities	(160)	(20)
Changes in assets and liabilities:		
Accrued interest receivable	(82)	(264)
Other assets	(219)	(376)
Accrued interest payable	(55)	201
Other liabilities	162	391
Net cash provided by operating activities	594	25,372
Cash flows from investing activities		
Net decrease (increase) in federal funds sold	458	(6,494)
Activity in available-for-sale securities:		
Purchases	(16,861)	(17,914)
Sales	—	—
Maturities and repayments	5,175	559
Activity in held-to-maturity securities:		
Purchases	(14,370)	—
Maturities and repayments	877	—
Redemptions (purchases) of Federal Home Loan Bank stock	(368)	40
Net increase in loans	(25,873)	(32,564)
Purchases of property and equipment	(1,957)	(1,727)
Net cash used in investing activities	(52,919)	(58,100)
Cash flows from financing activities		
Net increase in deposits	41,125	32,389
Proceeds from issuance of guaranteed preferred beneficial		
Interests in the company's junior subordinated debentures	—	8,248
Proceeds from issuance of debt	13,000	—
Repayment of borrowings	(7,000)	(1,500)
Net cash provided by financing activities	47,125	39,137
Net increase (decrease) in cash and cash equivalents	(5,200)	6,409
Cash and cash equivalents, beginning	10,108	5,114
Cash and cash equivalents, ending	$ 4,908	$ 11,523

See Notes to Unaudited Consolidated Financial Statements

Consolidated Statements of Cash Flows (Unaudited)
For the nine months ended September 30, 2008 and 2007
(In thousands)

	2008	2007
Supplemental disclosure of cash flow information		
Interest paid	$7,002	$ 6,135
Taxes paid	$ 885	$ 16
Supplemental disclosure of non-cash investing activities		
Real estate and other assets acquired in settlement of loans	$ 92	$ —
Reclassification of available-for –sale and held-to-maturity Securities to trading	$ —	$23,984
Investment in non-bank subsidiary	$ —	$ 248

See Notes to Unaudited Consolidated Financial Statements

Notes to Unaudited Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

The results presented here are for Oak Ridge Financial Services, Inc. (the "Company"), the parent company of Bank of Oak Ridge (the "Bank"). In 2006, the Bank's Board of Directors and shareholders approved the formation of a bank holding company, of which the Bank would become a wholly owned subsidiary. The reorganization was effected through a share exchange in which each of the Bank's shareholders received one share of common stock of the Company in exchange for each of his, her or its shares of the Bank's common stock (the "Reorganization"). The Company became the Bank's parent holding company in April of 2007. Because the Company has no separate operations and conducts no business on its own other than owning the Bank, this discussion concerns primarily the business of the Bank. However, because the financial statements are presented on a consolidated basis, the Company and the Bank are collectively referred to as the "Company" unless otherwise noted.

The Bank was organized and incorporated under the laws of the State of North Carolina and commenced operations on April 10, 2000. Including its main office, the Bank operates five (5) full service branch offices in Oak Ridge, Summerfield, and Greensboro, North Carolina. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the North Carolina Commissioner of Banks (the "Commissioner") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank has formed an investment subsidiary, Oak Ridge Financial Corporation, that has not been funded and is inactive.

The Company formed Oak Ridge Statutory Trust I (the "Trust") during 2007 to facilitate the issuance of trust preferred securities. The Trust is a statutory business trust formed under the laws of the State of Connecticut, of which all common securities are owned by the Company. Under Financial Accounting Standards Board ("FASB") Interpretation No. ("FIN") 46, *Consolidation of Variable Interest Entities,* Oak Ridge Financial Statutory Trust I is not included in the Company's consolidated financial statements. The junior subordinated debentures issued by the Company to the Trust are included in long-term debt and the Company's equity interest in the Trust is included in other assets.

The accounting and reporting policies of the Company follow generally accepted accounting principles and general practices within the financial services industry. The accompanying consolidated financial statements include the accounts and transactions of the Company and the Bank, its wholly owned subsidiary. All significant intercompany transactions and balances have been eliminated in consolidation.

In management's opinion, the financial information, which is unaudited, reflects all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial information as of and for the three-and nine-month periods ended September 30, 2008 and 2007, in conformity with accounting principles generally accepted in the United States of America ("GAAP").

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities at the date of the financial statements, as well as the amounts of income and expense during the reporting period. Actual results could differ from those estimates. Operating results for the three- and nine-month periods ended September 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2008.

The balance sheet as of December 31, 2007 has been derived from audited financial statements. The unaudited financial statements of the Company have been prepared in accordance with instructions from Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation have been included.

The organization and business of the Company, accounting policies followed by the Company and other relevant information are contained in the notes to the financial statements filed as part of the Company's annual report on Form 10-KSB for the year ended December 31, 2007. This quarterly report should be read in conjunction with the annual report.

Certain reclassifications have been made to the prior period's financial statements to place them on a comparable basis with the current year. Net income and stockholders' equity previously reported were not affected by these reclassifications.

Notes to Unaudited Consolidated Financial Statements

Note 2. Earnings Per Share

Basic Earnings per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

Diluted Earnings per Share

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

Note 3. Fair Value Measurements

As discussed in Note 7, Statement of Financial Accounting Standards ("SFAS") 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following is a description of the valuation methodologies used to measure and disclose fair value of financial assets and liabilities on a recurring or nonrecurring basis:

Trading assets and Securities Available-For-Sale

Trading assets and securities available-for-sale are recorded at fair value on a recurring basis. Fair value is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1).

The assets presented at fair value on the Company's financial statements are related to trading assets, available-for-sale securities real estate owned, net, and impaired loans, all of which are valued based on Level 1, 2, or 3 inputs. For Level 3 inputs, management utilizes appraisals, listing prices, market information from local realtors and market research reports to base the fair value measurement.

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Notes to Unaudited Consolidated Financial Statements

Note 3. Fair Value Measurements, continued

The following table presents the balances of assets measured at fair value on a recurring basis at September 30, 2008 (in thousands):

	Fair Value at September 30, 2008			
	Level 1	Level 2	Level 3	Total
Trading assets				
Government-sponsored enterprise securities	$ 801	$ —	$ —	$ 801
Available-for-sale securities				
Government-sponsored enterprise securities	1,035	—	—	1,035
Corporate bonds	—	—	500	500
Mortgage-backed securities	27,554	—	—	27,554
Total	$29,390	$ —	$ 500	$29,890

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	December 31, 2007	Additions	Fair Value Adjustments	Transfers Out	Gain (Loss)	September 30, 2008
			(in thousands)			
Corporate bonds	$ —	$ 500	$ —	$ —	$—	$ 500
Real estate owned, net	—	92	—	(27)	—	65
Impaired loans	—	2,519	(13)	(122)	—	2,384

There were no material liabilities carried at fair value, measured on a recurring or nonrecurring basis, at September 30, 2008.

Note 4. Critical Accounting Policies

The Company's financial statements are prepared in accordance with GAAP. The notes to the audited financial statements included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2007 contain a summary of its significant accounting policies. Management believes the Company's policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments, such as the recoverability of intangible assets, involve a higher degree of complexity and require management to make difficult and subjective judgments that often require assumptions or estimates about highly uncertain matters. Accordingly, the Company considers the policies related to those areas as critical.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on the historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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Note 4. Critical Accounting Policies, continued

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

Note 5. Stock-based Compensation

The Bank has adopted both the *Employee Stock Option Plan* ("Incentive Plan") and the *Director Stock Option Plan* ("Nonstatutory Plan"). Under each plan up to 178,937 shares may be issued for a total of 357,874 shares. Options granted under both plans expire no more than 10 years from date of grant. The option exercise price under both plans is set by a committee of the Board of Directors at the date of grant, and is not less than 100 percent of fair market value at the date of the grant. Options granted under either plan vest according to the terms of each particular grant. In connection with the Reorganization, the Company assumed the Incentive Plan and the Nonstatutory Plan Options to acquire the Company's stock were issued in substitution for the outstanding options to acquire Bank stock at the time of the Reorganization.

Activity under the Company plans during the nine months ended September 30, 2008 is summarized below:

	Incentive Plan		Nonstatutory Plan	
	Available For Grant	Granted	Available For Grant	Granted
Balance, December 31, 2007	3,600	173,237	3	178,934
Additional options made available				
Granted	—	—	—	—
Exercised	—	—	—	—
Forfeited	2,563	(2,563)	—	—
Expired	—	—	—	—
Balance, September 30, 2008	6,163	170,674	3	178,934

A stock option may be exercised, in whole or in part, by giving written notice of exercise to the Corporate Secretary of the Company, or such other officer of the Company as the committee shall designate, specifying the number of shares to be purchased along with payment in full of the exercise price. The committee may, in the relevant award agreement, also permit a participant (either on a selective or group basis) to simultaneously exercise stock options and sell the shares of common stock thereby acquired, and use the proceeds from such sale as payment of the exercise price of such stock options. Payment instruments shall be received by the Company subject to collection. The proceeds received by the Company upon exercise of any stock option may be used by the Company for general corporate purposes.

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Notes to Unaudited Consolidated Financial Statements

Note 5. Stock-based Compensation, continued

Information regarding the stock options outstanding at September 30, 2008 is as follows (dollars in thousands, except option prices):

Range of Exercise Prices	Number Outstanding and Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Aggregate Intrinsic Value
$8.80-9.99	101,512	2.58 Years	$ 8.80	$ 11
$10.00-10.39	140,544	5.92 Years	$ 10.00	—
$10.40-11.20	107,552	5.77 Years	$ 10.71	—
	349,608	4.90 Years	$ 9.87	$ 11

On June 8, 2006, the shareholders adopted the Oak Ridge Financial Services, Inc. Long-Term Stock Incentive Plan (the “Omnibus Plan”), which became effective upon the consummation of the Reorganization. The Omnibus Plan is a means to attract new talent and retain current personnel as the Company and the Bank each continue to grow. Employees and directors of the Company and the Bank, who are designated as eligible participants by the Compensation Committee of the Company’s Board of Directors (the “Committee”), may receive Awards (as defined below) under the Omnibus Plan. The Omnibus Plan provides that employees eligible for Awards shall consist of key employees who are officers or managers of the Company and/or the Bank who are responsible for the management, growth and protection of the business of the Company and/or the Bank and whose performance or contribution, in the sole discretion of the Committee, benefits or will benefit the Company in a significant manner. Non-employees (e.g., those with third party relationships such as non-employee directors of the Company and/or the Bank) shall be eligible participants for Awards of non-qualified stock options (“NSOs”) and/or Restricted Stock (as defined in the Omnibus Plan) at the sole discretion of the Committee. Non-employees shall not be eligible to receive incentive stock options (“ISOs”) or Performance Units (as defined in the Omnibus Plan). As of September 30, 2008, no Awards have been granted under the Omnibus Plan.

Note 6. Guaranteed Preferred Beneficial Interest in the Company’s Junior Subordinated Debentures

Oak Ridge Statutory Trust I, a statutory business trust (the “Trust”), was created by the Company on June 28, 2007, at which time the Trust issued $8.0 million in aggregate liquidation amount of $1 par value preferred capital trust securities that mature on June 28, 2037. Distributions are payable on the securities at the floating rate equal to the three-month London Interbank Offered Rate (“LIBOR”) plus 1.60%, and the securities may be prepaid at par by the Trust at any time after June 17, 2012. The principal assets of the Trust are $8.3 million of the Company’s junior subordinated debentures which mature on June 17, 2037, and bear interest at the floating rate equal to the three month LIBOR plus 1.60%, and which are callable by the Company after June 28, 2012. All $248,000 in the aggregate liquidation amount of the Trust’s common securities are held by the Company.

Note 7. Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 141(R), “Business Combinations,” (“SFAS 141(R)”) which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

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Notes to Unaudited Consolidated Financial Statements

Note 7. Recent Accounting Pronouncements, continued

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting noncontrolling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financials statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company believes the adoption of SFAS 160 will have no impact on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improving the transparency of financial reporting. It is intended to enhance the current disclosure framework in SFAS 133 by requiring that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This disclosure better conveys the purpose of derivative use in terms of the risks that the entity is intending to manage. SFAS 161 is effective for the Company on January 1, 2009. This pronouncement does not impact accounting measurements but will result in additional disclosures if the Company is involved in material derivative and hedging activities at that time.

In February 2008, the FASB issued FASB Staff Position No. 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" ("FSP 140-3"). This FSP provides guidance on accounting for a transfer of a financial asset and the transferor's repurchase financing of the asset. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing are not evaluated as a linked transaction and are evaluated separately under Statement 140. FSP 140-3 will be effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years and earlier application is not permitted. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company is currently evaluating the impact, if any, the adoption of FSP 140-3 will have on its financial position, results of operations and cash flows.

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets". The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and early adoption is prohibited. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company does not believe the adoption of FSP 142-3 will have a material impact on its financial position, results of operations or cash flows.

Notes to Unaudited Consolidated Financial Statements

Note 7. Recent Accounting Pronouncements, continued

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles," ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP (the "GAAP Hierarchy"). SFAS No. 162 will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board's amendments to AU Section 411, "*The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles." The FASB has stated that it does not expect SFAS No. 162 will result in a change in current practice. The application of SFAS No. 162 will have no effect on the Company's financial position, results of operations or cash flows.

The FASB issued FASB Staff Position No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP No. APB 14-1"). Staff Position specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 provides guidance for initial and subsequent measurement as well as derecognition provisions. This Staff Position is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. The adoption of this Staff Position will have no material effect on the Company's financial position, results of operations or cash flows.

In June, 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities," ("FSP EITF 03-6-1"). This Staff Position provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and must be included in the earnings per share computation. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period earnings per share data presented must be adjusted retrospectively. Early application is not permitted. The adoption of this Staff Position will have no effect on the Company's financial position, results of operations or cash flows until it issues shares under its Omnibus Plan.

Effective January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157") which provides a framework for measuring and disclosing fair value under GAAP. SFAS 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

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Notes to Unaudited Consolidated Financial Statements

Note 7. Recent Accounting Pronouncements, continued

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

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

The Company is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be level 2 inputs. The aggregate carrying amount of impaired loans at September 30, 2008 was $810,000.

FASB Staff Position No. FAS 157-2 delays the implementation of SFAS 157 until the first quarter of 2009 with respect to goodwill, other intangible assets, real estate and other assets acquired through foreclosure and other non-financial assets measured at fair value on a nonrecurring basis.

In May, 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 162, “The Hierarchy of Generally Accepted Accounting Principles,” (“SFAS No. 162”). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS No. 162 is effective November 15, 2008. The FASB has stated that it does not expect SFAS No. 162 will result in a change in current practice. The application of SFAS No. 162 will have no effect on the Company’s financial position, results of operations or cash flows.

Notes to Unaudited Consolidated Financial Statements

Note 7. Recent Accounting Pronouncements, continued

FSP SFAS 133-1 and FIN 45-4, “Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161,” (“FSP SFAS 133-1 and FIN 45-4”) was issued September 2008, effective for reporting periods (annual or interim) ending after November 15, 2008. FSP SFAS 133-1 and FIN 45-4 amends SFAS 133 to require the seller of credit derivatives to disclose the nature of the credit derivative, the maximum potential amount of future payments, fair value of the derivative, and the nature of any recourse provisions. Disclosures must be made for entire hybrid instruments that have embedded credit derivatives.

The staff position also amends FIN 45 to require disclosure of the current status of the payment/performance risk of the credit derivative guarantee. If an entity utilizes internal groupings as a basis for the risk, how the groupings are determined must be disclosed as well as how the risk is managed.

The staff position encourages that the amendments be applied in periods earlier than the effective date to facilitate comparisons at initial adoption. After initial adoption, comparative disclosures are required only for subsequent periods.

FSP SFAS 133-1 and FIN 45-4 clarifies the effective date of SFAS 161 such that required disclosures should be provided for any reporting period (annual or quarterly interim) beginning after November 15, 2008. The adoption of this Staff Position will have no material effect on the Company’s financial position, results of operations or cash flows.

The SEC’s Office of the Chief Accountant and the staff of the FASB issued press release 2008-234 on September 30, 2008 (“Press Release”) to provide clarifications on fair value accounting. The press release includes guidance on the use of management’s internal assumptions and the use of “market” quotes. It also reiterates the factors in SEC Staff Accounting Bulletin (“SAB”) Topic 5M which should be considered when determining other-than-temporary impairment: the length of time and extent to which the market value has been less than cost; financial condition and near-term prospects of the issuer; and the intent and ability of the holder to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value.

On October 10, 2008, the FASB issued FSP SFAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“FSP SFAS 157-3”). This FSP clarifies the application of SFAS No. 157, “Fair Value Measurements” (see Note 3) in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that asset is not active. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. For the Company, this FSP is effective for the quarter ended September 30, 2008.

The Company considered the guidance in the Press Release and in FSP SFAS 157-3 when conducting its review for other-than-temporary impairment as of September 30, 2008 and determined that it did not result in a change to its impairment estimation techniques.

Other accounting standards that have been issued or proposed by 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.

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

Comparison of Results of Operations for the Nine-Month Periods Ending September 30, 2008 and 2007

Net Income

For the nine months ended September 30, 2008, the Company reported an increase in net income of 35 percent to $820,000 compared to $607,000 for the same period in 2007. Net income per diluted share increased 36 percent to $0.45 compared to $0.33 for the prior year period. Annualized returns on average assets and average equity were 0.38 percent and 6.18 percent, respectively, for the nine months ended September 30, 2008, compared to 0.37 percent and 4.86 percent for the prior year period.

The primary factors contributing to the increase in net income from 2007 to 2008 were increases in net interest income and noninterest income, which were offset by increases in the provision for loan losses and noninterest expense.

Net Interest Income

Net interest income was $6.4 million for the nine months ended September 30, 2008 compared to $5.6 million for the prior year. The 15 percent increase in net interest income was due primarily to growth in average earning assets, but was offset by a decline in the net interest margin due to earning assets repricing downward faster than interest-bearing liabilities.

Net interest margin is interest income earned on loans, securities, and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the nine months ended September 30, 2008 was 3.11 percent compared to 3.54 percent for the prior year period. The average yield on earning assets for the current period was 6.56 percent compared to 7.68 percent for the prior year period, and the average cost of interest-bearing liabilities was 3.71 percent for the current period compared to 4.56 percent for the prior year period. The decline in interest rate spread from 3.12 percent to 2.85 percent was impacted by a decline in the ratio of average interest-earning assets to average interest-bearing liabilities, which decreased from 109.80 percent at September 30, 2007 to 107.17 percent at September 30, 2008.

Between September 18, 2007 and April 30, 2008, the Federal Reserve Board decreased short-term interest rates seven times for a total of 325 basis points. The rapid decline in short-term interest rates immediately impacts the Company's yield on variable rate loans, which represent approximately 39 percent of the Company's total interest-earning assets. However, the impact on interest-bearing liabilities, particularly certificates of deposit, occur as the fixed rate liabilities mature and reprice at market interest rates. Therefore, when the Federal Reserve Board decreases short-term interest rates rapidly it has a short-term negative impact on the Company's net interest margin. Generally, once the fixed rate liabilities reprice at market rates the net interest margin returns to previous levels. The Company is beginning to see fixed rate liabilities, primarily certificates of deposit, reprice at lower levels, but intense local competition for deposits could negatively impact the Company's net interest margin in the future. The Company is attempting to negate the potential negative impact to its net interest margin by focusing on attracting lower-cost deposits, particularly business demand deposit accounts.

Provision for Loan Losses

The Company's provision for loan losses for the nine months ended September 30, 2008 was $337,000 compared to $273,000 recorded in the prior year period. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level we deem appropriate. In evaluating the allowance for loan losses, we consider factors that include growth and composition of the loan portfolio, historical loan loss experience, individual loans that may have estimated losses, and other relevant factors. The Company experienced greater net charge offs in the nine months ended September 30, 2008 compared to the same period in 2007, and this was the primary reason for the increase in the provision in 2008 compared to 2007. Net charge offs in the first nine months of 2008 were $76,000 compared to $9,000 during the same period in 2007. Some loan loss provision is recognized when loans are originated so greater loan production generally leads to higher loan loss provisions. The allowance for loan losses to total loans was 1.00 percent at September 30, 2008 and December 31, 2007, and 1.03 percent at September 30, 2007.

Noninterest Income

Noninterest income totaled $2,549,000 for the nine months ended September 30, 2008, up $802,000, or 46 percent, from $1,747,000 for the same period in 2007. Service fees and charges, which represent a relatively stable and predictable source of noninterest income, totaled $575,000 for the nine months ended September 30, 2008, a 42 percent increase over the $405,000 of service fees and charges earned for the same period in 2007. Even though mortgage loan fee income increased from 2007 to 2008, the increased efforts of the mortgage originators were negatively impacted by the economic slowdown that began in the latter part of 2007 and continued into the first nine months of 2008. Mortgage loan origination fees totaled $330,000 for the nine months ended September 30, 2008, a 4 percent increase over the $316,000 of mortgage loan fee income earned for 2007. The Bank's Investment Services Group, which services its banking offices, and the Oak Ridge Wealth Management division, which was formed in 2005 and operates independently of the Bank, comprise all of the investment and insurance commissions noninterest income category. Investment and insurance commissions totaled $687,000 for the nine months ended September 30, 2008, an 10 percent increase over the $626,000 earned in 2007, largely due to increased revenue from both the Investment Services Group and the Oak Ridge Wealth Management business units. Fee income from accounts receivable financing totaled $561,000 for the nine months ended September 30, 2008, a 138 percent increase over the $236,000 earned in the same period in 2007. This increase is largely due to the addition of seven new customers in the first quarter of 2008. Trading income was only $1,000 for the nine months ended September 30, 2008. During the first nine months of 2008 the Company held only one bond in its trading portfolio with a balance of approximately $800,000. Since this bond is relatively close to its maturity date its changes in market value are relatively minimal. In the nine months ended September 30, 2007, the Company recorded a $135,000 trading loss due to two factors – the Company's adoption of SFAS 159 on April 30, 2007, and the subsequent sale of substantially all of the Company's investment portfolio in June of 2007. Income earned on bank owned life insurance was relatively unchanged from 2007 to 2008. Other service charges and fees benefited from the Bank's increased number of product offerings and deposit accounts, as well as higher debit card interchange income, and totaled $274,000 for the nine months ended September 30, 2008, a 51 percent increase over the $181,000 earned in 2007.

Noninterest Expense

Noninterest expenses were $7.3 million for the nine months ended September 30, 2008 compared to $6.1 million for the prior year period. The $1.2 million or 20 percent increase reflects the continuing efforts to expand the Company's infrastructure and branch network, and was specifically related to the opening of the Bank's fifth banking location in January of 2008. Of the $1.2 million increase in total noninterest expense, approximately $900,000 was in salaries and employee benefits, occupancy expense, equipment expense, and other expenses, which are expenses impacted by the branch network and infrastructure improvements.

Salaries and employee benefits for the nine months ended September 30, 2008 were $3.9 million reflecting a $500,000 increase when compared to the $3.4 million for the same period in 2007. Increases in salaries and employee benefits were due to an increase in support positions to service the Bank's continued growth, as well as the opening of the Bank's fifth banking location in January of 2008.

Occupancy expense for the nine months ended September 30, 2008 were $434,000 reflecting a $67,000 increase when compared to the $367,000 for the same period in 2007. The increase in occupancy expense was due to the opening of the Bank's fifth banking office in Greensboro in January 2008, offset by a reduction in depreciation expense related to the Bank's operations facility, which was opened in 2000 as the Bank's original banking office and is now fully depreciated.

Equipment expense was relatively unchanged from 2007 to 2008 as these expenses were not significantly impacted by the Bank's continued growth, and were positively impacted by an emphasis on controlling such expenses.

Data and items processing expense for the nine months ended September 30, 2008 were $334,000 reflecting a $111,000 increase when compared to $223,000 for the prior year period. In March of 2008, the Bank negotiated a new pricing agreement with the provider of its core processing banking system. The Bank's growth over the prior three-year period caused the pricing on the new agreement to be higher, since the software licensing fees are based on the Bank's total assets at the time of renegotiation.

Professional and advertising expenses for the nine months ended September 30, 2008 were $850,000, reflecting a $133,000 increase when compared to $717,000 for the same period in 2007. Increases in accounting and auditing, marketing and advertising, shareholder communications, and expenses for outsourced services contributed to the overall increase in professional and advertising expenses from 2007 to 2008.

Stationary and supplies expense was higher in the first nine months compared to the same period in 2007 due primarily to the opening of the Bank's fifth banking office in January 2008. Telecommunications expense was higher due to the Company's continued growth, as well as the decision to equip certain employees with mobile smartphones to allow them to work more efficiently and effectively.

Other noninterest expenses for the nine months ended September 30, 2008 were $1,005,000 reflecting a $281,000 increase when compared to $724,000 for the same period in 2007. Increases in FDIC insurance premiums of $140,000, dues and memberships of $16,000, and insurance expense of $25,000 contributed to the overall increase in other noninterest expenses. Additionally, expenses related to the servicing of the Bank's accounts receivable financing program increased by $113,000 from 2007 to 2008. These increases were offset by decreases in expenses related to employee travel, training and education, postage, and charitable expenses.

Income Taxes

Income tax expense was $471,000 for the nine months ended September 30, 2008 and $305,000 for the same period in 2007. The increase in income tax expense from 2007 to 2008 was primarily due to higher net income before provision for income taxes in 2008 as compared to 2007.

Comparison of Results of Operations for the Three-Month Periods Ending September 30, 2008 and 2007

Net Income

For the three months ended September 30, 2008, the Company reported an increase in net income of 25 percent to $375,000 compared to $299,000 for the same period in 2007. Net income per diluted share increased 24 percent to $0.21 compared to $0.17 for the prior year period. Annualized returns on average assets and average equity were 0.51 percent and 8.41 percent, respectively, for the three months ended September 30, 2008, compared to 0.51 percent and 7.01 percent for the prior year period.

The primary factors contributing to the increase in net income from 2007 to 2008 were increases in the Company's net interest income and noninterest income, which were offset by increases in noninterest expense and income tax expense.

Net Interest Income

Net interest income was $2.3 million for the three months ended September 30, 2008 compared to $1.9 million for the prior year period. The 19 percent increase in net interest income was due primarily to growth in average earning assets, but was offset by a decline in the net interest margin due to earning assets repricing downward faster than interest-bearing liabilities.

Net interest margin is interest income earned on loans, securities, and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the three months ended September 30, 2008 was 3.28 percent compared to 3.51 percent for the prior year period. The average yield on earning assets for the current period was 6.33 percent compared to 7.69 percent for the prior year period, and the average cost of interest-bearing liabilities was 3.34 percent for the current period compared to 4.68 percent for the prior year period. The decline in interest rate spread from 3.01 percent to 2.99 percent was impacted by a decline in the ratio of average interest-earning assets to average interest-bearing liabilities, which decreased from 109.18 percent at September 30, 2007 to 106.12 percent at September 30, 2008.

Between September 18, 2007 and April 30, 2008, the Federal Reserve Board decreased short-term interest rates seven times for a total of 325 basis points. The rapid decline in short-term interest rates immediately impacts the Company's yield on variable rate loans, which represent approximately 39 percent of the Company's total interest-earning assets. However, the impact on interest-bearing liabilities, particularly certificates of deposit, occur as the fixed rate liabilities mature and reprice at market interest rates. Therefore, when the Federal Reserve Board decreases short-term interest rates rapidly it has a short-term negative impact on the Company's net interest margin. Generally, once the fixed rate liabilities reprice at market rates the net interest margin returns to previous levels. The Company is beginning to see fixed rate liabilities, primarily certificates of deposit, reprice at lower levels, but intense local competition for deposits could negatively impact the Company's net interest margin in the future. The Company is attempting to negate the potential negative impact to its net interest margin by focusing on attracting lower-cost deposits, particularly business demand deposit accounts.

Provision for Loan Losses

The Company's provision for loan losses for the three months ended September 30, 2008 was $74,000 compared to $110,000 recorded in the prior year period. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level we deem appropriate. In evaluating the allowance for loan losses, we consider factors that include growth and composition of the loan portfolio, historical loan loss experience, individual loans that may have estimated losses, and other relevant factors. The Company experienced less loan growth in the third quarter of 2008 compared to the same period in 2007, which was the primary reason for the decline in the provision between the two periods. Some loan loss provision is recognized when loans are originated so greater loan production generally leads to higher loan loss provisions. The allowance for loan losses to total loans was 1.00 percent at September 30, 2008 and December 31, 2007, and 1.03 percent at September 30, 2007.

Noninterest Income

Noninterest income totaled $898,000 for the three months ended September 30, 2008, up $163,000, or 22 percent, from $735,000 for the same period in 2007. Service fees and charges, which represent a relatively stable and predictable source of noninterest income, totaled $222,000 for the three months ended September 30, 2008, a 39 percent increase over $160,000 of service fees and charges earned for same period in 2007. Due to greater calling and marketing efforts and despite an overall weaker economic environment, mortgage loan origination fees totaled $98,000 for the three months ended September 30, 2008, a 4 percent increase over $94,000 of mortgage loan origination fees earned for the same period in 2007. The Bank's Investment Services Group, which services its banking offices, and the Oak Ridge Wealth Management division, which was formed in 2005 and operates independently of the Bank, comprise all of the investment and insurance commissions noninterest income category. Investment and insurance commissions totaled $237,000 for the three months ended September 30, 2008, a 4 percent decline over the $246,000 earned in 2007, largely due to lower asset management fees due to lower underlying market values of the assets under management. Fee income from accounts receivable financing totaled $209,000 for the three months ended September 30, 2008, an 85 percent increase over $113,000 earned in the same period in 2007. This increase is largely due to the addition of seven new customers in the first quarter of 2008. Income earned on bank owned life insurance was relatively unchanged from 2007 to 2008. Other service charges and fees benefited from the Bank's increased number of product offerings and deposit accounts, as well as higher debit card interchange income, and totaled $93,000 for the three months ended September 30, 2008, a 31 percent increase over $71,000 earned in 2007.

Noninterest Expense

Noninterest expenses were $2.5 million for the three months ended September 30, 2008 compared to $2.1 million for the prior year period. The $400,000 or 20 percent increase reflects the continuing efforts to expand the Company's infrastructure and branch network, and was specifically related to the opening of the Bank's fifth banking location in January of 2008. All of the $400,000 increase in total noninterest expense was caused by increases in salaries and employee benefits, occupancy expense, equipment expense, and other expenses, which are expenses impacted by the branch network and infrastructure improvements.

Salaries and employee benefits for the three months ended September 30, 2008 were $1.3 million reflecting a $200,000 increase compared to $1.1 million for the same period in 2007. Increases in salaries and employee benefits were due to an increase in support positions to service the Company's continued growth, as well as the opening of the Bank's fifth banking location in January 2008.

Occupancy expense for the three months ended September 30, 2008 was $171,000 reflecting a $50,000 increase when compared to $121,000 for the prior year period. The increase in occupancy expense related to the opening of the Bank's fifth banking office was somewhat offset by a reduction in depreciation expense related to the Bank's operations facility, which was opened in 2000 as the Bank's original banking office and is now fully depreciated.

Equipment expense for the three months ended September 30, 2008 was $158,000 reflecting a $13,000 increase when compared to $145,000 for the prior year period. Most of the increases were due to increased depreciation related to computer and related equipment purchases necessary to support the Company's continued growth.

Data and items processing expense for the three months ended September 30, 2008 were $122,000 reflecting a $33,000 increase when compared to $89,000 for the prior year period. Most of the increase is due to higher items processing fees in 2008 compared to 2007, as well as increased data processing expenses related to new services offered in 2008 such as merchant capture and mobile banking.

Professional and advertising expenses for the three months ended September 30, 2008 were $259,000, reflecting a $10,000 decrease when compared to $269,000 for the same period in 2007. Decreases in marketing and advertising, and shareholder communications contributed to the overall decrease in professional and advertising expenses from 2007 to 2008.

Stationary and supplies and telecommunications expenses were relatively unchanged from 2007 to 2008. Other noninterest expenses for the three months ended September 30, 2008 were $315,000 reflecting a $65,000 increase when compared to $250,000 for the same period in 2007. Increases in FDIC insurance premiums of $38,000, insurance expenses of $12,000, and losses and charge offs of $7,000 contributed to the overall increase in other noninterest expenses. Additionally, expenses related to the servicing of the Company's accounts receivable financing program increased by $18,000 from 2007 to 2008.

Income Taxes

Income tax expense was $224,000 for the three months ended September 30, 2008 and $164,000 for the same period in 2007. The increase in income tax expense from 2007 to 2008 was primarily due to higher net income before provision for income taxes in 2008 as compared to 2007.

Analysis of Financial Condition

Average earning assets increased to $267.6 million during the nine months ended September 30, 2008, 31 percent from $204.1 million during the same period in 2007. Earning assets represented 94 percent of total assets during the nine months ended September 30, 2008, and 93 percent during the same period in 2007. The mix of average earning assets was unchanged in the nine months ended September 30, 2007 compared to the same period in 2008, with loans representing 80.0 percent of total assets in 2007 and 2008, and investment securities representing 10 percent of total assets in 2007 and 2008. Federal funds sold and interest-bearing bank deposits represented 3 percent of total average assets in 2007 and 2008.

Loans Receivable

The Bank makes both commercial and consumer loans to borrowers in all neighborhoods within its market areas, including low- and moderate-income areas. The Bank emphasizes commercial loans to small and medium sized businesses, real estate loans, and consumer loans.

Loans receivable totaled $236.2 million at September 30, 2008, up $25.5 million, or 12 percent, from $210.7 million at December 31, 2007. Three factors contributed to the strong growth in loans from the end of 2007 to the end of the third quarter in 2008. First, the Bank's continued expansion into Greensboro led to more commercial loan opportunities. Second, the weakening economy led large financial institutions to abandon entire lines of business that led to quality loan opportunities. In the second quarter loan growth moderated somewhat, due to a decrease in the number of lending opportunities as a result of the slowing economy and the Bank's continued strong underwriting standards. However, in the third quarter, the continued turmoil in the financial services industry created new opportunities for well-underwritten loans that led to strong loan growth during that period of time. Third, many more borrowers, particularly commercial borrowers, that were customers of large financial institutions, moved their lending and deposit relationships to our Bank due to dissatisfaction with their current bank.

Allowance for Loan Losses and Asset Quality

The allowance for loan losses totaled $2.4 million at September 30, 2008, up $259,000, or 12 percent, from $2.1 million at December 31, 2007.

The allowance for loan losses is maintained at a level considered adequate by management to provide for anticipated loan losses based on management's assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions and loss experience and an overall evaluation of the quality of the underlying collateral. The allowance is increased by provisions charged to operations and reduced by loans charged off, net of recoveries.

As of September 30, 2008, the Bank did not have any loans that it considered to be subprime or investment securities with any significance of subprime 1-4 residential loans on its balance sheet. Nonperforming assets to period-end loans increased slightly from 0.18% at December 31, 2007 to 0.28% at September 30, 2008, and nonperforming assets and accruing loans past due 90 days or more increased from $375,000 at December 31, 2007 to $659,000 at September 30, 2008. A substantial portion of the nonperforming loans were secured by residential property or 1-4 family residences. The Bank had $65,000 in other real estate owned at September 30, 2008, with none at December 31, 2007 or September 30, 2007.

Investments and other interest-earning assets

The Company's portfolios of investment securities, which are classified as trading, available-for-sale, or held-to-maturity, consist of government sponsored enterprises, government sponsored enterprises guaranteed mortgage-backed securities, and mortgage backed securities not guaranteed by government sponsored enterprises. Other interest-earning assets consist of interest-bearing deposits with banks and Federal Funds sold.

Investments and other interest-earning assets totaled $44.9 million at September 30, 2008, up $13.2 million, or 42 percent, from $31.7 million at December 31, 2007. The large increase was due to the purchase in March and September of 2008 of $27.2 million in mortgage-backed securities not guaranteed by government-sponsored enterprises.

Deposits

Deposits totaled $259.6 million at September 30, 2008, up $41.1 million, or 19 percent, from $218.5 million at December 31, 2007. Of the $41.1 million increase in total deposits from December 31, 2007 to September 30, 2008, $4.4 million of the increase was in noninterest-bearing deposits with the remaining increase in interest-bearing deposits. The increase in noninterest-bearing deposits was due to a Company wide focus on gathering noninterest-bearing deposits, particularly deposits held by business and non-profit entities, as well as the Company's continued expansion into Greensboro, North Carolina.

Borrowings

Borrowings, which consist of short and long-term debt, and junior subordinated notes related to trust preferred securities, totaled $30.3 million at September 30, 2008, up $6.0 million, or 25 percent, from $24.3 million at December 31, 2007. The increase in borrowings, which consist of Federal Home Loan Bank of Atlanta advances, was to fund loan and investment growth during the first nine months of 2008.

Stockholders' Equity

Stockholders' equity totaled $18.2 million at September 30, 2008, up approximately $500,000, or 29 percent, from $17.7 million at December 31, 2007. In September 2006, FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4, "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). EITF 06-4 was effective for the Company on January 1, 2008. The Company did adopt EITF 06-04 on January 1, 2008, which resulted in a $259,000 decrease to retained earnings. The decrease to retained earnings was offset by net income of $820,000 for the nine months ended September 30, 2008. The remaining net change in stockholders' equity was due to a decrease in accumulated other comprehensive income.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Pursuant to Item 305(e) of Regulation S-K, the Company, as a smaller reporting company, is not required to provide the information required by this Item.

Item 4T. Controls And Procedures

As of the end of the period to which this report relates, the Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures in accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act").

The design of any system of controls is based in part upon certain assumptions about the likelihood of future events. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, there can be no assurance that any design will succeed in achieving its stated goal under every potential condition, regardless of how remote. While we have evaluated the operation of our disclosure controls and procedures and found them effective, there can be no assurance that they will succeed in every instance to achieve their objective.

Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report effectively and in a timely manner the information required to be disclosed in reports we file under the Exchange Act. There have not been any changes in our internal control over financial reporting that occurred during the last quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

Oak Ridge Financial Services, Inc.

Part II. Other Information

Item 6. Exhibits

13(a) Exhibits

Exhibit (3)(i)	Articles of Incorporation, incorporated herein by reference to Exhibit (3)(i) to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (3)(ii)	Bylaws, incorporated herein by reference to Exhibit (3)(ii) to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (4)	Specimen Stock Certificate, incorporated herein by reference to Exhibit 4 to the Form 8-K filed with the SEC on May 10, 2007.
Exhibit (10)(i)	Employment Agreement with Ronald O. Black, as amended, incorporated herein by reference to Exhibit (10)(i) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(ii)	Employment Agreement with L. William Vasaly, III, as amended, incorporated herein by reference to Exhibit (10)(ii) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(iii)	Employment Agreement with Thomas W. Wayne, as amended, incorporated herein by reference to Exhibit (10)(iii) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(iv)	Outparcel Ground Lease between J.P. Monroe, L.L.C. and Bank of Oak Ridge dated June 1, 2002, incorporated herein by reference to Exhibit (10)(iv) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(v)	Ground and Building Lease between KRS of Summerfield, LLC and Bank of Oak Ridge dated September 25, 2002, incorporated herein by reference to Exhibit (10)(v) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(vi)	Ground Lease between Friendly Associates XVIII LLLP and Bank of Oak Ridge dated September 13, 2004, incorporated herein by reference to Exhibit (10)(vi) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(vii)	Bank of Oak Ridge Second Amended and Restated Director Stock Option Plan (amended March 16, 2004; approved by stockholders June 8, 2004), incorporated herein by reference to Exhibit 10(ix) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(viii)	Bank of Oak Ridge Second Amended and Restated Employee Stock Option Plan (amended March 16, 2004; approved by stockholders June 8, 2004), incorporated herein by reference to Exhibit (10)(x) to the Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(ix)	Salary Continuation Agreements with Ronald O. Black, L. William Vasaly III and Thomas W. Wayne dated January 20, 2006, incorporated herein by reference to Exhibits (10)(ix) to Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(x)	Salary Continuation Agreements with L. William Vasaly III dated January 20, 2006, incorporated herein by reference to Exhibits (10)(x) to Form 8-K filed with the SEC on March 28, 2008.

Exhibit (10)(xi)	Salary Continuation Agreements with Thomas W. Wayne dated January 20, 2006, incorporated herein by reference to Exhibits (10)(xi) to Form 8-K filed with the SEC on March 28, 2008.
Exhibit (10)(xii)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and Ronald O. Black, incorporated herein by reference to Exhibit (10)(xiii) to the Form 8-K filed with the SEC on December 21, 2007.
Exhibit (10)(xiii)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and L. William Vasaly III, incorporated herein by reference to Exhibit (10)(xiv) to the Form 8-K filed with the SEC on December 21, 2007.
Exhibit (10)(xiv)	Amended Endorsement Split Dollar Agreement between Bank of Oak Ridge and Thomas W. Wayne, incorporated herein by reference to Exhibit (10)(xv) to the Form 8-K filed with the SEC on December 21, 2007.
Exhibit (10)(xv)	Indemnification Agreement, incorporated herein by reference to Exhibit (10)(xvi) to the Form 8-K filed with the SEC on March 7, 2008.
Exhibit (10)(xvi)	Contract for the Purchase and Sale of Real Property, incorporated herein by reference to Exhibit 99.1 to the Form 8-K filed with the SEC on January 14, 2008.
Exhibit (10)(xvii)	Oak Ridge Financial Services, Inc. Long-Term Stock Incentive Plan, incorporated herein by reference to Exhibit (10)(xiii) to the Form 10-QSB filed with the SEC on May 15, 2007.
Exhibit (10)(xviii)	Loan Agreement by and between Oak Ridge Financial Services, Inc. and Silverton Bank, National Association dated September 30, 2008, incorporated herein by reference to Exhibit (10)(xviii) to Form 8-K filed with the SEC on July 1, 2008.
Exhibit (10)(xix)	Stock Pledge Agreement by and between Oak Ridge Financial Services, Inc. and Silverton Bank, National Association dated September 30, 2008, incorporated herein by reference to Exhibit (10)(xix) to Form 8-K filed with the SEC on July 1, 2008.
Exhibit (31.1)	Certification of Ronald O. Black.
Exhibit (31.2)	Certification of Thomas W. Wayne.
Exhibit (32)	Certification of Periodic Financial Report Pursuant to 18 U.S.C. Section 1350.

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Oak Ridge Financial Services, Inc.

Signatures

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

	Oak Ridge Financial Services, Inc. (Registrant)
Date: November 4, 2008	/s/ Ronald O. Black Ronald O. Black President and Chief Executive Officer (Duly Authorized Representative)
Date: November 4, 2008	/s/ Thomas W. Wayne Thomas W. Wayne Chief Financial Officer (Duly Authorized Representative)

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Section 2: EX-31.(1) (SECTION 302 CEO CERTIFICATION)

Exhibit (31.1)

CERTIFICATIONS

I, **Ronald O. Black**, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Oak Ridge Financial Services, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Securities Exchange Act Rules 13(a) – 15(f) and 15(d)-15(f)) for the Registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: November 4, 2008

/s/ Ronald O. Black
Ronald O. Black
President and Chief Executive Officer

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Section 3: EX-31.(2) (SECTION 302 CFO CERTIFICATION)

Exhibit (31.2)

CERTIFICATIONS

I, **Thomas W. Wayne**, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Oak Ridge Financial Services, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Securities Exchange Act Rules 13(a) – 15(f) and 15(d)-15(f)) for the Registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: November 4, 2008

/s/ Thomas W. Wayne
Thomas W. Wayne
Chief Financial Officer

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Section 4: EX-32 (SECTION 906 CEO AND CFO CERTIFICATION)

Exhibit (32)

OAK RIDGE FINANCIAL SERVICES, INC.

Certification of Periodic Financial Report

Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officers of Oak Ridge Financial Services, Inc. (the "Company") certify that the Quarterly Report on Form 10-Q of the Company for the fiscal period ended September 30, 2008 fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and information contained in that Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 4, 2008	/s/ Ronald O. Black Ronald O. Black President and Chief Executive Officer
Date: November 4, 2008	/s/ Thomas W. Wayne Thomas W. Wayne Chief Financial Officer

* This certification is made solely for purpose of 18 U.S.C. Section 1350, subject to the knowledge standard contained therein, and not for any other purpose.

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