MetroCorp Bancshares, Inc.
Form 10-Q
August 09, 2011

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

FORM 10-Q

(Mark One)

þ	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 000-25141

MetroCorp Bancshares, Inc.
(Exact name of registrant as specified in its charter)

Texas	76-0579161
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9600 Bellaire Boulevard, Suite 252
Houston, Texas 77036
(Address of principal executive offices including zip code)

(713) 776-3876
(Registrant's telephone number, including area code)

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 R No £

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 R 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 definitions of "accelerated filer," "large 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 R

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

As of August 3, 2011, the number of outstanding shares of Common Stock was 13,331,815.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

METROCORP BANCSHARES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	June 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 21,925	$ 21,406
Federal funds sold and other short-term investments	147,211	130,319
Total cash and cash equivalents	169,136	151,725
Securities available-for-sale, at fair value	137,461	134,369
Securities available-for-sale pledged with creditors’ right to repledge, at fair value	36,248	41,337
Total securities available-for-sale	173,709	175,706
Securities held-to-maturity (fair value $4,270 and $4,167 at June 30, 2011 and December 31, 2010, respectively)	4,045	4,045
Other investments	6,705	6,925
Loans, net of allowance for loan losses of $30,393 and $33,757 at June 30, 2011 and December 31, 2010, respectively	1,034,774	1,110,553
Accrued interest receivable	4,254	4,682
Premises and equipment, net	4,881	5,377
Goodwill	17,327	17,327
Core deposit intangibles	159	202
Deferred tax asset, net	16,209	17,781
Customers' liability on acceptances	3,440	4,708
Foreclosed assets, net	15,814	19,956
Cash value of bank owned life insurance	30,713	29,988
Prepaid FDIC assessment	6,295	7,610
Other assets	3,484	2,000
Total assets	$ 1,490,945	$ 1,558,585
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 233,868	$ 223,105
Interest-bearing	1,006,934	1,071,079
Total deposits	1,240,802	1,294,184
Junior subordinated debentures	36,083	36,083
Other borrowings	36,352	56,804
Accrued interest payable	347	447
Acceptances outstanding	3,440	4,708
Other liabilities	10,299	7,592
Total liabilities	1,327,323	1,399,818
Commitments and contingencies	–	–
Shareholders' equity:		

Preferred stock, $1.00 par value, 2,000,000 shares authorized; 45,000 shares issued and outstanding at June 30, 2011 and December 31, 2010		45,498		45,427
Common stock, $1.00 par value, 50,000,000 shares authorized; 13,297,815 and 13,230,315 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively		13,298		13,230
Additional paid-in-capital		33,550		33,178
Retained earnings		72,447		69,168
Accumulated other comprehensive loss		(1,171)		(2,236)
Total shareholders' equity		163,622		158,767
Total liabilities and shareholders' equity	$	1,490,945	$	1,558,585

See accompanying notes to condensed consolidated financial statements

METROCORP BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended June 30, 2011	For the Three Months Ended June 30, 2010	For the Six Months Ended June 30, 2011	For the Six Months Ended June 30, 2010
Interest income:				
Loans	$ 15,330	$ 18,571	$ 31,332	$ 37,757
Securities:				
Taxable	1,160	823	2,388	1,613
Tax-exempt	99	118	197	239
Other investments	42	75	84	150
Federal funds sold and other short-term investments	106	102	187	158
Total interest income	16,737	19,689	34,188	39,917
Interest expense:				
Time deposits	1,974	3,201	4,200	6,547
Demand and savings deposits	927	1,475	1,847	3,096
Junior subordinated debentures	325	520	649	1,040
Subordinated debentures and other borrowings	263	272	544	511
Total interest expense	3,489	5,468	7,240	11,194
Net interest income	13,248	14,221	26,948	28,723
Provision for loan losses	1,245	2,430	1,575	10,328
Net interest income after provision for loan losses	12,003	11,791	25,373	18,395
Noninterest income:				
Service fees	1,034	1,123	2,090	2,162
Loan-related fees	82	119	179	214
Letters of credit commissions and fees	165	186	349	385
Gain (loss) on securities, net	(24)	59	(74)	45
Total other-than-temporary impairments (“OTTI”) on securities	(78)	(97)	(183)	(283)
Less: Noncredit portion of “OTTI”	(1)	(2)	(18)	(87)
Net impairments on securities	(77)	(95)	(165)	(196)
Other noninterest income	391	391	851	777
Total noninterest income	1,571	1,783	3,230	3,387
Noninterest expenses:				
Salaries and employee benefits	5,243	4,907	10,488	10,357
Occupancy and equipment	1,847	1,937	3,649	3,898
Foreclosed assets, net	844	3,442	1,519	4,279
FDIC assessment	523	779	1,384	1,590
Goodwill impairment	—	—	—	2,000
Other noninterest expense	1,566	2,118	4,746	4,089
Total noninterest expenses	10,023	13,183	21,786	26,213

Income (loss) before provision for income taxes	3,551	391	6,817	(4,431)
Provision (benefit) for income taxes	1,188	307	2,328	(1,137)
Net income (loss)	$ 2,363	$ 84	$ 4,489	$ (3,294)
Dividends and discount – preferred stock	(605)	(602)	(1,210)	(1,200)
Net income (loss) available to common shareholders	$ 1,758	$ (518)	$ 3,279	$ (4,494)
Earnings (loss) per common share:				
Basic	$ 0.13	$ (0.04)	$ 0.25	$ (0.39)
Diluted	$ 0.13	$ (0.04)	$ 0.25	$ (0.39)
Weighted average shares outstanding:				
Basic	13,142	11,874	13,139	11,399
Diluted	13,234	11,874	13,215	11,399
Dividends per common share	$ –	$ –	$ –	$ –

See accompanying notes to condensed consolidated financial statements

METROCORP BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	For the Three Months Ended June 30, 2011	For the Three Months Ended June 30, 2010	For the Six Months Ended June 30, 2011	For the Six Months Ended June 30, 2010
Net income (loss)	$ 2,363	$ 84	$ 4,489	$ (3,294)
Other comprehensive income (loss), net of taxes:				
Change in accumulated loss on effective cash flow hedging derivatives	(241)	(556)	(92)	(801)
Unrealized loss on investment securities, net:				
Securities with OTTI charges during the period	(50)	(62)	(117)	(181)
Less: OTTI charges recognized in net income	(49)	(61)	(105)	(126)
Net unrealized losses on investment securities with OTTI	(1)	(1)	(12)	(55)
Unrealized holding gain arising during the period	1,584	1,163	1,122	1,922
Less: reclassification adjustment for gain (loss) included in net income	(15)	38	(47)	29
Net unrealized gains on investment securities	1,599	1,125	1,169	1,893
Other comprehensive income	1,357	568	1,065	1,037
Total comprehensive income (loss)	$ 3,720	$ 652	$ 5,554	$ (2,257)

See accompanying notes to condensed consolidated financial statements

METROCORP BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Six Months Ended June 30, 2011
(In thousands)
(Unaudited)

	Preferred Stock		Common Stock		Additional paid-in capital	Retained earnings	Accumulated other compre-hensive income (loss)	Total
	Shares	Amount	Shares	Amount				
Balance at December 31, 2010	45	$ 45,427	13,230	$ 13,230	$ 33,178	$ 69,168	$ (2,236)	$ 158,767
Issuance of common stock	–	–	68	68	329	–	–	397
Stock-based compensation expense related to stock options recognized in earnings	–	–	–	–	43	–	–	43
Net income	–	–	–	–	–	4,489	–	4,489
Amortization of preferred stock discount	–	71	–	–	–	(71)	–	–
Other comprehensive income	–	–	–	–	–	–	1,065	1,065
Dividends – preferred stock	–	–	–	–	–	(1,139)	–	(1,139)
Balance at June 30, 2011	45	$ 45,498	13,298	$ 13,298	$ 33,550	$ 72,447	$ (1,171)	$ 163,622

See accompanying notes to condensed consolidated financial statements

METROCORP BANCSHARES, INC
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	For the Six Months Ended June 30, 2011	2010
Cash flows from operating activities:		
Net income (loss)	$ 4,489	$ (3,294)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	723	840
Provision for loan losses	1,575	10,328
Impairment on securities	165	196
Goodwill impairment	—	2,000
Gain (loss) on securities transactions, net	74	(45)
Loss on writedown and sale of foreclosed assets	698	2,454
Gain on sale of premises and equipment	—	(7)
Amortization of premiums and discounts on securities, net	39	(1)
Amortization of deferred loan fees and discounts	(576)	(635)
Amortization of core deposit intangibles	43	63
Stock-based compensation	43	117
Changes in:		
Accrued interest receivable	428	116
Other assets	425	(2,391)
Accrued interest payable	(100)	(42)
Other liabilities	2,614	1,956
Net cash provided by operating activities	10,640	11,655
Cash flows from investing activities:		
Purchases of securities available-for-sale	(35,922)	(67,308)
Purchases of securities held-to-maturity	—	—
Purchases of other investments	(1)	(47)
Proceeds from sales of securities available-for-sale	186	—
Proceeds from maturities, calls, and principal paydowns of securities available-for-sale	39,263	26,707
Proceeds from sales and maturities of other investments	221	4,386
Net change in loans	64,984	33,644
Proceeds from sale of foreclosed assets	13,240	13,593
Proceeds from sale of premises and equipment	—	9
Purchases of premises and equipment	(227)	(679)
Net cash provided by investing activities	81,744	10,305
Cash flows from financing activities:		
Net change in:		
Deposits	(53,382)	(7,248)
Other borrowings	(20,452)	31,508
Proceeds from issuance of common stock	—	4,037

Cash dividends paid on preferred stock		(1,139)		(561)
Net cash (used in) provided by financing activities		(74,973)		27,736
Net increase in cash and cash equivalents		17,411		49,696
Cash and cash equivalents at beginning of period		151,725		108,093
Cash and cash equivalents at end of period	$	169,136	$	157,789
Supplemental information:				
Interest paid	$	7,340	$	11,235
Income taxes paid		692		2,000
Noncash investing and financing activities:				
Issuance of common stock pursuant to incentive plan		397		322
Foreclosed assets acquired		9,796		12,239
Loans originated to finance foreclosed assets		2,676		3,505

See accompanying notes to condensed consolidated financial statements

6

METROCORP BANCSHARES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements include the accounts of MetroCorp Bancshares, Inc. (the "Company") and wholly-owned subsidiaries, MetroBank, National Association ("MetroBank") and Metro United Bank ("Metro United"), in Texas and California, respectively (collectively, the "Banks"). MetroBank is engaged in commercial banking activities through its thirteen branches in the greater Houston and Dallas, Texas metropolitan areas, and Metro United is engaged in commercial banking activities through its six branches in the San Diego, Los Angeles and San Francisco, California metropolitan areas. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain principles which significantly affect the determination of financial position, results of operations and cash flows are summarized below.

A legal entity is referred to as a Variable Interest Entity ("VIE") if any of the following conditions exist: (1) the total equity at risk is insufficient to permit the legal entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors that cannot make significant decisions about the entity's operations or that do not absorb their proportionate share of the expected losses or receive the expected returns of the entity. In addition, as specified in VIE accounting guidance, a VIE must be consolidated by the Company if it is deemed to be the primary beneficiary of the VIE. The primary beneficiary is the party that has both (1) the power to direct the activities of an entity that most significantly impact the VIE's economic performance, and (2) through its interests in the VIE, the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. All facts and circumstances are taken into consideration when determining whether the Company has variable interest that would deem it the primary beneficiary and, therefore, require consolidation of the related VIE or otherwise rise to the level where disclosure would provide useful information to the users of the Company's financial statements. In the case of the Company's sole VIE, MCBI Statutory Trust I, it is qualitatively clear based on the extent of the Company's involvement that the Company is not the primary beneficiary of the VIE. Accordingly, the accounts of this entity are not consolidated in the Company's financial statements.

The accompanying unaudited condensed consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal and recurring adjustments, necessary for a fair statement of the Company's financial position at June 30, 2011, results of operations for the three and six months ended June 30, 2011 and 2010, and cash flows for the six months ended June 30, 2011 and 2010. Interim period results are not necessarily indicative of results for a full year period. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles.

These unaudited financial statements and the notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

2. SECURITIES

The amortized cost and approximate fair value of securities is as follows:

	As of June 30, 2011				
	Amortized Cost	Unrealized Gains	Losses	OTTI	Fair Value
Securities available-for-sale			(In thousands)		
Debt Securities					
U.S. Treasury and other U.S. government corporations and agencies	$ 104,903	$ 165	$ (593)	$	$ 104,475
Obligations of state and political subdivisions	4,352	108			4,460
Mortgage-backed securities and collateralized mortgage obligations					
Government issued or guaranteed	49,896	645	(78)		50,463
Privately issued residential	1,081	311	(27)	(465)	900
Asset backed securities	263	57		(192)	128
Equity Securities					
Investment in CRA funds	13,417		(134)		13,283
Total available-for-sale securities	$ 173,912	$ 1,286	$ (832)	$ (657)	$ 173,709
Securities held-to-maturity					
Obligations of state and political subdivisions	$ 4,045	$ 225	$	$	$ 4,270
Total held-to-maturity securities	$ 4,045	$ 225	$	$	$ 4,270
Other investments					
FHLB/Federal Reserve Bank stock (1)	$ 5,622	$	$	$	$ 5,622
Investment in subsidiary trust (1)	1,083				1,083
Total other investments	$ 6,705	$	$	$	$ 6,705

	As of December 31, 2010				
	Amortized Cost	Gains	Unrealized Losses	OTTI	Fair Value
			(In thousands)		
Securities available-for-sale					
Debt Securities					
U.S. Treasury and other U.S. government corporations and agencies	$ 112,959	$ 196	$ (1,554)	$	$ 111,601
Obligations of state and political subdivisions	4,356	57	(42)		4,371
Mortgage-backed securities and collateralized mortgage obligations					
Government issued or guaranteed	45,285	476	(377)		45,384
Privately issued residential	1,564	289	(65)	(558)	1,230
Asset backed securities	342	67		(231)	178
Equity Securities					
Investment in CRA funds	13,210		(268)		12,942
Total available-for-sale securities	$ 177,716	$ 1,085	$ (2,306)	$ (789)	$ 175,706
Securities held-to-maturity					
Obligations of state and political subdivisions	$ 4,045	$ 122	$	$	$ 4,167
Total held-to-maturity securities	$ 4,045	$ 122	$	$	$ 4,167
Other investments					
FHLB/Federal Reserve Bank stock (1)	$ 5,842	$	$	$	$ 5,842
Investment in subsidiary trust (1)	1,083				1,083
Total other investments	$ 6,925	$	$	$	$ 6,925

(1) Represents securities with restrictions and limited marketability and are carried at cost.

The following table displays the gross unrealized losses and fair value of securities available-for-sale as of June 30, 2011 for which other-than-temporary impairments ("OTTI") have not been recognized, that were in a continuous unrealized loss position for the periods indicated. There were no securities held-to-maturity in a continuous unrealized loss position as of June 30, 2011 or December 31, 2010.

	June 30, 2011					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)					
Securities available-for-sale						
Debt securities						
U.S. Treasury and other U.S. government corporations and agencies	$ 68,057	$ (593)	$ -	$ -	$ 68,057	$ (593)
Mortgage-backed securities and collateralized mortgage obligations						
Government issued or guaranteed	12,281	(78)	-	-	12,281	(78)
Privately issued residential	-	-	230	(27)	230	(27)
Equity Securities						
Investment in CRA funds	13,283	(134)	-	-	13,283	(134)
Total available-for-sale securities	$ 93,621	$ (805)	$ 230	$ (27)	$ 93,851	$ (832)

	December 31, 2010					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)					
Securities available-for-sale						
Debt securities						
U.S. Treasury and other U.S. government corporations and agencies	$ 77,784	$ (1,554)	$	$	$ 77,784	$ (1,554)
Obligations of state and political subdivisions	2,220	(42)			2,220	(42)
Mortgage-backed securities and collateralized mortgage obligations						
Government issued or guaranteed	22,674	(377)			22,674	(377)
Privately issued residential			398	(65)	398	(65)
Equity Securities						
Investment in CRA funds	12,942	(268)			12,942	(268)

Total available-for-sale securities	$	115,620	$	(2,241	)	$	398		$	(65	)	$	116,018	$	(2,306	)

As of June 30, 2011, management does not have the intent to sell any of the securities classified as available-for-sale in the table above and believes it is not more likely than not that the Company will have to sell any such securities before a recovery of the cost. The unrealized losses are largely due to price declines in privately issued mortgage securities related to overall market weakness in the real estate sector. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such securities decline. Management does not believe that any of the unrealized losses above are due to credit quality. Accordingly, management believes the $832,000 of gross unrealized losses is temporary and the remaining $657,000 of OTTI represents an unrealized loss for which an impairment has been recognized in other comprehensive loss.

Other-Than-Temporary Impairments (OTTI)

The following table presents a rollforward for the three and six months ended June 30, 2011, of the credit loss component of OTTI losses that have been recognized in income related to debt securities that the Company does not intend to sell.

	Impairment related to credit losses	
	Three months ended June 30, 2011	Six months ended June 30, 2011
	(In thousands)	
Credit losses at beginning of period	$ 1,489	$ 1,600
Addition of OTTI that was not previously recognized	-	-
Additions to OTTI that were previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	18	18
Transfers from accumulated other comprehensive income to OTTI related to credit losses	59	147
Reclassifications from OTTI to realized losses on sales of securities	(2)	(201)
Credit losses at end of period	$ 1,564	$ 1,564

For the six months ended June 30, 2011, credit-related losses of $132,000 on 11 non-agency residential mortgage-backed securities and $33,000 on two asset-backed securities were recognized. To measure credit losses, external credit ratings and other relevant collateral details and performance statistics on a security-by-security basis were considered. Securities exhibiting significant deterioration are subjected to further analysis. Assumptions were developed for prepayment speed, default rate, and loss severity for each security using third party sources and based on the collateral history. The resulting projections of future cash flows of the underlying collateral were then discounted by the underlying yield before any write-downs were considered to determine the net present value of the cash flows (“NPV”). The difference between the cost basis and the NPV was taken as a credit loss in the current period to the extent that these losses have not been previously recognized. The difference between the NPV and the quoted market price is considered a noncredit related loss and was included in other comprehensive loss.

Other Securities Information

The following sets forth information concerning sales (excluding calls and maturities) of available-for-sale securities (in thousands). There were no sales or transfers of held-to-maturity securities.

	Six Months Ended June 30,	
	2011	2010
Amortized cost	$ 292	$ —
Proceeds	186	—
Gross realized gains	—	—
Gross realized losses	(105)	—

At June 30, 2011, future contractual maturities of debt securities were as follows (in thousands):

Securities Securities

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$ 498	$ 504	$ —	$ —
Within two to five years	25,559	25,533	—	—
Within six to ten years	80,438	80,070	—	—
After ten years	3,023	2,956	4,045	4,270
Mortgage-backed securities and collateralized mortgage obligations	50,977	51,363	—	—
Total debt securities	$ 160,495	$ 160,426	$ 4,045	$ 4,270

The Company holds mortgage-backed securities which may mature at an earlier date than the contractual maturity due to prepayments. The Company also holds certain securities which may be called by the issuer at an earlier date than the contractual maturity date.

3. LOANS

The loan portfolio is classified by major type as follows:

	As of June 30, 2011		As of December 31, 2010	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial and industrial	$ 334,489	31.35%	$ 349,891	30.52%
Real estate mortgage				
Residential	40,498	3.80	38,667	3.37
Commercial	681,406	63.86	718,795	62.69
	721,904	67.66	757,462	66.06
Real estate construction				
Residential	6,700	0.62	10,983	0.96
Commercial	-	0.00	24,291	2.12
	6,700	0.62	35,274	3.08
Consumer and other	3,943	0.37	3,928	0.34
Gross loans	1,067,036	100.00%	1,146,555	100.00%
Unearned discounts, interest and deferred fees	(1,869)		(2,245)	
Total loans	1,065,167		1,144,310	
Allowance for loan losses	(30,393)		(33,757)	
Loans, net	$ 1,034,774		$ 1,110,553	

The recorded investment in loans is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, or finance charges, and may also reflect a previous direct write-down of the loan.

The recorded investment in loans at the dates indicated is determined as follows (in thousands):

June 30, 2011	Gross Loan Balance	Deferred Loan Fees	Accrued Interest Receivable	Recorded Investment in Loans
Commercial and industrial	$334,489	$(881)	$ 1,038	$ 334,646
Real estate-mortgage	721,904	(984)	2,391	723,311
Real estate-construction	6,700	(4)	21	6,717
Consumer and other	3,943	-	8	3,951
Total	$1,067,036	$(1,869)	$ 3,458	$ 1,068,625

December 31, 2010	Gross Loan Balance	Deferred Loan Fees	Accrued Interest Receivable	Recorded Investment in Loans
Commercial and industrial	$ 349,891	$ (932)	$ 1,116	$ 350,075
Real estate-mortgage	757,462	(1,091)	2,653	759,024
Real estate-construction	35,274	(21)	94	35,347
Consumer and other	3,928	(201)	8	3,735

Total	$ 1,146,555	$ (2,245)	$ 3,871	$ 1,148,181

Loan Origination/Risk Management

The Company selectively extends credit for the purpose of establishing long-term relationships with its customers. The Company mitigates the risks inherent in lending by focusing on businesses and individuals with demonstrated payment history, historically favorable profitability trends and stable cash flows. In addition to these primary sources of repayment, the Company looks to tangible collateral and personal guarantees as secondary sources of repayment. Lending officers are provided with detailed underwriting policies covering all lending activities in which the Company is engaged and that require all lenders to obtain appropriate approvals for the extension of credit. The Company also maintains documentation requirements and extensive credit quality assurance practices in order to identify credit portfolio weaknesses as early as possible so any exposures that are discovered may be reduced.

The Company has certain lending procedures in place that are designed to maximize loan income within an acceptable level of risk. These procedures include the approval of lending policies and underwriting guidelines by the Board of Directors of each bank, and separate policy, administrative and approval oversight by the Directors' Loan Committee of MetroBank, and by the Directors' Credit Committee of Metro United. Additionally, MetroBank's loan portfolio is reviewed by its internal loan review department, and Metro United's loan portfolio is reviewed by an external third-party company. These procedures also serve to identify changes in asset quality in a timely manner and to ensure proper recording and reporting of nonperforming assets.

Inherent in all lending is the risk of nonpayment. The types of collateral required, the terms of the loans and the underwriting practices discussed under each loan category below are all designed to minimize the risk of nonpayment. In addition, as further risk protection, the Banks rarely make loans at their respective legal lending limits. MetroBank generally does not make loans larger than $12 million to one borrower and Metro United generally does not make loans larger than $6 million to one borrower. Loans greater than the Banks' lending limits are subject to participation with other financial institutions, including with each other. Loans originated by MetroBank are approved by the Chief Credit Officer, Chief Lending Officer, Senior Credit Officer, MetroBank's Loan Committee, or the Director's Credit Committee based on the size of the loan relationship and its risk rating. Loans originated by Metro United are approved by the Director's Credit Committee except for certain consumer loans. Control systems and procedures are in place to ensure all loans are approved in accordance with credit policies. The Company also uses interest rate floors on a majority of its variable rate loans to control interest rate risk within the commercial and real estate loan portfolios.

Commercial and Industrial Loans. Generally, the Company's commercial loans are underwritten on the basis of the borrower's ability to service such debt as reflected by cash flow projections. Commercial loans are generally collateralized by business assets, which may include real estate, accounts receivable and inventory, certificates of deposit, securities, guarantees or other collateral. The Company also generally obtains personal guarantees from the principals of the business. Working capital loans are primarily collateralized by short-term assets, whereas term loans are primarily collateralized by long-term assets. As a result, commercial loans involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans. Indigenous to individuals in the Asian business community is the desire to own the building and land which house their businesses. Accordingly, while a loan may be principally driven and classified by the type of business operated, real estate is frequently the primary source of collateral.

Real Estate Mortgage - Commercial and Residential Mortgage Loans. The Company makes commercial mortgage loans to finance the purchase of real property, which generally consists of developed real estate. The Company's commercial mortgage loans are collateralized by first liens on real estate. For MetroBank, these loans typically have variable rates and amortize over a 15 to 20 year period, with balloon payments due at the end of five to seven years. For Metro United, these loans have both variable and fixed rates and amortize over a 25 to 30 year period, with balloon payments due at the end of five to ten years. Payments on loans collateralized by such properties are dependent on the successful operation or management of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. In underwriting commercial mortgage loans, consideration is given to the property's historical cash flow, current and projected occupancy, location and physical condition. The underwriting analysis also includes credit checks, appraisals, environmental impact reports and a review of the financial condition of the borrower. The Company also originates two to seven year balloon residential mortgage loans with a 15 to 30-year amortization primarily collateralized by owner occupied residential properties, which are retained in the Company's residential mortgage portfolio.

Real Estate Construction Loans. The Company makes loans to finance the construction of residential and non-residential properties. The majority of the Company's residential construction loans in Texas are for single-family dwellings that are pre-sold or are under earnest money contracts. The Company also originates loans to finance the construction of commercial properties such as multi-family, office, industrial, warehouse and retail centers. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover the entire unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminable period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Consumer Loans. The Company, through its subsidiary Metro United, offers a wide variety of loan products to retail customers through its branch network. Loans to retail customers include automobile loans, lines of credit and other personal loans. The terms of these loans typically range from 12 to 60 months depending on the nature of the collateral and the size of the loan.

Loan review process. In addition to MetroBank's loan portfolio review by its internal loan review department and Metro United's loan portfolio review by an external third-party company, other ongoing reviews are performed by loan officers and involves the grading of each loan by its respective loan officer. Depending on the grade, a loan will be aggregated with other loans of similar grade and a loss factor is applied to the total loans in each group to establish the required level of allowance for loan losses. For both Banks, grades of 1-10 are applied to each loan, with loans graded 7-10 requiring the most allowance for loan losses. Factors utilized in the grading process include but are not limited to historical performance, payment status, collateral value, and financial strength of the borrower. Oversight of the loan review process is the responsibility of the Loan Review/Compliance Officer. Differences of opinion are resolved among the loan officer, compliance officer, and the Chief Credit Officer. See "Allowance for Loan Losses and Reserve for Unfunded Lending Commitments" for additional discussion on loan grades.

MetroBank's credit department reports credit risk grade changes on a monthly basis to its management and the Board of Directors. MetroBank and Metro United perform monthly and quarterly concentration analyses based on industries, collateral types and business lines. Findings are reported to the Director's Loan Committee of MetroBank and the Directors' Credit Committee of Metro United. Loan concentration reports based on type are prepared, monitored and reviewed quarterly and presented to the Directors' Loan Committee for MetroBank, the Directors' Credit Committee for Metro United and the Board of Directors of each respective bank.

In addition, the Company reviews the real estate values, and when necessary, orders new appraisals on loans collateralized by real estate when loans are renewed, prior to foreclosure and at other times as necessary, particularly in problem loan situations. In instances where updated appraisals reflect reduced collateral values, an evaluation of the borrower's overall financial condition is made to determine the need, if any, for possible charge-offs or appropriate additions to the allowance for loan losses. The Company records other real estate at fair value at the time of acquisition less estimated costs to sell.

The following table presents the recorded investment in loans by credit risk profile, and which were updated as of the date indicated (in thousands):

As of June 30, 2011	Commercial and industrial	Real estate-mortgage	Real estate - construction	Consumer and other	Total
Grade:					
1-6 - "Pass"	$292,820	$ 566,898	$2,447	$3,950	$ 866,115
7 - "Special Mention"/ "Watch"	5,699	22,112	-	-	27,811
8 - "Substandard"	36,127	134,077	4,270	1	174,475
9 -"Doubtful"	-	224	-	-	224
Total	$334,646	$ 723,311	$6,717	$3,951	$ 1,068,625

As of December 31, 2010	Commercial and industrial	Real estate-mortgage	Real estate - construction	Consumer and other	Total

Grade:					
1-6 - “Pass”	$ 301,919	$ 563,003	$ 12,831	$ 3,732	$ 881,485
7 - “Special Mention”/ “Watch”	8,063	45,776	3,536	-	57,375
8 - “Substandard”	40,093	149,988	18,980	3	209,064
9 -“Doubtful"	-	257	-	-	257
Total	$ 350,075	$ 759,024	$ 35,347	$ 3,735	$ 1,148,181

There can be no assurance, however, that the Company’s loan portfolio will not become subject to increasing pressures from deteriorating borrowers’ financial condition due to general economic and other factors. While future deterioration in the loan portfolio is possible, management is continuing its risk assessment and resolution program. In addition, management is focusing its attention on minimizing the Company’s credit risk through diversification.

Nonperforming Assets

The Company generally places a loan on nonaccrual status and ceases accruing interest when, in the opinion of management, full payment of loan principal or interest is in doubt. All loans past due 90 days are placed on nonaccrual status unless the loan is both well collateralized and in the process of collection. Cash payments received while a loan is classified as nonaccrual are recorded as a reduction of principal as long as significant doubt exists as to collection of the principal. Loans are restored to accrual status only when interest and principal payments are brought current and, in management's judgment, future payments are reasonably assured. In addition to nonaccrual loans, the Company evaluates on an ongoing basis other loans which are potential problem loans as to risk exposure in determining the adequacy of the allowance for loan losses.

A loan is considered impaired based on current information and events if 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. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual basis for other loans. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price or based on the fair value of the collateral if the loan is collateral-dependent.

Loans are classified as a troubled debt restructuring in cases where a borrower is experiencing financial difficulty and the Banks make concessionary modifications to contractual terms. Restructured loans typically involve a modification of terms such as a reduction of the stated interest rate and/or an extension of the maturity date(s). Generally, a nonaccrual loan that is restructured remains on nonaccrual for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. Once performance has been demonstrated the loan may be returned to performing status after the calendar year end.

The Company requires that nonperforming assets be monitored by the special assets department or senior lenders for MetroBank, and the special asset team consisting of internal credit personnel with the assistance of third party consultants and attorneys for Metro United. All nonperforming assets are actively managed pursuant to the Company's loan policy. Senior management is apprised on a weekly basis of the workout endeavors and provides assistance as necessary to determine the best strategy for problem loan resolution and maximizing repayment on nonperforming assets.

In addition to the Banks' loan review process described in the preceding paragraphs, the Office of the Comptroller of the Currency ("OCC") periodically examines and evaluates MetroBank, while the Federal Deposit Insurance Corporation ("FDIC") and California Department of Financial Institutions ("CDFI") periodically examine and evaluate Metro United. Based upon such examinations, the regulators may revalue the assets of the institution and require that it charge-off certain assets, establish specific reserves to compensate for the difference between the regulators-determined value and the book value of such assets or take other regulatory action designed to lessen the risk in the asset portfolio.

The following table provides an analysis of the age of the recorded investment in loans by portfolio segment at the date indicated (in thousands):

As of June 30, 2011	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Recorded Investment in Loans	Recorded Investment 90 Days and Accruing

Commercial and industrial	$2,177	$2,945	$11,942	$17,064	$317,582	$334,646	$ -
Real estate mortgage:							
Residential	-	15	5,838	5,853	34,720	40,573	-
Commercial	5,479	5,862	15,485	26,826	655,912	682,738	126
Real estate construction:							
Residential	-	-	-	-	6,717	6,717	-
Commercial	-	-	-	-	-	-	-
Consumer and other	6	11	-	17	3,934	3,951	-
Total	$7,662	$8,833	$33,265	$49,760	$1,018,865	$1,068,625	$ 126

15

The following table presents the recorded investment in nonaccrual loans, including nonaccruing troubled debt restructurings, by portfolio segment at the dates indicated (in thousands):

Recorded investment in nonaccrual loans	June 30, 2011	December 31, 2010
Commercial and industrial	$15,864	$ 16,614
Real estate mortgage:		
Residential	266	286
Commercial	44,889	48,592
Real estate construction:		
Residential	—	196
Commercial	—	5,193
Consumer and other	—	3
Total	$ 61,019	$ 70,884

The following table presents information regarding nonperforming assets at the dates indicated (in thousands):

	June 30, 2011	December 31, 2010
Nonaccrual loans (1)	$39,628	$ 50,985
Accruing loans 90 days or more past due (1)	121	334
Troubled debt restructurings – accruing (1)	132	1,314
Troubled debt restructurings – nonaccruing (1)	21,534	20,198
Other real estate (“ORE”)	15,814	19,956
Total nonperforming assets	$77,229	$ 92,787

(1) Represents the unpaid principal balance.

Information on impaired loans, which includes nonaccrual loans and troubled debt restructurings, and the related specific allowance for loan losses on such loans at June 30, 2011 and December 31, 2010, is presented below (in thousands):

As of June 30, 2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
Impaired loans with no allowance				
Commercial and industrial	$ 9,697	$ 9,738	$ —	$ 15,073
Real estate mortgage:				
Residential	266	266	—	278
Commercial	30,765	30,821	—	35,035
Real estate construction:				
Residential	—	—	—	98
Commercial	—	—	—	2,848
Impaired loans with an allowance				

Commercial and industrial	$ 6,299	$ 6,305	$ 462	$ 1,749
Real estate mortgage:				
Residential	—	—	—	—
Commercial	14,124	14,164	794	11,390
Real estate construction:				
Residential	—	—	—	—
Commercial	—	—	—	—
Total:				
Commercial and industrial	$ 15,996	$ 16,043	$ 462	$ 16,822
Real estate mortgage	45,155	45,251	794	46,703
Real estate construction	—	—	—	2,946

16

As of December 31, 2010	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
Impaired loans with no allowance				
Commercial and industrial	$ 17,940	$ 18,004	$ —	$ 14,385
Real estate mortgage:				
Residential	286	286	—	265
Commercial	41,012	41,093	—	31,663
Real estate construction:				
Residential	197	197	—	2,279
Commercial	5,205	5,213	—	6,330
Impaired loans with an allowance				
Commercial and industrial	$ 98	$ 98	$ 57	$ 1,037
Real estate mortgage:				
Residential	—	—	—	—
Commercial	7,581	7,606	483	13,713
Real estate construction:				
Residential	—	—	—	238
Commercial	—	—	—	828
Total:				
Commercial and industrial	$ 18,038	$ 18,102	$ 57	$ 15,422
Real estate mortgage	48,879	48,985	483	45,641
Real estate construction	5,402	5,410	—	9,675

For the six months ended June 30, 2011 and 2010, interest income of $96,000 and $201,000 was recognized on impaired loans, which consisted of nonaccrual loans that were paid in full and accruing TDRs.

Allowance for Loan Losses and Reserve for Unfunded Lending Commitments

The allowance for loan losses provides for the risk of losses inherent in the lending process and the Company allocates the allowance for loan losses according to management's assessments of risk inherent in the portfolio. The allowance for loan losses is increased by provisions charged against current earnings and is reduced by net charge-offs. Loans are charged off when they are deemed to be uncollectible in whole or in part. Recoveries are recorded when cash payments are received. In developing the assessment, the Company relies on estimates and exercises judgment regarding matters where the ultimate outcome is uncertain. Circumstances may change and future assessments of credit risk may yield materially different results, resulting in an increase or decrease in the allowance for credit losses.

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments and is maintained at levels that the Company believes are adequate to absorb probable losses inherent in the loan portfolio and unfunded lending commitments as of the date of the financial statements. The Company employs a systematic methodology for determining the allowance for credit losses that consists of four components: (1) a formula-based general reserve based on historical average losses by loan grade and grade migration, (2) specific reserves on larger impaired individual credits that are based on the difference between the current loan balance and the loan's collateral value, observable market price, or discounted present value, (3) a qualitative component that reflects current market conditions and other factors precedent to losses different from historical averages, and (4) a reserve for unfunded lending commitments.

In setting the qualitative reserve portion of the allowance for loan losses, the factors the Company may consider include, but are not limited to, concentrations of credit, common characteristics of known problem loans, potential problem loans and other loans that exhibit weaknesses or deterioration, the general economic environment in the Company's markets as well as the national economy, particularly the real estate markets, changes in value of the collateral securing loans, results of portfolio stress tests, and changes in lending processes, procedures and personnel. After the aforementioned assessment of the loan portfolio, the general economic environment and other relevant factors, management determines the appropriate allowance for loan loss level and makes the provision necessary to achieve that level. This methodology is consistently followed so that the level of the allowance for loan losses is reevaluated on an ongoing basis in response to changes in circumstances, economic conditions or other factors.

The Company follows a loan review program to evaluate the credit risk in the loan portfolio as discussed under "Nonperforming Assets." Through the loan review process, the Company maintains an internally classified loan list which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans classified as "substandard" are risk-rated as grade 8, and are those loans with well-defined weaknesses such as a highly-leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition, which may jeopardize recoverability of the debt. Loans classified as "doubtful" are risk-rated as grade 9, and are those loans which have characteristics similar to substandard loans but with an increased risk that a loss may occur, or at least a portion of the loan may require a charge-off if liquidated at present. Although loans classified as substandard do not duplicate loans classified as doubtful, both substandard and doubtful loans include some loans that are delinquent at least 30 days or on nonaccrual status. Loans classified as "loss" are risk-rated as grade 10 and are those loans which are charged off.

In addition to the internally classified loan list and delinquency list of loans, the Company maintains a separate "watch list" for loans risk-rated as grade 7, which further aids the Company in monitoring loan portfolios. Watch list loans show potential weaknesses where the present status portrays one or more deficiencies that require attention in the short-term or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted. These loans do not have all of the characteristics of a classified loan (substandard or doubtful) but do show weakened elements compared with those of a satisfactory credit. The Company reviews these loans to assist in assessing the adequacy of the allowance for loan losses.

Policies and procedures have been developed to assess the adequacy of the allowance for loan losses and the reserve for unfunded lending commitments that include the monitoring of qualitative and quantitative trends described above. Management of both banks review and approve their respective allowance for loan losses and the reserve for unfunded lending commitments monthly and perform a comprehensive analysis quarterly, which is also presented for approval by each bank's Board of Directors. The allowance for credit losses is also subject to federal and California State banking regulations. The Banks' primary regulators conduct periodic examinations of the allowance for credit losses and make assessments regarding its adequacy and the methodology used in its determination.

The Company maintains a reserve for unfunded commitments to provide for the risk of loss inherent in its unfunded lending related commitments. The process used in determining the reserve is consistent with the process used for the allowance for loan losses discussed above.

The following table presents the allowance for loan losses and recorded investment in loans by portfolio segment at the date indicated (in thousands):

As of and for the three months ended June 30, 2011	Commercial and industrial	Real estate-mortgage	Real estate - construction	Consumer and other	Unallocated	Total
Allowance for loan losses at beginning of period	$ 8,218	$ 20,668	$ 1,012	$ 247	$ 1,738	$ 31,883
Provision for loan losses	1,282	286	(522)	(88)	287	1,245
Charge-offs	(2,493)	(418)	—	(10)	—	(2,921)
Recoveries	129	54	—	3	—	186
Allowance for loan losses at end of period	$ 7,136	$ 20,590	$ 490	$ 152	$ 2,025	$ 30,393
Ending allowance for loan losses balance for loans individually evaluated for impairment	$ 462	$ 794	$ —	$ —		$ 1,256
Ending allowance for loan losses balance for loans collectively evaluated for impairment	$ 6,674	$ 19,796	$ 490	$ 152		$ 27,112
Loans:						
Recorded investment in loans	$ 334,646	$ 723,311	$ 6,717	$ 3,951		$ 1,068,625
Recorded investment in loans individually evaluated for impairment	$ 15,996	$ 45,154	$ —	$ —		$ 61,150
Recorded investment in loans collectively evaluated for impairment	$ 318,650	$ 678,157	$ 6,717	$ 3,951		$ 1,007,475

As of and for the six months ended June 30, 2011	Commercial and industrial	Real estate-mortgage	Real estate - construction	Consumer and other	Unallocated	Total
Allowance for loan losses at beginning of period	$ 8,187	$ 22,016	$ 1,993	$ 194	$ 1,367	$ 33,757
Provision for loan losses	1,339	1,832	(2,219)	(35)	658	1,575
Charge-offs	(2,625)	(3,323)	—	(31)	—	(5,979)
Recoveries	235	65	716	24	—	1,040
Allowance for loan losses at end of period	$ 7,136	$ 20,590	$ 490	$ 152	$ 2,025	$ 30,393
Ending allowance for loan losses balance for loans individually evaluated for impairment	$ 462	$ 794	$ —	$ —		$ 1,256
Ending allowance for loan losses balance for loans collectively evaluated for impairment	$ 6,674	$ 19,796	$ 490	$ 152		$ 27,112
Loans:						
Recorded investment in loans	$ 334,646	$ 723,311	$ 6,717	$ 3,951		$ 1,068,625
Recorded investment in loans individually evaluated for impairment	$ 15,996	$ 45,154	$ —	$ —		$ 61,150
Recorded investment in loans collectively evaluated for impairment	$ 318,650	$ 678,157	$ 6,717	$ 3,951		$ 1,007,475

Changes in the allowance for loan losses and unfunded lending commitments as of and for the three and six months ended June 30, 2010 are as follows:

	As of and for the three months ended June 30, 2010	As of and for the six months ended June 30, 2010
	(Dollars in thousands)	
Allowance for loan losses at beginning of period	$34,732	$29,403
Provision for loan losses	2,430	10,328
Charge-offs	(1,492)	(4,285)
Recoveries	334	558
Allowance for loan losses at end of period	36,004	36,004
Reserve for unfunded lending commitments at beginning of period	988	1,043

Provision for unfunded lending commitments	(166)	(221)
Reserve for unfunded lending commitments at end of period	822	822
Allowance for credit losses	$36,826	$36,826

4. GOODWILL

Changes in the carrying amount of the Company's goodwill for the periods indicated below were as follows (in thousands):

	As of and for the six months ended June 30, 2011	As of and for the year ended December 31, 2010
Balance as of January 1		
Goodwill	$ 17,327	$ 21,827
Accumulated impairment losses	—	(2,500)
	17,327	19,327
Impairment losses	—	(2,000)
Balance as of end of period	$ 17,327	$ 17,327
Accumulated impairment losses	$ (4,500)	$ (4,500)

Goodwill is recorded on the acquisition date of each entity, and evaluated annually for possible impairment. Goodwill is required to be tested for impairment on an annual basis or as events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company's only reporting unit with assigned goodwill is Metro United.

Annual Evaluation

The Company completed its 2010 annual impairment testing based on information as of August 31, 2010. The review utilized guideline company and guideline transaction information where available, discounted cash flow analysis, and quoted stock prices for the Company and guideline banks to estimate the fair value of Metro United.

Due to the staleness of the bank transaction multiples and fluctuations in market capitalization of peer banks used in the market methods, management relied primarily on the income approach for the step one evaluation. The Company also performed a reconciliation of the estimated fair value to the stock price of the Company. Because the step-one impairment test failed, the Company performed the step-two analysis to derive the implied fair value of goodwill.

Under the step-two analysis, the implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. The fair value of Metro United's assets and liabilities, including unrecognized intangible assets, is individually evaluated. The excess of the fair value of Metro United over the fair value of its net assets is the implied fair value of goodwill. The Company estimated the fair value of Metro United's assets and liabilities, including previously unrecognized intangible assets, through a variety of valuation techniques that incorporated interest rates, credit or nonperformance risk, as well as market risk adjustments that are indicative of the current economic environment. The estimated values are based on an exit price and reflect management's expectations regarding how a market participant would value the assets and liabilities. The implied goodwill was significantly affected by the estimated fair value of the loans pertaining to Metro United and the Company's stock price. The significant market risk adjustment that is a consequence of the current distressed market conditions was a significant contributor to the valuation discounts associated with these loans. To the extent that market liquidity returns and the fair value of the individual assets or loans of Metro United increases at a faster rate than the fair value of Metro United as a whole, that may cause the implied goodwill to be lower than the carrying value of goodwill. Future potential changes in valuation assumptions may also impact the estimated fair value of Metro United, therefore resulting in additional impairment of the goodwill.

In the step-two analysis, the estimated implied fair value of Metro United goodwill as of August 31, 2010 exceeded its respective carrying value; therefore, the Company determined there was no impairment of goodwill as of that date.

Second Quarter Evaluation

As of June 30, 2011, the Company's stock price, although improved significantly since the first quarter of 2011, had continued to trade below the book value per share; therefore, an additional goodwill impairment test was done.

The review utilized guideline company and guideline transaction information where available, discounted cash flow analysis, and quoted stock prices for the Company and guideline banks to estimate the fair value of Metro United. Under the discounted cash flow method, the Company used an average growth rate of 8.4% for the five-year period and discounted Metro United's terminal value using a 10% rate of return. The Company also performed a sensitivity analysis utilizing additional discount rates ranging from 8% to 15%. An 8% discount rate indicated a fair value that was $12.8 million greater than carrying value, an 11% discount rate indicated that fair value and carrying value were approximately equal, and a 15% discount rate indicated a fair value that was $7.5 million less than the carrying value.

The Company also considered the fair value of Metro United in relation to the Company's stock price and performed a reconciliation to the market price, which was performed by first using the Company's market price on a minority basis with an estimated control premium of 30%. The Company then allocated the total fair value to both of its reporting units, MetroBank and Metro United.

The derived fair value of Metro United was compared with the carrying value of its equity. The fair value at the evaluation date exceeded the carrying value, therefore the Company determined there was no impairment of goodwill as of that date.

Goodwill impairment if any is a noncash adjustment to the Company's financial statements. As goodwill and other intangible assets are not included in the calculation of regulatory capital, the Company's well capitalized regulatory ratios are not affected. Subsequent reversal of goodwill impairment is prohibited.

5. EARNINGS PER COMMON SHARE

Basic earnings per common share ("EPS") is computed by dividing net income (after deducting dividends on preferred stock) by the weighted-average number of common shares outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted-average number of common shares and potentially dilutive common shares outstanding during the period. Stock options, restricted common shares and warrants can be dilutive common shares and are therefore considered in the earnings per share calculation, if dilutive. Stock options, restricted common shares and warrants that are antidilutive are excluded from earnings per share calculation. Stock options, restricted common shares and warrants are antidilutive when the exercise price is higher than the current market price of the Company's common stock. For the three months ended June 30, 2011 and 2010, there were 1,044,068 and 1,791,932 antidilutive stock options, respectively. For the six months ended June 30, 2011 and 2010, there were 1,179,781 and 1,823,770 antidilutive stock options, respectively. The number of potentially dilutive common shares is determined using the treasury stock method.

	As of and for the Three Months Ended June 30,		As of and for the Six Months Ended June 30,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Net income (loss) available to common shareholders	$ 1,758	$ (518)	$ 3,279	$ (4,494)
Weighted average common shares in basic EPS	13,142	11,874	13,139	11,399
Effect of dilutive securities	92	—	76	—
Weighted average common and potentially dilutive common shares used in diluted EPS	13,234	11,874	13,215	11,399
Earnings (loss) per common share:				
Basic	$ 0.13	$ (0.04)	$ 0.25	$ (0.39)
Diluted	$ 0.13	$ (0.04)	$ 0.25	$ (0.39)

6. COMMITMENTS AND CONTINGENCIES

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include various guarantees, commitments to extend credit and standby letters of credit. Additionally, these instruments may involve, to varying degrees, credit risk in excess of the amount recognized in the statement of financial condition. The Company's maximum exposure to credit loss under such arrangements is represented by the contractual amount of those instruments. The Company applies the same credit policies and collateralization guidelines in making commitments and conditional obligations as they do for on-balance sheet instruments. Off-balance sheet financial instruments include commitments to extend credit and guarantees under standby and other letters of credit.

The contractual amount of the Company's financial instruments with off-balance sheet risk at June 30, 2011 and December 31, 2010 is presented below:

	As of June 30, 2011	As of December 31, 2010
	(Dollars in thousands)	
Unfunded loan commitments including unfunded lines of credit	$ 72,004	$ 63,967
Standby letters of credit	5,991	5,137
Commercial letters of credit	8,345	5,019
Operating leases	8,503	8,698
Total financial instruments with off-balance sheet risk	$ 94,483	$ 82,821

Litigation. The Company is involved in various litigation that arises from time to time in the normal course of business. In the opinion of management, after consultations with its legal counsel, such litigation is not expected to have a material adverse effect of the Company's consolidated financial position, result of operations or cash flows.

7. SHAREHOLDERS' EQUITY

In connection with the Company's participation in the Capital Purchase Program ("CPP"), on January 16, 2009, the Company issued and sold to the U.S. Treasury (i) 45,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $1.00 per share, with a liquidation value of $1,000 per share (the "Series A Preferred Stock"), and (ii) a warrant ("Warrant") to purchase 771,429 shares of the Company's Common Stock, at an exercise price of $8.75 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of $45.0 million in cash. Approximately $44.3 million was allocated to the initial carrying value of the preferred stock and $711,000 to the warrant based on their relative estimated fair values on the issue date. The fair value of the warrant was determined using a valuation model which incorporates assumptions including the Company's Common Stock price, dividend yield, stock price volatility and the risk-free interest rate. The fair value of the preferred stock was determined based on assumptions regarding the discount rate for the Company which was estimated to be approximately 8% at the date of issuance. The difference between the initial carrying value of the preferred stock and the $45 million full redemption value is accreted over five years using a straight-line method over the expected life of the preferred stock. The total capital raised through this issue qualifies as Tier 1 regulatory capital and can be used in calculating all regulatory capital ratios.

The Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. Pursuant to Section 111 of the Emergency Economic Stabilization Act of 2008, as amended, the Company may, at its option, subject to the necessary bank regulatory approval, redeem the Series A Preferred Stock at par value plus accrued and unpaid dividends.

The Company may not declare or pay dividends on its common stock or, with certain exceptions, repurchase common stock without first having paid all accrued cumulative preferred dividends that are due. For three years from the issue date, the Company also may not increase its common stock dividend rate above a quarterly rate of $0.04 per share or repurchase its common shares without Treasury's consent, unless Treasury has transferred all the preferred shares to third parties or the preferred stock has been redeemed.

The Company's Board of Directors elected to suspend its common stock dividend indefinitely in April 2009 and to defer the dividend on the Series A Preferred Stock for the second quarter of 2010. The Board of Directors of the Company later elected to resume payment of dividends on the Series A Preferred Stock, but continued to defer the one dividend payment from the second quarter of 2010. The payment of future dividends paid by the Company will be made at the discretion of the Company's Board of Directors and will be subject to any regulatory restrictions imposed by the Federal Reserve Board. Additionally, future determination of dividends will depend on a number of factors, including but not limited to current and prospective earnings, capital requirements, financial condition, and other factors that the Board of Directors may deem relevant to the Company and its subsidiary banks.

The Company paid no common dividends for the six months ended June 30, 2011 and 2010. Preferred dividends paid for the six months ended June 30, 2011 and 2010 were $1.1 million and $561,000, respectively.

8. REGULATORY MATTERS

The Banks are subject to regulations and, among others things, may be limited in their ability to pay dividends or otherwise transfer funds to the holding company. Under applicable restrictions as of June 30, 2011, no dividends could be paid by the Company, or by MetroBank and Metro United to the Company without regulatory approval. In addition, dividends paid by the Banks to the holding company would be prohibited if the effect thereof would cause the Banks' capital to be reduced below applicable minimum capital requirements.

On August 10, 2009, MetroBank entered into a written agreement (the "Agreement") with the OCC. The Agreement is based on the findings of the OCC during the annual on-site examination of MetroBank performed in the first quarter of 2009 and is primarily focused on matters related to MetroBank's asset quality. Pursuant to the Agreement, the Board of Directors of MetroBank has appointed a compliance committee to monitor and coordinate MetroBank's performance under the Agreement. The Agreement provides for, among other things, the development and implementation of written programs to reduce MetroBank's credit risks, monitor and reduce the level of criticized assets and manage commercial real estate loan concentrations in light of current adverse commercial real estate market conditions generally and in its market areas. During and since the completion of the examination, management of MetroBank has proactively made adjustments to policies and procedures in an effort to alleviate the effects of the credit challenge caused by the economic deterioration and market conditions generally and in its market areas.

On July 22, 2010, Metro United entered into a Stipulation to the Issuance of a Consent Order ("Stipulation") with the FDIC and the CDFI. Pursuant to the Stipulation, Metro United has consented to the issuance of a Consent Order ("Order") by the FDIC and CDFI, also effective as of July 22, 2010. The Order is based on the findings during the annual on-site examination of Metro United performed in the first quarter of 2010 utilizing financial information as of December 31, 2009. The Order represents the agreements between Metro United, the FDIC and the CDFI as to areas of Metro United's operations that warrant improvement and requires the submission of plans for making those improvements. The Order imposes no fines or penalties on Metro United.

Under the terms of the Order, Metro United cannot declare or pay cash dividends and shall not establish any new branches or other offices without the prior written consent of certain officials of the FDIC and the CDFI. In addition, pursuant to the Order, Metro United developed and submitted a written capital plan to achieve and maintain ratios of Tier 1 capital to average total assets (leverage) of at least 9% and total capital to total risk-weighted assets of at least 13% by December 31, 2010. As of June 30, 2011, Metro United's Tier 1 leverage ratio was 11.51% and its total risk-based capital ratio was 16.04%. The Order requires certain corrective steps, imposes limits on activities (such as payment of dividends), prescribes regulatory parameters (such as asset management) and requires the adoption of new or revised policies, procedures and controls on Metro United's operations. In many cases, Metro United must adopt or revise the policies and submit them to the FDIC and CDFI for approval within the time frames prescribed.

Although Metro United meets the capital levels deemed to be "well-capitalized", due to the capital requirement within the Order, it cannot be considered better than "adequately capitalized" for capital adequacy purposes, even if it exceeds the levels of capital set forth in the Order. As an adequately capitalized institution, Metro United may not pay interest rates on deposits that are more than 75 basis points above the rate of the applicable market of Metro United as determined by the FDIC. Additionally, neither MetroBank nor Metro United may accept, renew or roll over brokered deposits without prior approval of the OCC or the FDIC and CDFI, respectively.

Management and the Boards of Directors of the Company, MetroBank and Metro United have taken steps to address the findings of the respective exams and are working with the OCC to comply with the requirements of the Agreement and the FDIC and CDFI to comply with the requirements of the Order. Failure by MetroBank and Metro United to meet the requirements and conditions imposed by the Agreement and Order, respectively, could result in more severe regulatory enforcement actions such as capital directives to raise additional capital, civil money penalties, cease and desist or removal orders, injunctions, and public disclosure of such actions against MetroBank and Metro United. Any such failure and resulting regulatory action could have a material adverse effect on the financial condition and results of operations of the Company, MetroBank and Metro United.

The Company and the Banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. The regulations require the Company to meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Banks' capital classification is 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 and the Banks to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of June 30, 2011, that the Company and the Banks met all capital adequacy requirements to which they were subject.

As of June 30, 2011, the most recent notifications from the OCC with respect to MetroBank categorized MetroBank as “well capitalized” under the regulatory framework for prompt corrective action. There are no conditions or events since the notifications that management believes have changed MetroBank’s level of capital adequacy.

Although regulatory standards require the ratios stated below, as a result of the Order, Metro United is required to maintain a leverage ratio at least 9.0% and a total risk-based capital ratio of at least 13.0%. Due to the capital requirement within Metro United's Order, Metro United cannot be considered to be any better than "adequately capitalized" for capital adequacy purposes even if it exceeds the capital levels set forth in the Order.

The following table provides a comparison of the Company’s and each of the Banks’ leverage and risk-weighted capital ratios as of June 30, 2011 to the minimum and well-capitalized regulatory standards:

	Actual		Minimum Required For Capital Adequacy Purposes		To be Categorized as Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2011						
Total risk-based capital ratio						
MetroCorp Bancshares, Inc.	$ 190,339	16.74%	$ 90,971	8.00%	$ N/A	N/A%
MetroBank, N.A.	139,580	16.64	67,105	8.00	83,881	10.00
Metro United Bank	47,738	16.04	23,811	8.00	29,764	10.00
Tier 1 risk-based capital ratio						
MetroCorp Bancshares, Inc.	175,912	15.47	45,485	4.00	N/A	N/A
MetroBank, N.A.	128,931	15.37	33,552	4.00	50,329	6.00
Metro United Bank	43,967	14.77	11,906	4.00	17,859	6.00
Leverage ratio						
MetroCorp Bancshares, Inc.	175,912	11.83	59,489	4.00	N/A	N/A
MetroBank, N.A.	128,931	11.63	44,330	4.00	55,412	5.00
Metro United Bank	43,967	11.51	15,282	4.00	19,103	5.00
As of December 31, 2010						
Total risk-based capital ratio						
MetroCorp Bancshares, Inc.	$ 184,573	15.13%	$ 97,599	8.00%	$ N/A	N/A%
MetroBank, N.A.	133,737	14.92	71,727	8.00	89,658	10.00
Metro United Bank	46,141	14.28	25,840	8.00	32,300	10.00
Tier 1 risk-based capital ratio						
MetroCorp Bancshares, Inc.	169,087	13.86	48,799	4.00	N/A	N/A
MetroBank, N.A.	122,366	13.65	35,863	4.00	53,795	6.00
Metro United Bank	42,031	13.01	12,920	4.00	19,380	6.00
Leverage ratio						
MetroCorp Bancshares, Inc.	169,087	10.75	62,893	4.00	N/A	N/A
MetroBank, N.A.	122,366	10.64	46,003	4.00	57,503	5.00
Metro United Bank	42,031	9.84	17,089	4.00	21,361	5.00

9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The balance of and changes in each component of accumulated other comprehensive income as of and for the six months ended June 30, 2011 are as follows (net of taxes):

	Gains (Losses) on Effective Cash Hedging Derivatives	Net Unrealized Losses on Investments with OTTI	Net Unrealized Investment Gains (Losses)	Total Accumulated Other Comprehensive Income (Loss)
Balance December 31, 2010	$ (949)	$ (977)	$ (310)	$ (2,236)
Current period change	(92)	(12)	1,169	1,065
Balance June 30, 2011	$ (1,041)	$ (989)	$ 859	$ (1,171)

10. DERIVATIVE FINANCIAL INSTRUMENTS

The fair value of derivative financial instruments outstanding is included in other assets and other liabilities in the accompanying consolidated balance sheets and in the net change in each of these financial statement line items in the accompanying consolidated statements of cash flows.

Interest Rate Derivatives. The Company uses derivatives (interest rate swaps and caps) to mitigate exposure to interest rate risk and the objectives of such are described below.

During the third quarter of 2009, the Company entered into a forward-starting interest rate swap contract on its junior subordinated debentures with a notional amount of $17.5 million. The interest rate swap contract was designated as a hedging instrument in a cash flow hedge with the objective of protecting the quarterly interest payments on a portion of the Company’s $36.1 million of junior subordinated debentures issued to the Company’s unconsolidated subsidiary trust, MCBI Statutory Trust I, throughout the five-year period beginning in December 2010 and ending in December 2015 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swap contract, beginning December 2010, the Company will pay a fixed interest rate of 5.38% and receive a variable interest rate of three-month LIBOR plus a margin of 1.55% on a total notional amount of $17.5 million, with quarterly settlements which began in March 2011.

The Company applies hedge accounting to the interest rate swap above. To qualify for hedge accounting, a derivative must be highly effective at reducing the risk associated with the exposure being hedged. In addition, for a derivative to be designated as a hedge, the risk management objective and strategy must be documented. Hedge documentation must identify the derivative hedging instrument, the asset or liability and type of risk to be hedged, and how the effectiveness of the derivative will be assessed prospectively and retrospectively. To assess effectiveness, the Company compares the dollar-value of the change in the fair value of the derivative to the change in the fair value or cash flows of the hedged item. The extent to which a derivative has been, and is expected to continue to be, effective at offsetting changes in the fair value or cash flows of the hedged item must be assessed and documented at least quarterly. Any hedge ineffectiveness (i.e., the amount by which the gain or loss on the designated derivative instrument does not exactly offset the gain or loss on the hedged item attributable to the hedged risk) must be reported in current-period earnings. If it is determined that a derivative is not highly effective at hedging the designated exposure, hedge accounting is discontinued.

At the end of the second quarter of 2011, the Company entered into an interest rate cap with a notional amount of $15.0 million with the objective of mitigating the effect of potential future interest rate increases. The interest rate cap contract is not designated nor accounted for as a hedging instrument. The interest rate cap contract was effective July 1, 2011 for a five-year term. Under the interest rate cap contract, beginning October 3, 2011 and ending July 1, 2016, the Company will receive quarterly settlements for the difference between the three-month LIBOR interest rate and the cap rate of 2.0%, if the three-month LIBOR interest rate exceeds the cap rate on the settlement date.

The Company obtains dealer quotations to value its interest rate derivative contract designated as a hedge of cash flows and its non-hedging interest rate derivative. The notional amounts and estimated fair values of interest rate derivative contracts outstanding at June 30, 2011 and December 31, 2010 are presented in the following table (in thousands).

	June 30, 2011		December 31, 2010	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate derivative contract designated as a hedge of cash flows	$17,500	$(1,627)	$17,500	$(1,483)
Interest rate derivative contract not designated as a hedge of cash flows	$15,000	$594	$—	$—

Gains, Losses and Derivative Cash Flows. For designated cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income in the Condensed Consolidated Statement of Comprehensive Income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other non-interest income in the Condensed Consolidated Statement of Operations. Net cash flows from the interest rate swap on junior subordinated debentures designated as a hedging instrument in an effective hedge of cash flows are included in interest expense on junior subordinated debentures in the Condensed Consolidated Statement of Operations.

For interest rate derivatives not designated as a hedging instrument, gains or losses due to changes in fair value are included in other non-interest income in the Condensed Consolidated Statement of Operations.

Amounts included in the Condensed Consolidated Statements of Operations and in the Condensed Consolidated Statement of Comprehensive Income for the period related to the interest rate derivative designated as a hedge of cash flows were as follows. There were no interest rate derivatives designated as hedges of fair value at June 30, 2011.

	Gains/(losses) recorded in income and other comprehensive income (loss) (in thousands)				
Three months ended June 30, 2011	Derivative effective portion reclassified from AOCI into income	Hedge ineffectiveness recorded directly in income	Total income statement impact	Derivative effective portion recorded in OCI	Total change in OCI for period
Interest rate derivative designated as a hedge of cash flows:					
Interest rate swap	$ —	$ —	$ —	$ (378)	$ (378)
Three months ended June 30, 2010					
Interest rate derivative designated as a hedge of cash flows:					
Interest rate swap	$ —	$ —	$ —	$ (868)	$ (868)

27

	Gains/(losses) recorded in income and other comprehensive income (loss) (in thousands)				
Six months ended June 30, 2011	Derivative effective portion reclassified from AOCI into income	Hedge ineffectiveness recorded directly in income	Total income statement impact	Derivative effective portion recorded in OCI	Total change in OCI for period
Interest rate derivative designated as a hedge of cash flows:					
Interest rate swap	$ —	$ —	$ —	$ (144)	$ (144)
Six months ended June 30, 2010					
Interest rate derivative designated as a hedge of cash flows:					
Interest rate swap	$ —	$ —	$ —	$ (1,251)	$ (1,251)

Amounts included in the consolidated statements of operations for the period related to non-hedging interest rate derivatives were as follows (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Non-hedging interest rate derivative:				
Other non-interest income	$11	$—	$11	$—

Counterparty Credit Risk. Derivative contracts involve the risk of dealing with institutional derivative counterparties and their ability to meet contractual terms. Derivative contracts are generally executed with a Credit Support Annex, (“CSA”), which is a bilateral ratings-sensitive agreement that requires collateral postings at established credit threshold levels. CSA agreements protect the interests of the Company and its counterparties, should either party suffer a credit rating deterioration. Institutional counterparties must have an investment grade credit rating. There was no CSA on the interest rate cap contract because the counterparty was the FHLB of Dallas, a government sponsored enterprise. The Company’s credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty. The Company’s credit exposure on the interest rate cap is the value of the expected interest payments that would be collected over the life of the cap contract. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. There are no credit-risk-related contingent features associated with any of the Company’s derivative contracts. The Company had no credit exposure relating to the interest rate swap at June 30, 2011. The amount of cash collateral posted by the Company related to derivative contracts was $1.9 million and $2.1 million at June 30, 2011 and December 31, 2010, respectively.

11. OPERATING SEGMENT INFORMATION

The Company operates two community banks in distinct geographical areas, and manages its operations and prepares management reports and other information with a primary focus on these geographical areas. Performance assessment and resource allocation are based upon this geographical structure. The operating segment identified as “Other” includes the parent company and eliminations of transactions between segments. The accounting policies of the individual operating segments are the same as those of the Company as described in Note 1. Transactions between operating segments are primarily conducted at fair value, resulting in profits that are eliminated for reporting consolidated results of operations. Operating segments pay for centrally provided services based upon estimated or actual usage of those services.

The following is a summary of selected operating segment information as of and for the three and six months ended June 30, 2011 and 2010:

	For the three months ended June 30, 2011				For the three months ended June 30, 2010			
	MetroBank	Metro United	Other	Consolidated Company	MetroBank	Metro United	Other	Consolidated Company
	(In thousands)							
Total interest income	$12,628	$4,103	$6	$ 16,737	$14,282	$5,391	$16	$ 19,689
Total interest expense	2,357	794	338	3,489	3,643	1,293	532	5,468
Net interest income	$10,271	$3,309	$(332)	$ 13,248	10,639	4,098	(516)	14,221
Provision for loan losses	1,200	45	-	1,245	2,400	30	—	2,430
Net interest income after provision for loan losses	9,071	3,264	(332)	12,003	8,239	4,068	(516)	11,791
Noninterest income	1,836	66	(331)	1,571	2,016	83	(316)	1,783
Noninterest expenses	7,496	2,528	(1)	10,023	10,386	2,748	49	13,183
Income (loss) before income tax provision	3,411	802	(662)	3,551	(131)	1,403	(881)	391
Provision (benefit) for income taxes	1,099	311	(222)	1,188	(25)	591	(259)	307
Net income (loss)	$2,312	$491	$(440)	$ 2,363	$(106)	$812	$(622)	$ 84

	For the six months ended June 30, 2011				For the six months ended June 30, 2010			
	MetroBank	Metro United	Other	Consolidated Company	MetroBank	Metro United	Other	Consolidated Company
	(In thousands)							
Total interest income	$ 25,690	$ 8,486	$ 12	$ 34,188	$ 29,116	$ 10,769	$ 32	$ 39,917
Total interest expense	4,928	1,638	674	7,240	7,260	2,875	1,059	11,194
Net interest income	$ 20,762	$ 6,848	$ (662)	$ 26,948	21,856	7,894	(1,027)	28,723
Provision for loan losses	1,500	75	—	1,575	6,000	4,328	—	10,328
Net interest income after provision for	19,262	6,773	(662)	25,373	15,856	3,566	(1,027)	18,395

loan losses								
Noninterest income	3,749	143	(662)	3,230	3,837	182	(632)	3,387
Noninterest expenses	16,498	5,245	43	21,786	18,145	8,003	65	26,213
Income before income tax provision	6,513	1,671	(1,367)	6,817	1,548	(4,255)	(1,724)	(4,431)
Provision (benefit) for income taxes	2,093	693	(458)	2,328	314	(942)	(509)	(1,137)
Net income (loss)	$ 4,420	$ 978	$ (909)	$ 4,489	$ 1,234	$ (3,313)	$ (1,215)	$ (3,294)

	As of June 30, 2011				As of June 30, 2010			
	MetroBank	Metro United	Other	Consolidated Company	MetroBank	Metro United	Other	Consolidated Company
	(In thousands)							
Net loans	$742,139	$292,635	$—	$ 1,034,774	$852,695	$336,323	$—	$ 1,189,018
Total assets	1,096,543	396,575	(2,173)	1,490,945	1,167,310	461,904	(5,055)	1,624,159
Deposits	926,204	323,055	(8,457)	1,240,802	998,532	370,628	(12,241)	1,356,919

29

12. FAIR VALUE

Fair value is the exchange price that would be received to sell 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. Fair value is reported based on a hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value are:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.

- 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 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.

Financial assets measured at fair value on a recurring basis are as follows:

Securities. Where quoted prices are available in an active market, securities are reported at fair value utilizing Level 1 inputs. Level 1 securities are comprised of bond funds. If quoted market prices are not available, the Company obtains fair values from an independent pricing service. The fair value measurements consider data that may include proprietary pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities are comprised of highly liquid government bonds, and collateralized mortgage and debt obligations. Market values provided by the pricing service are compared with prices from other sources for reasonableness. The Company has not adjusted the values from the pricing service.

Interest Rate Derivatives. The Company's derivative positions are classified within Level 2 in the fair value hierarchy and are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivatives are determined using discounted cash flow models. These models' key assumptions include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, yield curves, non-performance risk and volatility. Derivative contracts, with counterparties other than government sponsored enterprises, are executed with a Credit Support Annex, which is a bilateral ratings-sensitive agreement that requires collateral postings at established credit threshold levels. These agreements protect the interests of the Company and its counterparties, should either party suffer a credit rating deterioration. Derivative contracts with a government sponsored enterprise as the counterparty are assumed to have low risk of credit rating deterioration for the counterparty.

The following table presents the financial instruments carried at fair value on a recurring basis by caption on the consolidated balance sheets and by valuation hierarchy (as described above) at June 30, 2011 and December 31, 2010:

	Fair Value Measurements, using (In thousands)			
June 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Measurements
Securities available-for-sale				
U.S. Treasury and other U.S. government corporations and agencies	$ –	$ 104,475	$ –	$ 104,475
Obligations of state and political subdivisions	–	4,460	–	4,460
Mortgage-backed securities and collateralized mortgage obligations				
Government issued or guaranteed	–	50,463	–	50,463
Privately issued residential	–	900	–	900
Asset backed securities	–	128	–	128
Investment in CRA funds	13,283	–	–	13,283
Total available-for-sale securities	13,283	160,426	–	173,709
Derivative assets				
Interest rate cap	–	594	–	594
Total assets measured at fair value on a recurring basis	$ 13,283	$ 161,020	$ –	$ 174,303
Derivative liabilities				
Interest rate swap	$ –	$ (1,627)	$ –	$ (1,627)
December 31, 2010				
Securities available-for-sale				
U.S. Treasury and other U.S. government corporations and agencies	$ –	$ 111,601	$ –	$ 111,601
Obligations of state and political subdivisions	–	4,371	–	4,371
Mortgage-backed securities and collateralized mortgage obligations				
Government issued or guaranteed	–	45,384	–	45,384
Privately issued residential	–	1,230	–	1,230
Asset backed securities	–	178	–	178
Investment in CRA funds	12,942	—	–	12,942
Total available-for-sale securities	$ 12,942	$ 162,764	$ –	$ 175,706
Derivative liabilities				
Interest rate swap	$ –	$ (1,483)	$ –	$ (1,483)

There were no transfers between Level 1 and Level 2 financial instruments carried at fair value on a recurring basis.

Certain non-financial assets measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets measured at fair value for impairment assessment, as well as foreclosed assets. Certain financial assets are measured at fair value on a non-recurring 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).

Non-financial and financial assets measured at fair value on a non-recurring basis include the following:

Goodwill. Goodwill is measured at fair value on a non-recurring basis using Level 3 inputs. In the first step of a goodwill impairment test, the Company primarily uses a review of the valuation of recent guideline bank acquisitions, if available, as well as discounted cash flow analysis. If the second step of a goodwill impairment test is required, the implied fair value of goodwill is determined in the same manner as goodwill is recognized in a business combination. See Note 4 “Goodwill” for additional information.

31

Foreclosed Assets. Foreclosed assets are carried at fair value less costs to sell. The fair value measurements of foreclosed assets can include Level 2 measurement inputs such as real estate appraisals and comparable real estate sales information, in conjunction with Level 3 measurement inputs such as cash flow projections, qualitative adjustments, sales cost estimates, etc. As a result, the categorization of foreclosed assets is Level 3 of the fair value hierarchy. In connection with the measurement and initial recognition of certain foreclosed assets, the Company may recognize charge-offs through the allowance for loan losses.

Impaired Loans. Certain impaired loans with a valuation reserve are measured for impairment using the practical expedient, whereby fair value of the loan is based on the fair value of the loan's collateral, provided the loan is collateral dependent. The fair value measurements of loan collateral can include real estate appraisals, comparable real estate sales information, cash flow projections, realization estimates, etc., all of which can include observable and unobservable inputs. As a result, the categorization of collateral dependent impaired loans can be either Level 2 or Level 3 of the fair value hierarchy, depending on the nature of the inputs used for measuring the related collateral's fair value.

The following presents assets carried at fair value on a nonrecurring basis by caption on the condensed consolidated balance sheets and by valuation hierarchy (as described above) at June 30, 2011 and December 31, 2010 (in thousands):

	As of June 30, 2011		As of December 31, 2010	
	Level 2	Level 3	Level 2	Level 3
Assets				
Goodwill	$ -	$ 17,327	$ -	$ 17,327
Foreclosed assets	-	15,814	-	19,956
Impaired loans (1)	19,080	-	7,121	-

(1) Impaired loans represent collateral dependent impaired loans with a specific valuation reserve.

The following presents losses related to fair value adjustments that are included in the Consolidated Statements of Operations for the three months ended June 30, 2011 and 2010 related to assets held at those dates (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Losses related to:				
Goodwill	$ —	$ —	$ —	$ 2,000
Foreclosed assets (1)	452	2,107	643	2,627
Impaired loans (2)	1,940	—	3,536	1,295

(1) Losses represent related losses on foreclosed properties that were written down subsequent to their initial classification as foreclosed properties.
(2) Losses on impaired loans represent charge-offs which are netted against the allowance for loan losses.

Fair Value of Financial Instruments

The following table summarizes the carrying value and estimated fair values of financial instruments as of June 30, 2011 and December 31, 2010:

	As of June 30, 2011		As of December 31, 2010	
	Carrying or Contract Amount	Estimated Fair Value	Carrying or Contract Amount	Estimated Fair Value
	(In thousands)			
Financial Assets				
Cash and cash equivalents	$ 169,136	$ 169,136	$ 151,725	$ 151,725
Investment securities available-for-sale	173,709	173,709	175,706	175,706
Investment securities held-to-maturity	4,045	4,270	4,045	4,167
Other investments	6,705	6,705	6,925	6,925
Loans held-for-investment, net	1,034,774	939,940	1,110,553	990,818
Cash value of bank owned life insurance	30,713	30,713	29,988	29,988
Accrued interest receivable	4,254	4,254	4,682	4,682
Interest rate cap	594	594	—	—
Financial Liabilities				
Deposits				
Transaction accounts	706,778	706,778	707,000	707,000
Time deposits	534,024	532,248	587,184	586,342
Total deposits	1,240,802	1,239,026	1,294,184	1,293,342
Other borrowings	36,352	38,556	56,804	59,028
Junior subordinated debentures	36,083	36,083	36,083	36,083
Interest rate swap	1,627	1,627	1,483	1,483
Accrued interest payable	347	347	447	447
Off-balance sheet financial instruments				
Unfunded loan commitments, including unfunded lines of credit	—	224	—	179
Standby letters of credit	—	21	—	13
Commercial letters of credit	—	—	—	—

The following methodologies and assumptions were used to estimate the fair value of the Company's financial instruments as disclosed in the table:

Assets for Which Fair Value Approximates Carrying Value. The fair values of certain financial assets and liabilities carried at cost, including cash and due from banks, deposits with banks, federal funds sold, cash value of bank owned life insurance, certificates of deposit with banks denominated in a foreign currency, due from customers on acceptances and accrued interest receivable, are considered to approximate their respective carrying values due to their short-term nature and/or negligible credit losses.

Investment Securities. Fair values are based primarily upon quoted market prices obtained from an independent pricing service.

Loans. The fair value of loans originated by the Banks is estimated by discounting the expected future cash flows using the current interest rates at which similar loans with similar terms would be made. The presence of floors on a large portion of the variable rate loans has supported the yields above current market levels and is the key factor causing the fair value of the variable rate loans with floors to exceed the book value. The fair value of the remainder of the variable rate loans approximates the carrying value while fixed rate loans are generally above the carrying values. Using these results, valuation adjustments are made for specific credit risks as well as general portfolio credit and market risks to arrive at the fair value.

Liabilities for Which Fair Value Approximates Carrying Value. The estimated fair value for transactional deposit liabilities with no stated maturity (i.e., demand, savings, and money market deposits) approximates the carrying value. The estimated fair value of deposits does not take into account the value of the Company's long-term relationships with depositors, commonly known as core deposit intangibles, which are separate intangible assets, and not considered financial instruments. Nonetheless, the company would likely realize a core deposit premium if its deposit portfolio were sold in the principal market for such deposits.

Interest Rate Derivatives. The fair value was estimated using discounted cash flow models that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations.

The fair value of acceptances outstanding, accounts payable and accrued liabilities are considered to approximate their respective carrying values due to their short-term nature.

Time Deposits. Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities on time deposits.

Other Borrowings. The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other borrowings maturing within fourteen days approximate their fair values. Fair values of other borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Junior Subordinated Debentures. The fair value of the junior subordinated debentures was estimated by discounting the cash flows through maturity based on the prevailing market rate.

Interest Rate Derivatives. The fair value was estimated using discounted cash flow models that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations.

Commitments to Extend Credit and Letters of Credit. The fair value of such instruments is estimated using fees currently charged for similar arrangements in the market. The estimated fair values of these instruments are not material as of the reporting dates.

13. INCOME TAXES

Income tax expense for the three months ended June 30, 2011 was $1.2 million, compared with $307,000 for the same period in 2010. The Company's effective tax rate was 33.5% for the three months ended June 30, 2011 compared with 78.5% for the three months ended June 30, 2010. The decrease in the effective income tax rate in 2011 as compared with 2010 was primarily the result of the effect of state income taxes. The Texas tax is based on the Company's gross margin with limited deductions. Because the Texas tax allows only limited deductions the tax may not correlate, from year to year, with pre-tax income. The California tax is based on the unitary income of the consolidated group which can vary disproportionately from pre-tax income depending on the apportionment of income among members of the unitary group. Income tax expense for the six months ended June 30, 2011 was $2.3 million, compared with income tax benefit of $1.1 million for the same period in 2010. The Company's effective tax rate was 34.2% for the six months ended June 30, 2011 compared with 25.7% for the six months ended June 30, 2010. The increase in the effective income tax rate in 2011 as compared with 2010 was primarily the result of non-deductible goodwill impairment and the effect of state income taxes.

As of June 30, 2011, the Company had approximately $16.2 million in net deferred tax assets. Deferred tax assets are subject to an evaluation of whether it is more likely than not that they will be realized. The Company has not provided a valuation allowance for the net deferred tax assets at June 30, 2011 and 2010 due primarily to its ability to offset reversals of net deductible temporary differences against income taxes paid in previous years and expected to be paid in future years. In making such judgments, significant weight is given to evidence that can be objectively verified. Because of historical losses that were recorded by the Company for the years ended December 31, 2009 and 2010, and if the Company is unable to generate sufficient taxable income in the future, then the Company may not be able to conclude it is more likely than not that the benefits of the deferred tax assets will be fully realized and may be required to recognize a valuation allowance and a corresponding income tax expense equal to the portion of the deferred tax asset that may not be realized.

As a result of the losses incurred in 2009 and 2010, the Company is in a three-year cumulative pretax loss position at June 30, 2011. A cumulative loss position is considered significant negative evidence in assessing the realizability of a deferred tax asset. The Company has concluded that there is sufficient positive evidence to overcome this negative evidence. The Company forecasts sufficient taxable income in the carryforward period, exclusive of tax planning strategies to fully realize its deferred tax asset. The Company has projected its pretax earnings based upon business that the Company intends to conduct going forward, which in the past has produced steady and strong earnings. During 2009 and 2010, earnings were negatively affected by the large increase in provisions for loan losses during the sharp economic downturn cycle. The Company reduced its cost structure, and taking this into account, the Company projects that it will generate sufficient pretax earnings within a five-year period.

The U.S. Federal and California State net operating loss carryforward period of 20 years provides enough time to utilize the deferred tax assets pertaining to the existing net operating loss carryforwards and any net operating losses that would be created by the reversal of the future net deductions which have not yet been taken on a tax return.

14. NEW AUTHORITATIVE ACCOUNTING GUIDANCE

Accounting Standards Update (“ASU”) No. 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income” amends Topic 220, "Comprehensive Income," to require that all nonowner changes in shareholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in shareholders' equity was eliminated. The new authoritative accounting guidance under ASU 2011-03 will be effective for the Company on January 1, 2012 and is not expected to have an impact on the Company's financial condition, results of operations, or cash flows.

ASU No. 2011-04, “Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. The new authoritative accounting guidance under ASU 2011-03 will be effective for the Company on January 1, 2012 and is not expected to have a significant impact on the Company's financial condition, results of operations, or cash flows.

ASU No. 2011-03, “Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreements.” ASU 2011-03 removes from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The new authoritative accounting guidance under ASU 2011-03 will be effective for the Company on January 1, 2012 and is not expected to have an impact on the Company's financial condition, results of operations, or cash flows.

ASU No. 2011-02, "A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring (Topic 310)." ASU 2011-02 provides additional guidance for determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. The new authoritative accounting guidance under ASU 2011-02 will be effective for the Company on July 1, 2011 and will be applied retrospectively to restructurings occurring on or after January 1, 2011. At the same time the Company adopts ASU 2011-002, it will be required to disclose the activity-based information about troubled debt restructurings that was previously deferred by ASU 2011-01 “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20”. The new authoritative accounting guidance under ASU 2011-02 and ASU 2011-01 is not expected to have a significant impact on the Company's financial condition, results of operations, or cash flows.

ASU No. 2010-29, "Business Combinations (Topic 805)—Disclosure of Supplementary Pro Forma Information for Business Combinations." ASU 2010-29 provides clarification regarding the acquisition date that should be used for reporting the pro forma financial information disclosures required by Topic 805 when comparative financial statements are presented. ASU 2010-29 also requires entities to provide a description of the nature and amount of material, nonrecurring pro forma adjustments that are directly attributable to the business combination. The new authoritative accounting guidance under ASU 2010-29 was effective for the Company prospectively for business combinations occurring after December 31, 2010.

ASU No. 2010-28, "Intangibles—Goodwill and Other (Topic 350)—When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The new authoritative accounting guidance under ASU 2010-28 was effective for the Company on January 1, 2011 and did not have a significant impact on the Company's financial condition, results of operations, or cash flows.

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

Special Cautionary Notice Regarding Forward-looking Statements

Statements and financial discussion and analysis contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of invoking these safe harbor provisions. These forward-looking statements include information about possible or assumed future results of the Company's operations or performance. Words such as "believe", "expect", "anticipate", "estimate", "continue", "intend", "may", "will", "should", or expressions, identifies these forward-looking statements. Many possible factors or events could affect the future financial results and performance of the Company and could cause those financial results or performance to differ materially from those expressed in the forward-looking statement. These possible events or factors include, without limitation:

- changes in the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations resulting in, among other things, a deterioration in credit quality or a reduced demand for credit, including the resultant effect on the Company's loan portfolio and allowance for loan losses;
- changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations;
- changes in the levels of loan prepayments and the resulting effects on the value of the Company's loan portfolio;
- changes in local economic and business conditions which adversely affect the ability of the Company's customers to transact profitable business with the Company, including the ability of borrowers to repay their loans according to their terms or a change in the value of the related collateral;
- increased competition for deposits and loans adversely affecting rates and terms;
- the concentration of the Company's loan portfolio in loans collateralized by real estate;
- the Company's ability to raise additional capital;
- the effect of MetroBank's compliance, or failure to comply within stated deadlines, of the provisions of the formal agreement with the OCC;
- the effect of Metro United's compliance, or failure to comply within stated deadlines, of the provisions of the consent order issued by the FDIC and CDFI;
- the timing, impact and other uncertainties of the Company's ability to enter new markets successfully and capitalize on growth opportunities;
- increased credit risk in the Company's assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan

portfolio;

- incorrect assumptions underlying the establishment of and provisions made to the allowance for loan losses;
- increases in the level of nonperforming assets;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on the results of operations;
- changes in the availability of funds resulting in increased costs or reduced liquidity;
- an inability to fully realize the Company's net deferred tax asset;
- a deterioration or downgrade in the credit quality and credit agency ratings of the securities in the Company's securities portfolio;

- increased asset levels and changes in the composition of assets and the resulting impact on the Company’s capital levels and regulatory capital ratios;

- potential environmental risk and associated cost on the Company's foreclosed real estate assets;

- the Company’s ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;

- increases in FDIC deposit insurance assessments;

- government intervention in the U.S. financial system;

- the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels; and

- changes in statutes and government regulations or their interpretations applicable to bank holding companies and the Company’s present and future banking and other subsidiaries, including changes in tax requirements and tax rates.

All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company analyzes the major elements of the Company's balance sheets and statements of income. This section should be read in conjunction with the Company's Condensed Consolidated Financial Statements and accompanying notes and other detailed information appearing elsewhere in this document.

Overview

The Company recorded net income of $2.4 million for the three months ended June 30, 2011, an increase of $2.3 million compared with the same quarter in 2010. The Company's diluted earnings per common share for the three months ended June 30, 2011 was $0.13, an increase of $0.17 per diluted common share compared with diluted loss per common share of ($0.04) for the same quarter in 2010. Diluted earnings (loss) per common share is computed by dividing net income (after deducting dividends and accretion of discount on preferred stock) by the weighted-average number of common shares and potentially dilutive common shares outstanding during the period. Preferred stock dividends accrued and discount accreted were $605,000 or $0.05 per diluted share, and $602,000 or $0.05 per diluted share for the three months ended June 30, 2011 and 2010, respectively. The Company recorded net income of $4.5 million for the six months ended June 30, 2011, an increase of $7.8 million compared with a net loss for the same period in 2010. The Company's diluted earnings per common share for the six months ended June 30, 2011 was $0.25, an increase of $0.64 per diluted share compared with diluted loss per common share of ($0.39) for the same period in 2010. Preferred stock dividends accrued and discount accreted were $1.2 million or $0.09 per diluted share and $1.2 million or $0.11 per diluted shared for the six months ended June 30, 2011 and 2010, respectively. Details of the changes in the various components of net income are further discussed below.

Total assets were $1.49 billion at June 30, 2011, a decrease of $67.6 million or 4.3% from $1.56 billion at December 31, 2010. Available-for-sale investment securities at June 30, 2011 were $173.7 million, a decrease of $2.0 million or 1.1% from $175.7 million at December 31, 2010. Net loans at June 30, 2011 were $1.03 billion, a decrease of $75.8 million or 6.8% from $1.11 billion at December 31, 2010. Total deposits at June 30, 2011 were $1.24 billion, a decrease of $53.4 million or 4.1% from $1.29 billion at December 31, 2010. Other borrowings at June 30, 2011 were $36.4 million, a decrease of $20.4 million or 36.0% from $56.8 million at December 31, 2010. The Company's return on average assets ("ROAA") for the three months ended June 30, 2011 and 2010 was 0.63% and 0.02%, respectively. The Company's return on average equity ("ROAE") for the three months ended June 30, 2011 and 2010 was 5.83% and 0.21%, respectively. The Company's ROAA for the six months ended June 30, 2011 and 2010 was 0.59% and (0.41)%, respectively. The Company's ROAE for the six months ended June 30, 2011 and 2010 was 5.61% and (4.22)%, respectively. Shareholders' equity at June 30, 2011 was $163.6 million compared with $158.8 million at December 31, 2010, an increase of $4.8 million or 3.1%. Details of the changes in the various balance sheet items are further discussed below.

Results of Operations

Net Interest Income and Net Interest Margin. For the three months ended June 30, 2011, net interest income, before the provision for loan losses, was $13.2 million, a decrease of $973,000 or 6.8% compared with $14.2 million for the same period in 2010, due primarily to a decline in average total loans and yields, partially offset by lower volume and cost of deposits. Average interest-earning assets for the three months ended June 30, 2011 were $1.41 billion, a decrease of $109.5 million or 7.2% compared with $1.52 billion for the same period in 2010, primarily due to lower loan volume, partially offset by growth in taxable securities. The weighted average yield on interest-earning assets for the second quarter of 2011 was 4.75%, a decrease of 44 basis points compared with 5.19% for the same quarter in 2010. Average interest-bearing liabilities for the three months ended June 30, 2011 were $1.10 billion, a decrease of $158.6 million or 12.6% compared with $1.26 billion for the same period in 2010, primarily due to a decline in time deposits and savings and money market accounts. The weighted average interest rate paid on interest-bearing liabilities for the second quarter 2011 was 1.27%, a decrease of 47 basis points compared with 1.74% for the same quarter in 2010.

For the six months ended June 30, 2011, net interest income, before the provision for loan losses, was $26.9 million, a decrease of $1.8 million or 6.2% compared with $28.7 million for the same period in 2010, primarily due to a decline in average total loans and yields, partially offset by lower volume and cost of deposits. Average interest-earning assets for the six months ended June 30, 2011 were $1.43 billion, a decrease of $74.5 million or 5.0% compared with $1.50 billion for the same period in 2010, primarily due to lower loan volume, partially offset by growth in taxable securities and federal funds sold and interest-bearing deposits. The weighted average yield on interest-earning assets for the six months ended June 30, 2011 was 4.83%, down 53 basis points compared with 5.36% for the same period in 2010. Average interest-bearing liabilities for the six months ended June 30, 2011 were $1.12 billion, a decrease of $120.3 million or 9.7% compared with $1.24 billion for the same period in 2010, primarily due to a decline in time deposits and savings and money market accounts. The weighted average rate paid on interest-bearing liabilities for the six months ended June 30, 2011 was 1.30%, down 52 basis points compared with 1.82% for the same period in 2010.

The net interest margin for the three months ended June 30, 2011 was 3.76%, an increase of one basis point compared with 3.75% for the same period in 2010. The yield on average earning assets decreased 44 basis points, and the cost of average earning assets decreased 45 basis points for the same periods. The net interest margin for the six months ended June 30, 2011 was 3.80%, a decrease of five basis points compared with 3.85% for the same period in 2010. The yield on average earning assets decreased 53 basis points, and the cost of average earning assets decreased 48 basis points for the same periods. The decrease in yield on earning assets and the cost of earning assets for the three and six months ended June 30, 2011 was due primarily to a decline in average total loans and yields, partially offset by lower volume and cost of deposits.

Total Interest Income. Total interest income for the three months ended June 30, 2011 was $16.7 million, a decrease of $3.0 million or 15.0% compared with $19.7 million for the same period in 2010. Total interest income for the six months ended June 30, 2011 was $34.2 million, a decrease of $5.7 million or 14.4% compared with $39.9 million for the same period in 2010. The decrease for the three and six months ended June 30, 2011 was primarily due to lower loan volume and loan yield, partially offset by an increase in the volume of taxable securities.

Interest Income from Loans. Interest income from loans for the three months ended June 30, 2011 was $15.3 million, a decrease of $3.2 million or 17.5% compared with $18.6 million for the same quarter in 2010. Average total loans for the three months ended June 30, 2011 were $1.07 billion compared with $1.24 billion for the same period in 2010, a decrease of $167.1 million or 13.5%. For the second quarter of 2011, the average yield on loans was 5.73%, a decrease of 27 basis points compared with 6.00% for the same quarter in 2010. Interest income from loans for the six months ended June 30, 2011 was $31.3 million, a decrease of $6.4 million or 17.0% compared with $37.8 million for the same period in 2010. The decrease for the three and six months ended June 30, 2011 was the result of lower loan volume and yields. Average total loans for the six months ended June 30, 2011 were $1.10 billion, a decrease of $157.5 million or 12.5% compared with average total loans for the same period in 2010 of $1.26 billion. For the six months ended June 30, 2011, the yield on average total loans was 5.75%, a decrease of 31 basis points compared with 6.06% for the same period in 2010.

Approximately $791.3 million or 74.2% of the total loan portfolio are variable rate loans that periodically reprice and are sensitive to changes in market interest rates. To lessen interest rate sensitivity in the event of a falling interest rate environment, the Company originates variable rate loans with interest rate floors. For the six months ended June 30, 2011, the average yield on total loans was approximately 250 basis points above the prime rate primarily because of interest rate floors. At June 30, 2011, approximately $631.5 million in loans or 59.2% of the total loan portfolio were variable rate loans with interest rate floors that carried a weighted average interest rate of 6.17%. At June 30, 2010, variable rate loans with interest rate floors comprised 56.4% of the total loan portfolio and carried a weighted average interest rate of 6.27%.

Interest Income from Investments. Interest income from investments (which includes investment securities, Federal funds sold, and other investments) for the three months ended June 30, 2011 was $1.4 million, an increase of $289,000 or 25.8% compared with $1.1 million for the same period in 2010, primarily due to a greater volume of taxable securities. Average total investments for the three months ended June 30, 2011 were $339.6 million compared with average total investments for the same period in 2010 of $282.1 million, an increase of $57.5 million or 20.4%. The increase in average total investments was primarily the result of an increase in taxable investment securities. For the second quarter 2011, the average yield on total investments was 1.66% compared with 1.59% for the same quarter in 2010, an increase of seven basis points primarily due to a greater volume of taxable securities.

Interest income from investments for the six months ended June 30, 2011 was $2.9 million, an increase of $696,000 or 32.2% compared with $2.2 million for the same period in 2010, primarily due to an increase in taxable investment securities. Average total investments for the six months ended June 30, 2011 were $328.9 million compared with average total investments for the same quarter in 2010 of $245.9 million, an increase of $83.0 million or 33.7%. The increase was primarily the result of an increase in taxable investment securities and in federal funds sold and interest-bearing deposits. For the six months ended June 30, 2011, the average yield on investments was 1.75% compared with 1.77% for the same quarter in 2010, a decrease of two basis points.

Total Interest Expense. Total interest expense for the three months ended June 30, 2011 was $3.5 million, a decrease of $2.0 million or 36.2% compared with $5.5 million for the same period in 2010. Total interest expense for the six months ended June 30, 2011 was $7.2 million, a decrease of $4.0 million or 35.2% compared with $11.2 million for the same period in 2010. Interest expense decreased for both the three and six months ended June 30, 2011 primarily due to lower deposit volume and deposit cost and lower interest cost on the junior subordinated debentures.

Interest Expense on Deposits. Interest expense on interest-bearing deposits for the three months ended June 30, 2011 was $2.9 million, a decrease of $1.8 million or 38.0% compared with $4.7 million for the same period in 2010. Average interest-bearing deposits for the three months ended June 30, 2011 were $1.02 billion compared with $1.17 billion for the same period in 2010, a decrease of $152.9 million or 13.0%. The average interest rate paid on interest-bearing deposits for the second quarter of 2011 was 1.14% compared with 1.60% for the same quarter in 2010, a decrease of 46 basis points. The decline in interest expense and the average interest rate paid on interest-bearing deposits was primarily due to lower deposit volume and declining interest rates in the deposit market.

Interest expense on interest-bearing deposits for the six months ended June 30, 2011 was $6.0 million, a decrease of $3.6 million or 37.3% compared with $9.6 million for the same period in 2010. Average interest-bearing deposits for the six months ended June 30, 2011 were $1.04 billion compared with the same period in 2010 of $1.17 billion, a decrease of $132.5 million or 11.3%. The average interest rate incurred on interest-bearing deposits for the six months ended June 30, 2011 was 1.18% compared with 1.67% for the same period in 2010, a decrease of 49 basis points. The decline in interest expense and the average interest rate paid on interest-bearing deposits was primarily due to lower deposit volume and declining interest rates in the deposit market.

Interest Expense on Junior Subordinated Debentures. Interest expense on junior subordinated debentures for the three months ended June 30, 2011 was $325,000, a decrease of $195,000 or 37.5% from $520,000 at June 30, 2010. Interest expense on junior subordinated debentures for the six months ended June 30, 2011 was $649,000 a decrease of $391,000 or 37.6% from $1.0 million at June 30, 2010. The decline for the three and six months ended June 30, 2011 was due to the unhedged portion of the debt converting from fixed rate to variable rate. Average junior subordinated debentures for the three and six months ended June 30, 2011 and 2010 were $36.1 million. The average interest rate incurred on junior subordinated debentures for the three months ended June 30, 2011 and 2010 was 3.56% and 5.76%, respectively. The average interest rate incurred on junior subordinated debentures for the six months ended June 30, 2011 and 2010 was 3.58% and 5.76%, respectively.

The junior subordinated debentures accrued interest at a fixed rate of 5.76% until December 15, 2010, at which time the debentures began accruing interest at a floating rate equal to the 3-month LIBOR plus 1.55%. Related to these debentures, the Company entered into a forward-starting interest rate swap contract. Under the swap, beginning December 15, 2010, the Company began paying a fixed interest rate of 5.38% and receiving a variable interest rate of three-month LIBOR plus a margin of 1.55% on a total notional amount of $17.5 million, with quarterly settlements that began March 2011. The interest rate swap contract was entered into with the objective of protecting a portion of the quarterly interest payments from the risk of variability resulting from changes in the three-month LIBOR interest rate. See Note 10, “Derivative Financial Instruments,” to the Condensed Consolidated Financial Statements for additional information related to this interest rate swap.

Interest Expense on Other Borrowings. Interest expense on other borrowings for the three months ended June 30, 2011 was $263,000, a decrease of $9,000 compared with $272,000 for the same period in 2010. Interest expense on other borrowed funds for the six months ended June 30, 2011 was $544,000, an increase of $33,000 compared with $511,000 for the same period in 2010. Average borrowed funds, consisting primarily of security repurchase agreements and borrowings from the Federal Home Loan Bank (“FHLB”), for the three months ended June 30, 2011 were $42.3 million a decrease of $5.7 million compared with $48.0 million for the same period in 2010. Other borrowings decreased primarily due to partial repayment of FHLB San Francisco advances in the second quarter of 2011. The average interest rate paid on borrowed funds for the second quarter of 2011 was 2.50% compared with 2.27% for the same quarter in 2010. Average borrowed funds for the six months ended June 30, 2011 were $49.4 million, an increase of $12.2 million compared with $37.2 million for the same period in 2010, primarily due to an increase in FHLB San Francisco borrowings. The average interest rate paid on borrowed funds for the six months ended June 30, 2011 was 2.22% compared with 2.77% for the same period in 2010.

The following table presents, for each major category of interest-earning assets and interest-bearing liabilities, the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates for the periods indicated. No tax-equivalent adjustments were made and all average balances are daily average balances. Nonaccruing loans have been included in the table as loans having a zero yield, with income, if any, recognized at the end of the loan term.

	For The Three Months Ended June 30,					
	2011			2010		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate(1)	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate(1)
	(Dollars in thousands)					
Assets						
Interest-earning assets:						
Loans	$ 1,073,549	$ 15,330	5.73%	$ 1,240,611	$ 18,571	6.00%
Taxable securities	167,400	1,160	2.78	98,602	823	3.35
Tax-exempt securities	8,398	99	4.73	10,184	118	4.65
Other investments (2)	6,760	42	2.49	17,277	75	1.74
Federal funds sold and other short-term investments	157,077	106	0.27	155,999	102	0.26
Total interest-earning assets	1,413,184	16,737	4.75	1,522,673	19,689	5.19
Allowance for loan losses	(32,235)			(35,281)		
Total interest-earning assets, net of allowance for loan losses	1,380,949			1,487,392		
Noninterest-earning assets	129,797			148,352		
Total assets	$ 1,510,746			$ 1,635,744		
Liabilities and shareholders' equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 62,885	$ 67	0.43%	$ 56,151	$ 72	0.51%
Savings and money market accounts	410,271	860	0.84	463,925	1,403	1.21
Time deposits	546,822	1,974	1.45	652,752	3,201	1.97
Junior subordinated debentures	36,083	325	3.56	36,083	520	5.76
Other borrowings	42,271	263	2.50	48,046	272	2.27
Total interest-bearing liabilities	1,098,332	3,489	1.27	1,256,957	5,468	1.74
Noninterest-bearing liabilities:						
	231,918			203,640		

Noninterest-bearing demand deposits						
Other liabilities	17,846			18,400		
Total liabilities	1,348,096			1,478,997		
Shareholders' equity	162,650			156,747		
Total liabilities and shareholders' equity	$ 1,510,746			$ 1,635,744		
Net interest income		$ 13,248			$ 14,221	
Net interest spread			3.48%			3.45%
Net interest margin			3.76%			3.75%

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(1) Annualized.

(2) Other investments include Federal Reserve Bank stock, Federal Home Loan Bank stock and investment in subsidiary trust.

	For The Six Months Ended June 30,					
	2011			2010		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate(1)	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate(1)
	(Dollars in thousands)					
Assets						
Interest-earning assets:						
Loans	$ 1,099,546	$ 31,332	5.75%	$ 1,257,042	$ 37,757	6.06%
Taxable securities	169,089	2,388	2.85	94,657	1,613	3.44
Tax-exempt securities	8,399	197	4.73	10,213	239	4.72
Other investments (2)	6,838	84	2.48	17,470	150	1.73
Federal funds sold and other short-term investments	144,591	187	0.26	123,609	158	0.26
Total interest-earning assets	1,428,463	34,188	4.83	1,502,991	39,917	5.36
Allowance for loan losses	(33,427)			(33,342)		
Total interest-earning assets, net of allowance for loan losses	1,395,036			1,469,649		
Noninterest-earning assets	129,660			145,080		
Total assets	$ 1,524,696			$ 1,614,729		
Liabilities and shareholders' equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 60,086	$ 127	0.43%	$ 55,233	$ 141	0.51%
Savings and money market accounts	410,608	1,720	0.84	466,643	2,955	1.28
Time deposits	564,369	4,200	1.50	645,702	6,547	2.04
Junior subordinated debentures	36,083	649	3.58	36,083	1,040	5.76
Other borrowings	49,390	544	2.22	37,154	511	2.77
Total interest-bearing liabilities	1,120,536	7,240	1.30	1,240,815	11,194	1.82
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	227,129			201,477		
Other liabilities	15,652			15,163		
Total liabilities	1,363,317			1,457,455		
Shareholders' equity	161,379			157,274		
Total liabilities and shareholders' equity	$ 1,524,696			$ 1,614,729		

Net interest income