Lazard Ltd
Form 10-Q
August 08, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ___________ to ___________

001-32492

(Commission File Number)

LAZARD LTD

(Exact name of registrant as specified in its charter)

Bermuda	**98-0437848**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

Clarendon House

2 Church Street

Hamilton HM11, Bermuda

(Address of principal executive offices)

Registrant s telephone number: (441) 295-1422

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

As of July 31, 2006, there were 37,503,059 shares of the registrant s Class A common stock and one share of the registrant s Class B common stock outstanding.

Table of Contents

TABLE OF CONTENTS

When we use the terms Lazard , we , us , our , and the Company , we mean Lazard Ltd, a company incorporated under the laws of Bermuda, and its subsidiaries, including Lazard Group LLC, a Delaware limited liability company (Lazard Group), that is the current holding company for our businesses. Lazard Ltd has no material assets other than indirect ownership as of June 30, 2006 of approximately 37.7% of the common membership interests in Lazard Group and its controlling interest in Lazard Group.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
Condensed Consolidated Financial Statements (Unaudited)*

* These unaudited condensed consolidated financial statements reflect the historical results of operations and financial position of Lazard Ltd, including consolidation of its investment in Lazard Group LLC, formerly known as Lazard LLC and referred to herein as Lazard Group, for all periods presented. Prior to May 10, 2005, the date of Lazard Ltd s equity public offering (as described in Note 1 of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements), the unaudited condensed consolidated financial statements included herein represent the financial statements of Lazard Group. The results of operations and financial condition for certain businesses that Lazard Group no longer owns are reported as discontinued operations. The historical unaudited condensed consolidated financial statements for the three month and six month periods ended June 30, 2005 do not reflect what the results of operations of Lazard Ltd or Lazard Group would have been had these companies been stand-alone, public companies for such periods. In addition, the results of operations for periods prior to May 10, 2005 are not comparable to results of operations for subsequent periods. Specifically, prior to May 10, 2005, the historical results of operations of Lazard Group do not give effect to the following matters:

Payment for services rendered by Lazard Group s managing directors, which, as a result of Lazard Group operating as a limited liability company, historically has been accounted for as distributions from members capital, or in some cases as minority interest, rather than as compensation and benefits expense. As a result, prior to May 10, 2005, Lazard Group s operating income included within the accompanying unaudited condensed consolidated financial statements did not reflect payments for services rendered by its managing directors. For periods subsequent to the consummation of the equity public offering and financing transactions, the Company now includes all payments for services rendered by its managing directors and distributions to holders of profit participation interests in Lazard Group (profit participation members) in compensation and benefits expense.

U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group s income had not been subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard Group historically had operated principally through subsidiary corporations and had been subject to local income taxes. Prior to May 10, 2005, income taxes reflected within Lazard Group s results of operations included within the accompanying unaudited condensed consolidated financial statements are attributable to taxes incurred in non-U.S. entities and to New York City Unincorporated Business Tax (UBT) attributable to Lazard Group s operations apportioned to New York City. Subsequent to the equity public offering, the unaudited condensed consolidated financial statements of Lazard Ltd include U.S. corporate federal income taxes on its allocable share of the results of operations of Lazard Group, giving effect to the post equity public offering structure.

Table of Contents

Minority interest in net income relating to LAZ-MD Holdings ownership interest of Lazard Group s common membership interests since May 10, 2005. Prior to May 10, 2005, Lazard Ltd had no ownership interest in Lazard Group and all net income was allocable to the then members of Lazard Group. Commencing May 10, 2005, minority interest in net income includes LAZ-MD Holdings ownership interest of Lazard Group s common membership interests.

The use of proceeds from the financing transactions.

The net incremental interest expense related to the financing transactions.

Table of Contents

LAZARD LTD

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

JUNE 30, 2006 AND DECEMBER 31, 2005

(UNAUDITED)

(dollars in thousands, except for per share data)

	June 30, 2006	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 442,355	$ 492,309
Cash and securities segregated for regulatory purposes	15,601	20,596
Securities purchased under agreements to resell	6,229	23,358
Securities owned at fair value:		
Bonds Corporate	383,424	228,927
Non-U.S. Government and agency securities	18,688	40,285
Equities	2,938	2,964
	405,050	272,176
Swaps and other contractual agreements	1,301	186
Receivables net:		
Banks	476,731	347,912
Fees	304,889	280,923
Customers	58,096	65,253
Related parties	19,545	53,932
	859,261	748,020
Long-term investments	81,372	80,843
Other investments	4,743	4,473
Property (net of accumulated amortization and depreciation of $170,366 and $156,935 at June 30, 2006 and December 31, 2005, respectively)	163,095	156,630
Goodwill	16,528	15,996
Other assets	113,983	96,310
Total assets	$ 2,109,518	$ 1,910,897

See notes to unaudited condensed consolidated financial statements.

Table of Contents

LAZARD LTD

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

JUNE 30, 2006 AND DECEMBER 31, 2005

(UNAUDITED)

(dollars in thousands, except for per share data)

	June 30, 2006	December 31, 2005
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS DEFICIENCY		
Liabilities:		
Securities sold under agreements to repurchase	$ 22,121	$ 31,853
Deposits and other customer payables	812,006	521,433
Related party payables	3,530	3,919
Accrued compensation and benefits	235,417	346,090
Swaps and other contractual agreements	614	3,028
Senior borrowings	1,089,111	1,022,082
Capital lease obligations	25,094	23,844
Other liabilities	424,126	517,590
Subordinated borrowings	200,000	200,000
Total liabilities	2,812,019	2,669,839
Commitments and contingencies		
Minority interest	42,584	111,729
STOCKHOLDERS DEFICIENCY		
Common stock:		
Class A, par value $.01 per share (500,000,000 shares authorized; 37,503,059 and 37,500,000 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively)	375	375
Class B, par value $.01 per share (1 share authorized; 1 share issued and outstanding)		
Additional paid-in-capital	(818,536)	(885,690)
Accumulated other comprehensive income (loss), net of tax	(7,738)	(34,342)
Retained earnings	84,993	48,986
	(740,906)	(870,671)
Less: Class A common stock held in treasury, at cost (115,000 shares at June 30, 2006)	(4,179)	
Total stockholders deficiency	(745,085)	(870,671)
Total liabilities, minority interest and stockholders deficiency	$ 2,109,518	$ 1,910,897

See notes to unaudited condensed consolidated financial statements.

Table of Contents

LAZARD LTD

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE MONTH AND SIX MONTH PERIODS ENDED JUNE 30, 2006 AND 2005

(UNAUDITED)

(dollars in thousands, except for per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
REVENUE				
Investment banking and other advisory fees	$ 252,803	$ 208,663	$ 472,386	$ 363,698
Money management fees	119,902	100,348	230,471	201,225
Commissions	4,856	3,941	9,279	7,785
Underwriting	8,746	2,775	10,425	5,529
Investment gains and losses net	(1,223)	5,312	9,225	3,502
Interest income	9,828	7,502	17,838	14,050
Other	18,380	7,857	23,925	10,616
Total revenue	413,292	336,398	773,549	606,405
Interest expense	26,384	19,035	50,383	28,943
Net revenue	386,908	317,363	723,166	577,462
OPERATING EXPENSES				
Compensation and benefits (and, commencing May 10, 2005, distributions to profit participation members)(*)	234,148	161,148	434,287	267,029
Premises and occupancy costs	17,545	17,477	34,136	33,860
Professional fees	20,527	14,737	35,404	23,595
Travel and entertainment	11,065	11,130	19,952	20,105
Communications and information services	6,957	6,850	14,429	14,892
Equipment costs	5,111	4,736	10,240	9,568
Other	6,862	11,565	11,909	20,424
Total operating expenses	302,215	227,643	560,357	389,473
OPERATING INCOME FROM CONTINUING OPERATIONS(*)	84,693	89,720	162,809	187,989
Provision for income taxes(*)	18,734	25,463	34,674	33,266
INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTEREST IN NET INCOME(*)	65,959	64,257	128,135	154,723
Minority interest in net income	42,414	26,346	84,904	36,606
INCOME FROM CONTINUING OPERATIONS(*)	23,545	37,911	43,231	118,117
LOSS FROM DISCONTINUED OPERATIONS(*) **(net of income tax provision of $2,824 and $3,077 for the three month and six month periods ended June 30, 2005, respectively)**		(10,318)		(17,168)
NET INCOME (NET INCOME ALLOCABLE TO MEMBERS OF LAZARD GROUP FOR PERIODS PRIOR TO MAY 10, 2005)(*)	$ 23,545	$ 27,593	$ 43,231	$ 100,949

WEIGHTED AVERAGE SHARES OF CLASS A COMMON STOCK OUTSTANDING(**):				
Basic	37,480,751	37,500,000	37,491,820	37,500,000
Diluted	43,980,216	100,000,000	42,511,380	100,000,000
NET INCOME PER SHARE OF CLASS A COMMON STOCK BASIC:				
Income from continuing operations(**)	$0.63	$0.30	$1.15	$0.30
NET INCOME PER SHARE OF CLASS A COMMON STOCK DILUTED:				
Income from continuing operations(**)	$0.59	$0.30	$1.10	$0.30
DIVIDENDS PAID PER SHARE OF CLASS A COMMON STOCK(**)	$0.09		$0.18	

(*) Excludes, as applicable, with respect to periods ended prior to May 10, 2005 (a) payments for services rendered by Lazard Group s managing directors, which, as a result of Lazard Group operating as a limited liability company, historically had been accounted for as distributions from members capital, or in some cases as minority interest, rather than as compensation and benefits expense, and (b) U.S. corporate federal income taxes, since Lazard Group has operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes.

(**) Applicable with respect to periods subsequent to May 10, 2005, the date of our equity public offering.

See notes to unaudited condensed consolidated financial statements.

Table of Contents

LAZARD LTD

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2006 AND 2005

(UNAUDITED)

(dollars in thousands)

	Six Months Ended June 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (net income allocable to members of Lazard Group prior to May 10, 2005)	$ 43,231	$ 100,949
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash charges included in net income:		
Depreciation and amortization of property	6,970	7,895
Amortization of deferred expenses, stock units and interest rate hedge	11,174	347
Gain on termination of strategic alliance in Italy	(13,695)	
Minority interest in net income	84,904	36,606
(Increase) decrease in operating assets:		
Cash and securities segregated for regulatory purposes	6,359	(13,385)
Securities purchased under agreements to resell	18,306	(14,135)
Securities owned, at fair value and swaps and other contractual agreements	(109,121)	18,111
Receivables	(71,647)	(366,965)
Marketable and long-term investments	3,879	160,039
Other assets	(14,911)	(326)
Assets of discontinued operations		1,485,363
Increase (decrease) in operating liabilities:		
Securities sold under agreements to repurchase	(11,795)	(33,062)
Swaps and other contractual agreements	(2,521)	1,525
Deposits and other payables	243,487	525,020
Accrued compensation and other liabilities	(155,468)	17
Liabilities of discontinued operations		(1,223,257)
Net cash provided by operating activities	39,152	684,742
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property	(3,332)	(1,833)
Disposals and retirements of property	607	829
Net cash used in investing activities	(2,725)	(1,004)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of Class A common stock, net of expenses of $65,844		871,656
Proceeds from issuance of Class B common stock		1
Proceeds from issuance of equity security units, net of expenses of $15,941		421,559
Distribution to members and capital withdrawals		(421,382)
Purchase contracts relating to equity security units		(6,013)
Settlement of interest rate hedge		(11,003)
Redemption of historical partner interests (including mandatorily redeemable preferred stock of $100,000)		(1,617,032)
Distribution of separated business		(248,384)
Distributions to LAZ-MD Holdings and LFCM Holdings		(150,000)
Indemnity from LFCM Holdings relating to U.K. pension		54,203
Proceeds from issuance of Lazard Group senior notes, net of original issue discount and other expenses of $4,010		545,990
Proceeds from other senior borrowings	1,898	14,418
Repayment of senior borrowings, including make-whole payment of $7,650 in 2005	(30,869)	(59,366)
Repayment of capital lease obligations	(581)	(7,668)

Distributions relating to minority interest, including, in 2006, $28,751 to LAZ-MD Holdings	(50,855)	(48,112)
Class A common stock dividends	(6,750)	
Additional costs relating to issuance of Class A common stock	(2,677)	
Purchase of Class A common stock	(4,179)	
Net cash used in financing activities	(94,013)	(661,133)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	7,632	(7,574)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(49,954)	15,031
CASH AND CASH EQUIVALENTS January 1	492,309	305,753
CASH AND CASH EQUIVALENTS June 30	$ 442,355	$ 320,784
Supplemental financing non-cash transaction:		
Issuance of senior promissory note for the acquisition of equity interest in Lazard Italy	$ 96,000	

See notes to unaudited condensed consolidated financial statements.

Table of Contents

LAZARD LTD

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS DEFICIENCY

FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2006

(UNAUDITED)

(dollars in thousands)

	Common Stock			Accumulated Other Comprehensive Income (Loss),		Class A Common Stock	Total
	Shares	$	Additional Paid-in-Capital	Net of Tax	Retained Earnings	Held In Treasury	Stockholders Deficiency
Balance January 1, 2006	37,500,001	$ 375	$ (885,690)	$ (34,342)	$ 48,986	$	$ (870,671)
Comprehensive income:							
Net income available for Class A common stockholders					43,231		43,231
Other comprehensive income net of tax:							
Currency translation adjustment				24,269			24,269
Minimum pension liability adjustment				1,785			1,785
Amortization of interest rate hedge				550			550
Comprehensive income							69,835
Class A common stock dividends					(6,750)		(6,750)
Amortization and issuance of stock units			9,738				9,738
Conversion of DSUs to Class A common stock	3,059						
RSU dividend-equivalents			474		(474)		
Purchase of 115,000 shares of Class A common stock						(4,179)	(4,179)
Other capital activities, including additional costs relating to issuance of Class A common stock			3,328				3,328
Adjustment to reclassify minority interest share of undistributed net income to additional paid-in-capital			53,614				53,614
Balance June 30, 2006	37,503,060(*)	$ 375	$ (818,536)	$ (7,738)	$ 84,993	$ (4,179)	$ (745,085)

(*) Includes 37,503,059 shares of the Company s Class A common stock and 1 share of the Company s Class B common stock

See notes to unaudited condensed consolidated financial statements.

7

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except for per share data, unless otherwise noted)

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

The accompanying unaudited condensed consolidated financial statements of Lazard Ltd and subsidiaries (collectively referred to as Lazard Ltd or the Company) including, subsequent to May 10, 2005, Lazard Ltd s investment in Lazard Group LLC (a Delaware limited liability company, collectively referred to, with its subsidiaries, as Lazard Group) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (U.S. GAAP) for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in Lazard Ltd s annual report on Form 10-K for the year ended December 31, 2005 (the Form 10-K). The December 31, 2005 unaudited condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The accompanying unaudited condensed consolidated financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the financial statements and the accompanying disclosures. Although these estimates are based on management s best knowledge of current events and actions that Lazard may undertake in the future, actual results may differ materially from the estimates. The consolidated results of operations for the three month and six month periods ended June 30, 2006 are not necessarily indicative of the results to be expected for any future period or the full fiscal year. Certain prior year amounts have been reclassified to conform to the manner of presentation in the current year.

Lazard Ltd is a Bermuda holding company that was incorporated in October 2004. Pursuant to a Registration Statement on Form S-1 (File No. 333-121407) declared effective by the SEC on May 4, 2005 (the Registration Statement) for the initial public offering of shares of Lazard Ltd s Class A common stock, par value $0.01 per share (Class A common stock), Lazard Ltd issued on May 10, 2005, at $25 per share, 34,183,162 shares of its Class A common stock in a registered initial public offering (the equity public offering). In addition, on May 10, 2005, pursuant to the IXIS Placements (see Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements) and the cashless exchange of certain of our chief executive officer s interests in Lazard Group with Lazard Ltd, the Company issued 2,000,000 shares of its Class A common stock and 1,316,838 shares of its Class A common stock, respectively. These issuances, together with the 34,183,162 shares of Class A common stock issued pursuant to the equity public offering, resulted in the Company having 37,500,000 shares of its Class A common stock outstanding at the time of the equity public offering. The Company, through a number of newly-formed, wholly-owned subsidiaries, contributed the net proceeds from the equity public offering, along with the net proceeds it received from the financing transactions (as described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements), to Lazard Group in exchange for 37,500,000 Lazard Group common membership interests, representing 37.5% of Lazard Group s total common membership interests as of May 10, 2005, and, after giving effect to (i) the repurchase and forfeiture of a portion of the Lazard Group common membership interests held by LAZ-MD Holdings LLC (LAZ-MD Holdings), as well as (ii) certain other share issuances by Lazard Ltd subsequent to December 31, 2005, approximately 37.7% and 37.6% of all outstanding Lazard Group common membership interests as of June 30, 2006 and December 31, 2005, respectively. The Company, through its control of the managing members of Lazard Group, controls Lazard Group.

Lazard Group is governed by an Operating Agreement dated as of May 10, 2005, as amended (the Operating Agreement).

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

The Company s sole operating asset is its ownership of the common membership interest of Lazard Group and its managing member interest of Lazard Group, whose current principal activities are divided into two business segments:

- Financial Advisory, which includes providing advice on mergers and acquisitions, restructurings, capital raising and similar transactions, and

- Asset Management, which includes the management of equity and fixed income securities and merchant banking funds.

In addition, Lazard Group records selected other activities in Corporate, including cash and marketable investments, certain long-term investments, and the commercial banking activities of Lazard Group s Paris-based Lazard Frères Banque SA (LFB). LFB is a registered bank regulated by the Banque de France. LFB s primary commercial banking operations include the management of the treasury positions of Lazard Group s Paris House through its money market desk and, to a lesser extent, credit activities relating to securing loans granted to clients of Lazard Frères Gestion SAS (LFG) and custodial oversight over assets of various clients. In addition, LFB operates many support functions of the Paris House. Lazard Group also allocates outstanding indebtedness to Corporate.

Prior to May 10, 2005, Lazard Group also had a business segment called Capital Markets and Other, which consisted of equity, fixed income and convertibles sales and trading, broking, research and underwriting services and merchant banking fund management activities outside of France as well as other specified non-operating assets and liabilities. This business segment s assets and liabilities (referred to below as the separated businesses) were separated from Lazard Group on May 10, 2005, and the operating results of this former segment are reflected as discontinued operations for all periods prior to May 10, 2005. We refer to the transfer of the separated business as the separation.

The unaudited condensed consolidated financial statements include Lazard Ltd, Lazard Group and Lazard Group s principal operating subsidiaries: Lazard Frères & Co. LLC (LFNY), a New York limited liability company, along with its subsidiaries, including Lazard Asset Management LLC and its subsidiaries (collectively referred to as LAM); Lazard Frères SAS and Maison Lazard SAS, French limited liability companies, along with their respective subsidiaries, including LFB and LFG (collectively referred to as LFP); and Lazard & Co., Limited (LCL), through Lazard & Co., Holdings Limited, an English private limited company (LCH); together with their jointly-owned affiliates and subsidiaries.

The Separation and Recapitalization Transactions

On May 10, 2005, Lazard completed the separation and recapitalization transactions, including the financing transactions described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements.

The Separation

In the separation, Lazard Group transferred the separated businesses to LFCM Holdings LLC (LFCM Holdings) through several steps. First, LAZ-MD Holdings was formed as the new holding company for Lazard Group. Pursuant to this formation, all of the persons who were members of Lazard Group prior to the formation became members of LAZ-MD Holdings and ceased to hold any membership interests in Lazard Group. Lazard Group then contributed the separated businesses to LFCM Holdings, which was then a subsidiary of Lazard Group, and distributed all of the LFCM Holdings interests to LAZ-MD Holdings. After the redemption of the

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

historical partners described below, LAZ-MD Holdings distributed all of the LFCM Holdings interests to its members. Accordingly, after the separation, LFCM Holdings was wholly-owned by the members of LAZ-MD Holdings, including Lazard Group s managing directors at the time of the separation.

In the separation, Lazard Group retained all of the Company s Financial Advisory and Asset Management businesses. In addition, under the business alliance agreement, dated as of May 10, 2005, between Lazard Group and LFCM Holdings (the business alliance agreement), Lazard Group was granted the option to acquire the North American and European merchant banking businesses of LFCM Holdings.

The Recapitalization

On the same day as the separation, LAZ-MD Holdings and Lazard Group effected a recapitalization of their companies. The recapitalization had three principal parts the financing transactions, the redemption of the historical partners interests and mandatorily redeemable preferred interests of Lazard Group and the issuance of LAZ-MD Holdings exchangeable interests to working members. Historical partners refers to certain former members of Lazard Group that existed prior to the recapitalization, which consisted of Eurazeo S.A., descendants and relations of Lazard Group s founders, several historical partners of Lazard Group s predecessor entities, several current and former managing directors and the other members of these classes. Working members refers to members of Lazard Group that existed prior to the recapitalization, which consisted of current and former managing directors of Lazard Group and the separated businesses.

The Financing Transactions

On May 10, 2005, the Company completed the financing transactions, which consisted of:

- the equity public offering,
- the initial offering of equity security units (the ESU offering),
- the private offering of Lazard Group senior notes, and
- the private placement of securities to IXIS Corporate & Investment Bank (IXIS).

For a further description of the financing transactions, see Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements.

The Company used the net proceeds from the financing transactions primarily to:

- redeem Lazard Group membership interests, including Lazard Group s mandatorily redeemable preferred stock, held by the historical partners for $1,617,032 (including the value of our chief executive officer s historical interests ($32,921), which were exchanged for shares of Lazard Ltd Class A common stock in lieu of cash, and the exchange of certain of these membership interests for specific Lazard Group long-term investments valued at $39,774), capitalize LFCM Holdings and LAZ-MD Holdings in the amount of $67,000 and $83,000, respectively,

repay the 7.53% senior notes due 2011 in aggregate principal amount of $50,000 as well as a related make-whole payment of $7,650, and

pay transaction fees and expenses.

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

The Redemption of the Historical Partners Interests

As noted above, a primary purpose of the financing transactions was the redemption of the historical partners interests. Prior to the separation and recapitalization, Lazard Group had three general classes of membership interests:

- the working member interests, which were owned by working members and consisted of capital and the right to participate in profit and the goodwill of Lazard Group if a fundamental transaction occurred,

- the historical partner interests, which were owned by the historical partners and consisted of capital and the right to participate in profit and the goodwill of Lazard Group if a fundamental transaction occurred, and

- the mandatorily redeemable preferred interests, which were owned by certain of the historical partners and consisted of the right to a preferred dividend of 8% per annum and a fixed liquidation amount.

As part of the recapitalization transactions, historical partner interests and preferred interests generally were redeemed for cash.

Exchange of Working Member Interests for LAZ-MD Holdings Interests

In connection with the formation of LAZ-MD Holdings, the working member interests were exchanged with LAZ-MD Holdings for limited liability company interests in LAZ-MD Holdings. Each holder of a working member interest at the time of the separation and recapitalization transactions received, in exchange for his or her working member interest, a redeemable capital interest in LAZ-MD Holdings consisting of an equivalent amount of capital of LAZ-MD Holdings, an exchangeable interest in LAZ-MD Holdings and, if applicable, a right to receive distributions from LAZ-MD Holdings. The former holders of working member interests hold all of the limited liability company interests in LAZ-MD Holdings.

The separation and recapitalization transactions were consummated pursuant to the master separation agreement, dated as of May 10, 2005, by and among Lazard Ltd, Lazard Group, LAZ-MD Holdings and LFCM Holdings (the master separation agreement).

Basis of Presentation

The consolidated financial statements are prepared in conformity with U.S. GAAP. The Company s policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest as well as variable interest entities (VIEs) where the Company is deemed to be the primary beneficiary. All material intercompany transactions and balances have been eliminated.

In accordance with Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46 (R), *Consolidation of Variable Interest Entities* (FIN 46 R), the Company also consolidates any VIEs for which it is the primary beneficiary. In connection with the separation, Lazard Group transferred its general partnership interests in various VIEs to a subsidiary of LFCM Holdings. Lazard Group has determined that it is no longer the primary beneficiary with respect to those VIEs and, as a result, the Company no longer consolidates such VIEs. Amounts related to consolidation of such VIEs, for the three month and six month periods ended June 30, 2005 are included in loss from discontinued operations on the unaudited condensed consolidated statements of income.

The Company prepared an assessment that considered quantitative factors and qualitative factors that included, but was not limited to, the structure and purpose of the separation and recapitalization transactions, corporate governance and the controlling parties of Lazard Group, and management concluded that Lazard Ltd is the entity that is most closely associated with Lazard Group and therefore should consolidate the operations of Lazard Group. Accordingly, the accompanying unaudited condensed consolidated statements of financial condition as of June 30, 2006 and December 31, 2005 reflect the consolidated statements of financial condition of Lazard Ltd. The

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

unaudited condensed consolidated statements of income for the three month and six month periods ended June 30, 2006 and the unaudited condensed consolidated statement of cash flows for the six month period ended June 30, 2006 reflect the consolidated operating results and cash flows of Lazard Ltd and its subsidiaries. The unaudited condensed consolidated statements of income for the three month and six month periods ended June 30, 2005 and the unaudited condensed consolidated statement of cash flows for the six month period ended June 30, 2005 relate to Lazard Group and its subsidiaries prior to May 10, 2005, and, from May 10, 2005 through June 30, 2005, reflect the consolidated operating results of Lazard Ltd and its subsidiaries.

The accompanying unaudited condensed consolidated statements of income for the three month and six month periods ended June 30, 2005 and the unaudited condensed consolidated statement of cash flows for the six month period ended June 30, 2005 do not reflect what the results of operations and cash flows of the Company would have been had it been a stand-alone, public company prior to May 10, 2005. In addition, the results of operations for periods until the equity public offering on May 10, 2005 are not comparable to results of operations for subsequent periods as described below.

Payments for services rendered by the Company s managing directors, which, as a result of Lazard Group operating as a limited liability company, historically had been accounted for as distributions from members capital, or in some cases as minority interest, rather than as compensation and benefits expense, and distributions to profit participation members. As a result, prior to May 10, 2005, Lazard Group s operating income included within the accompanying unaudited condensed consolidated financial statements did not reflect payments for services rendered by its managing directors. For periods subsequent to the consummation of the equity public offering and the financing transactions as described in Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements, the Company now includes all payments for services rendered by its managing directors and distributions to profit participation members in compensation and benefits expense.

Payments for services rendered by managing directors of LAM (and employee members of LAM) had, prior to May 10, 2005, been accounted for as minority interest in net income and since that date such payments, together with distributions to profit participation members, have been included within compensation and benefits expense.

The Company s income has not been subject to U.S. corporate federal income taxes, because Lazard Group operated in the U.S. as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. As a result, Lazard Group s income had not been subject to U.S. corporate federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Outside the U.S., Lazard Group historically had operated principally through subsidiary corporations and had been subject to local income taxes. Prior to May 10, 2005, income taxes reflected within Lazard Group s results of operations are attributable to taxes incurred in non-U.S. entities and to New York City Unincorporated Business Taxes (UBT) attributable to Lazard Group s operations apportioned to New York City. For periods subsequent to the equity public offering, the unaudited condensed consolidated financial statements of Lazard Ltd include U.S. corporate federal income taxes on its allocable share of the results of operations of Lazard Group, giving effect to the post equity public offering structure.

Commencing May 10, 2005, the unaudited condensed consolidated statements of income include a minority interest in net income relating to LAZ-MD Holdings ownership interest of Lazard Group s common membership interests. Prior to May 10, 2005, there was no such minority interest, as Lazard Ltd had no ownership interest in Lazard Group, and all net income was allocable to the then members of Lazard Group. As of June 30, 2006, LAZ-MD Holdings ownership interest in Lazard Group was approximately 62.3%.

12

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

The use of proceeds from the financing transactions.

The net incremental interest expense related to the financing transactions.

In accordance with U.S. GAAP, the results of operations of the separated businesses have been segregated and are reported as discontinued operations in the unaudited condensed consolidated statements of income for the three month and six month periods ended June 30, 2005. See Note 15 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information relating to discontinued operations.

2. EQUITY PUBLIC OFFERING AND OTHER FINANCING TRANSACTIONS

Equity Public Offering As described above, on May 10, 2005, Lazard Ltd consummated its equity public offering. The aggregate gross proceeds relating to the offering amounted to $854,579, and net proceeds to Lazard Ltd, after $65,844 of estimated expenses incurred by Lazard Ltd in connection with the issuance and distribution of the Lazard Ltd Class A common stock (including underwriting discounts and commissions, expenses paid to the underwriters and certain other expenses), was $788,735. Lazard Ltd contributed all the net proceeds from this offering to Lazard Group in exchange for a controlling interest in Lazard Group. In the six month period ended June 30, 2006, additional costs of $2,677 relating to issuance of Class A common stock were incurred, representing amounts in excess of estimated costs associated with the equity public offering. Such amount was recorded as a reduction to additional paid-in-capital.

Other Financing Transactions On May 10, 2005, the Company also completed the other financing transactions which are described below.

ESU Offering Concurrently with the equity public offering, the Company issued, for $25 per unit, equity security units (the ESUs) for an aggregate offering amount of $287,500 (and net proceeds of $276,535) in the ESU offering. Each unit consists of (a) a contract which obligates holders to purchase, and the Company to sell, on May 15, 2008, a number of newly-issued shares of Class A common stock equal to a settlement rate based on the trading price of its Class A common stock during a period preceding that date and (b) a 1/40, or 2.5%, ownership interest in a 6.12% senior note due 2035 of an affiliate, Lazard Group Finance LLC, a Delaware limited liability company (Lazard Group Finance), with a principal amount of $1 (the Lazard Group Finance Senior Notes). Prior to its merger with Lazard Group discussed below, Lazard Group Finance was a wholly-owned subsidiary of Lazard Group that was controlled by Lazard Ltd.

In connection with the quarterly contract adjustment payments on the purchase contracts, the Company recorded a liability as of May 10, 2005 for $6,013 for the present value of such payments (including the similar contract adjustment payments related to IXIS as described below), with a corresponding charge to additional paid-in-capital. The liability will accrete over the three year period ending May 15, 2008, with a corresponding charge to interest expense.

The Company began making quarterly contract adjustment payments on the purchase contracts at an annual rate of 0.505% on August 15, 2005. The Company has the right to defer these quarterly contract adjustment payments. In general, during any period in which it defers such payments, the Company cannot declare or pay dividends on, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment with respect to, any of its capital stock.

The Lazard Group Finance Senior Notes, which bear interest at an annual rate of 6.12%, will mature (a) in the event of a successful remarketing, on any date no earlier than May 15, 2010 and no later than May 15, 2035, as we may elect, (b) in the event of a failed remarketing, on May 15, 2008 (the stock purchase date) and

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

(c) otherwise on May 15, 2035. Lazard Group Finance used the proceeds from the ESU offering to purchase 6.12% senior notes from Lazard Group due 2035 (the Lazard Group Notes) with a principal amount of $287,500. The Lazard Group Notes, which have substantially similar terms to the Lazard Group Finance Senior Notes, were pledged to secure the obligations of the Lazard Group Finance Senior Notes.

On December 19, 2005, Lazard Group consummated a Plan of Merger (the Merger Agreement) with Lazard Group Finance. The Merger Agreement provided for the merger of Lazard Group Finance with and into Lazard Group (the Merger). Pursuant to the Merger, Lazard Group Finance merged with and into Lazard Group, with Lazard Group continuing as the surviving company. In addition, Lazard Group Finance ceased to be the managing member of Lazard Group, and the co-managing members of Lazard Group Finance, which are two indirect wholly-owned subsidiaries of Lazard Ltd, became the co-managing members of Lazard Group. In connection with the Merger, Lazard Group became the successor registrant for Lazard Group Finance under the Securities Exchange Act of 1934, as amended.

Pursuant to the Merger and in accordance with the Indenture, dated as of May 10, 2005 (the Lazard Group Finance Indenture), Lazard Group assumed the obligations, including the remarketing, of Lazard Group Finance with respect to an aggregate principal amount of $437,500 of Lazard Group Finance Senior Notes issued pursuant to the Lazard Group Finance Indenture (including an aggregate principal amount of $150,000 related to IXIS as described below), which notes form a part of the 6.625% ESUs previously issued by Lazard Ltd. Simultaneously with the consummation of the Merger, in accordance with the terms of the Lazard Group Finance Indenture, all of the outstanding Lazard Group Finance Senior Notes were exchanged for, and replaced by, an aggregate principal amount of $437,500 of Lazard Group Notes issued pursuant to the Indenture, dated as of May 10, 2005 (the Lazard Group Indenture), which Lazard Group Notes were previously held by Lazard Group Finance, and the Lazard Group Finance Indenture was discharged. In accordance with the terms of the Lazard Group Finance Indenture, after the completion of this exchange, the Lazard Group Notes replaced the Lazard Group Finance Senior Notes for all purposes under the ESUs, including by serving as collateral for the obligations of the holders of the ESUs in substitution for the Lazard Group Finance Senior Notes.

Prior to the issuance of the Class A common stock upon settlement of the purchase contracts, the ESUs will be reflected in Lazard Ltd s diluted net income per share using the treasury stock method. See Note 9 of Notes to Unaudited Condensed Consolidated Financial Statements for additional information regarding net income per share of Class A common stock.

IXIS Placements Under the IXIS placements, IXIS, which is a subsidiary of Caisse Nationale des Caisses d Epargne, purchased an aggregate of $200,000 of the Company s securities on May 10, 2005, $150,000 of which were ESUs (the IXIS ESU placement) and $50,000 of which were shares of Class A common stock. The terms of the ESUs issued in connection with the IXIS ESU placement are the same as the ESUs described above. The price per security paid by IXIS was equal, in the case of shares of Class A common stock, to the price per share in the equity public offering and, in the case of ESUs, the price per unit in the ESU offering. The Company contributed the net proceeds from the sale of Class A common stock to Lazard Group. Lazard Group Finance used the net proceeds from the IXIS ESU placement to purchase Lazard Group Notes with a principal amount of $150,000.

Lazard Group Senior Notes Concurrent with the equity public offering, Lazard Group issued, in a private placement, $550,000 aggregate principal amount of 7.125% senior notes due May 15, 2015 (the Lazard Group Senior Notes). The Lazard Group Senior Notes were issued net of original issue discount of $435. Interest on

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

the notes is due May 15 and November 15 of each year, commencing on November 15, 2005. The notes are unsecured. A registration rights agreement, dated as of May 10, 2005, among Lazard Group and the initial purchasers of the Lazard Group senior notes provided the holders of the Lazard Group senior notes with registration rights. In that agreement Lazard Group agreed to register the offer and sale of substantially identical notes (the exchange notes) in exchange for the privately-placed notes (the old notes). In connection therewith, Lazard Group filed a registration statement on Form S-4 that was declared effective by the SEC on September 28, 2005 and Lazard Group commenced an exchange offer (the exchange offer) on that date to exchange an aggregate principal amount of up to $550,000 of the old notes for an equal aggregate principal amount of the exchange notes. The exchange offer expired on October 26, 2005. On October 31, 2005, Lazard Group closed the exchange offer, at which time it exchanged $546,000 in aggregate principal amount of its old notes (approximately 99.3% of the aggregate principal amount of old notes outstanding) for $546,000 in aggregate principal amount of its exchange notes. The exchange notes are substantially identical to the old notes, except that the exchange notes have been registered under the Securities Act of 1933, as amended; and, as a result, the transfer restrictions applicable to the old notes do not apply to the exchange notes.

The indenture governing the Lazard Group Senior Notes contains covenants that limit Lazard Group s ability and that of its subsidiaries, subject to important exceptions and qualifications, to, among other things, create a lien on any shares of capital stock of any designated subsidiary, and consolidate, merge or transfer all or substantially all of its assets and the assets of its subsidiaries. The indenture also contains a customary make-whole provision in the event of early redemption.

In connection with the issuance of the Lazard Group Senior Notes, on April 1, 2005, Lazard Group entered into an interest rate forward agreement with a bank for a notional amount of $650,000. By entering into this interest rate forward agreement, Lazard Group was able to ensure that the base rate (excluding market-driven credit spreads) on the Lazard Group Senior Notes would be no greater than 4.5%. Lazard Group settled the interest rate forward agreement with the bank as of May 9, 2005, which required a payment by Lazard Group of $13,004. Of this amount, in accordance with Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* , as amended, $11,003 was deemed to be the effective portion of the hedge and has been recorded within other comprehensive income (loss) and is being amortized as a charge to interest expense over the ten year term of the Lazard Group Senior Notes.

Credit Facility Concurrent with the equity public offering, Lazard Group entered into a five year, $125,000 senior revolving credit facility (the Credit Facility) with a group of lenders. On May 17, 2006, the Credit Facility was amended to provide for an increase in the aggregate commitments from $125,000 to $150,000. As of June 30, 2006 and December 31, 2005, $0 and $30,000, respectively, was outstanding under the Credit Facility. The Credit Facility bears interest at either a Eurodollar or Federal Funds rate, plus an applicable margin, which varies from 125 to 200 basis points, depending on Lazard Group s rating as determined by designated credit rating agencies.

The Credit Facility contains affirmative and negative covenants. Such covenants include, among other things, limitations on the ability of Lazard Group to incur debt, grant liens, pay dividends, enter into mergers or to sell all or substantially all of its assets, as well as financial covenants that must be maintained.

3. SIGNIFICANT ACCOUNTING POLICIES

The policies below represent recent changes to the Company s significant accounting policies. A complete discussion of the Company s significant accounting policies are included in Lazard Ltd s Form 10-K.

Table of Contents

LAZARD LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(dollars in thousands, except for per share data, unless otherwise noted)

Share-Based Payments In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payments* (SFAS 123R). SFAS 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and its related guidance. SFAS 123R is effective for the Company s fiscal year beginning January 1, 2006. Prior to May 10, 2005, the date of the equity public offering, Lazard operated as a series of related partnerships under the control of the partners and Lazard did not have a capital structure that permitted share based compensation. In connection with equity awards granted pursuant to the Company s 2005 Equity Incentive Plan (described in more detail in Note 8 of Notes to Unaudited Condensed Consolidated Financial Statements), the Company adopted the fair value recognition provisions under SFAS 123. Accordingly, subsequent to the dates of grant during 2005, Lazard recognized in compensation expense the amortized portion of the fair value of the equity awards, net of an estimated forfeiture rate, over the service period specified in the award.

Effective for the first quarter of 2006, Lazard adopted SFAS 123R. Under SFAS 123R, share-based awards that do not require future service are expensed immediately. Share-based employee awards that require future service are amortized over the requisite service period. Lazard adopted SFAS 123R under the modified prospective method. Under that method, the provisions of SFAS 123R are applied to share-based awards granted subsequent to adoption. Share-based awards granted to employees prior to the adoption of SFAS 123R must continue to be amortized over the stated service periods of the awards, however, should the awards vest upon retirement, any unamortized cost would be recognized when the employee retires.

Additionally, SFAS 123R changed SFAS 123 by eliminating alternative methods for recognition of the costs of equity awards and recognition of award forfeitures. First, SFAS 123R changed SFAS 123 by precluding the use of the intrinsic method as provided for under APB 25 and requiring fair value recognition. Second, SFAS 123R differed from SFAS 123 by precluding the recognition of forfeitures on an actual basis by requiring the application of an estimated forfeiture rate to the amortizable cost of the award for all unvested awards. The Company adopted both the fair value recognition and the estimated forfeiture rate methods required under SFAS 123R in 2005 while accounting for equity awards under the provisions of SFAS 123.

SFAS 123R also requires that the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under prior accounting standards. This requirement reduces net operating cash flows and increases net financing cash flows in periods beginning with and subsequent to adoption of SFAS 123R. Total net cash flow remains unchanged from what would have been reported under prior accounting rules.

As a result of the Company adopting certain provisions consistent with SFAS 123R upon the introduction of its 2005 Equity Incentive Plan while under the provisions of SFAS 123, there is no significant effect resulting from the adoption of the provisions of SFAS 123R.

Investments in Limited Partnerships On January 1, 2006, the Company adopted, as required, the provisions of Emerging Issues Task Force (EITF) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or, Similar Entity When the Limited Partners Have Cont size="2" face="Times New Roman" style="font-size:1.0pt;">*

2,553,671

NA

See Notes to Financial Statements.

Table of Contents

Solera National Bancorp, Inc.

Statements of Changes in Stockholders Equity for the Six Months Ended June 30, 2008 (Unaudited)

	Shares Outstanding		Common Stock		Additional Paid-in Capital		Accumulated Deficit		Accumulated Other Comprehensive Income (loss)		Total
Balance at December 31, 2007	**2,553,671**	**$**	**25,536**	**$**	**25,347,342**	**$**	**(4,525,955)**	**$**	**2,412**	**$**	**20,849,335**
Comprehensive income (loss)											
Net loss							(1,105,532)				(1,105,532)
Net change in unrealized gains (losses) on investment securities available-for-sale									(288,726)		(288,726)
Total comprehensive income (loss)							(1,105,532)		(288,726)		(1,394,258)
Stock-based compensation					124,812						124,812
Balance at June 30, 2008	**2,553,671**	**$**	**25,536**	**$**	**25,472,154**	**$**	**(5,631,487)**	**$**	**(286,314)**	**$**	**19,579,889**

See Notes to Financial Statements.

Table of Contents

Solera National Bancorp, Inc.

Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007

(Unaudited)

	For the Six Months Ended June 30, 2008		2007	
CASH FLOWS FROM OPERATING ACTIVITIES				
Net (loss)	$	(1,105,532)	$	(935,861)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization		54,109		31,541
Provision for loan losses		87,104		
Net amortization of deferred loan fees/expenses		(653)		
Discount accretion on interest-bearing deposits with banks		(11,796)		
Federal Home Loan Bank stock dividend		(2,500)		
Net amortization of premiums on investment securities		26,983		
Gain on sale of investment securities		(45,264)		
Recognition of stock-based compensation on stock options		124,812		
Changes in operating assets and liabilities:				
Interest receivable		(155,050)		
Other assets		152,600		7,590
Deferred offering costs				(45,181)
Accrued interest payable		12,724		(4,728)
Accounts payable and other liabilities		9,888		160,050
Deferred rent liability		18,208		3,761
Net cash used in operating activities	$	(834,367)	$	(782,828)
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of investment securities, available-for-sale	$	(25,889,302)	$	
Proceeds from sales of investment securities, available-for-sale		4,849,038		
Proceeds from maturities/calls/pay downs of investment securities, available-for-sale		4,076,959		
Issuance of loans, net of paydowns		(7,703,942)		
Purchase of premises and equipment		(17,864)		(642,142)
Purchase of Federal Home Loan Bank stock		(500,000)		
Proceeds from redemption of Federal Reserve Bank stock		32,350		
Proceeds from maturity of interest-bearing deposits with banks		100,000		
Purchase of interest-bearing deposits with banks		(686,626)		
Net cash used in investing activities	$	(25,739,387)	$	(642,142)
CASH FLOWS FROM FINANCING ACTIVITIES				
Net change in deposits	$	13,437,039	$	
Advances from Organizers				450,000
Proceeds from Federal Home Loan Bank advances		10,000,000		
Proceeds from note payable				987,890
Proceeds from subscriptions receivable		1,600,000		
Net cash provided by financing activities	$	25,037,039	$	1,437,890
Net (decrease)/increase in cash and cash equivalents	$	(1,536,715)	$	12,920
CASH AND CASH EQUIVALENTS				

Beginning of period		5,306,126		6,978
End of period	$	3,769,411	$	19,898
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Cash paid during the period for:				
Interest	$	225,101	$	
Assets acquired under capital leases	$		$	192,350
Non-cash investing transactions:				
Unrealized loss on investment securities available-for-sale	$	(288,726)	$	

See Notes to Financial Statements.

Table of Contents

SOLERA NATIONAL BANCORP, INC.

UNAUDITED CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF ORGANIZATION

Solera National Bancorp, Inc. (the Company), is a Delaware corporation that was incorporated in 2006 to organize and serve as the holding company for Solera National Bank, a national bank that opened for business on September 10, 2007. Solera National Bank is a full-service commercial bank headquartered in Lakewood, Colorado initially serving the Denver metropolitan area.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial position of the Company as of June 30, 2008, and the results of its operations for the three and six months ended June 30, 2008 and 2007. Cash flows are presented for the six months ended June 30, 2008 and 2007. Certain reclassifications have been made to the consolidated financial statements and related notes of prior periods to conform to the current presentation. These reclassifications had no impact on stockholders equity or net loss for the periods. Additionally, certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to rules and regulations of the U.S. Securities and Exchange Commission. The Company believes that the disclosures in the unaudited condensed consolidated financial statements are adequate to make the information presented not misleading. However, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-KSB as of and for the year ended December 31, 2007.

The Company received approval as a bank in organization in the first quarter of 2007, conducted an initial closing of its common stock offering and commenced banking operations during the third quarter of 2007. Successful completion of the Company s development program and, ultimately, the attainment of profitable operations are dependent on future events, including the successful execution of the Company s business plan and achieving a level of revenue adequate to support the Company s cost structure.

Critical Accounting Policies

Income taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment.

Securities available-for-sale: Securities available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds terms and conditions, among other things.

Stock-based compensation: The Company accounts for stock-based compensation to employees as outlined in FASB Statement No. 123(R), *Share-Based Payment*, (SFAS 123R). The cost of employee services received in exchange for an award of equity instruments is based on the grant-date fair value of the award.

Table of Contents

Provision for loan losses: The allowance for loan losses represents the Company s recognition of the risks of extending credit and its evaluation of the loan portfolio. The allowance for loan losses is maintained at a level considered adequate to provide for probable loan losses based on management s assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, historical loss experience, evaluation of the quality of the underlying collateral, and holding and disposal costs. The allowance for loan losses is increased by provisions charged to expense and reduced by loans charged off, net of recoveries. Loan losses are charged against the allowance for loan losses when management believes the loan balance is uncollectible.

The Company has established a formal process for determining an adequate allowance for loan losses. The allowance for loan losses calculation process has two components. The first component represents the allowance for loan losses for impaired loans computed in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* (SFAS 114 Component), as amended by FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures - an amendment of FASB Statement No. 114*. To determine the SFAS 114 Component, collateral dependent impaired loans are evaluated using internal analyses as well as third-party information, such as appraisals. If an impaired loan is unsecured, it is evaluated using a discounted cash flow of the payments expected over the life of the loan using the loan s effective interest rate and giving consideration to currently existing factors that would impact the amount or timing of the cash flows. The second component is the allowance for loan losses calculated under FASB Statement No. 5, *Accounting for Contingencies* (SFAS 5 Component), and represents the estimated probable losses inherent within the portfolio due to uncertainties in economic conditions, delays in obtaining information about a borrower s financial condition, delinquent loans that have not been determined to be impaired, trends in speculative construction real estate lending, results of internal and external loan reviews, and other factors. This component of the allowance for loan losses is calculated by assigning a certain risk weighting, within a predetermined range, to each identified risk factor. The recorded allowance for loan losses is the aggregate of the SFAS 114 Component and SFAS 5 Component.

Recently Issued Accounting Pronouncements

In May 2008, the FASB issued Financial Accounting Standard No. 162, *The Hierarchy of Generally Accepted Accounting Principles, (SFAS 162)*. SFAS 162 identifies the sources of accounting principles and the framework for selecting the hierarchy of principles to be used in the preparation of financial statements that are presented in conformity with GAAP in the United States. The hierarchical guidance provided by SFAS 162 did not have a significant impact on the Company s financial statements.

NOTE 3 INVESTMENTS

The amortized costs and fair values of investment securities as of June 30, 2008 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:				
U.S. government agencies	$ 4,223,122	$ 1,044	$ (63,381)	$ 4,160,785
State and municipal	1,120,227		(60,582)	1,059,645
Mortgage-backed securities	25,496,606	32,685	(196,080)	25,333,211
Total securities available-for-sale	$ 30,839,955	$ 33,729	$ (320,043)	$ 30,553,641

Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Company has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. All of the Bank s investment securities were purchased during either the fourth quarter of 2007 or the first six months of 2008, therefore, no securities have been in a continuous loss position for over twelve months. As of June 30, 2008, no declines in value are deemed to be other than temporary.

As a consequence of higher long-term interest rates due to wider spreads, increased volatility and a shift in Federal Reserve sentiment, the Company recorded a net unrealized loss in the investment portfolio of $286,000 at June 30, 2008. Management continued to build the Company s investment portfolio which increased $16.9 million, or 122%, from an amortized cost of $13.9 million at December 31, 2007 to an amortized cost of $30.8 million at June 30, 2008.

Table of Contents

The Company sold six securities during the first quarter 2008 for a realized gain of $39,620 and the Company sold five securities during the second quarter 2008 for a net realized gain of $5,644.

Securities with carrying values of $3.7 million at June 30, 2008 and $495,000 at December 31, 2007, were pledged as collateral to secure public deposits. Securities with carrying values of $892,000 and $0 were pledged to secure a line-of-credit with the Bankers Bank of the West at June 30, 2008 and December 31, 2007, respectively. Securities with carrying values of $13.9 million and $0 were pledged to secure Federal Home Loan Bank advances at June 30, 2008 and December 31, 2007, respectively.

NOTE 4 INTEREST-BEARING DEPOSITS WITH BANKS

During the first quarter 2008, the Company invested approximately $700,000 in FDIC-insured certificates of deposit that earn a weighted-average yield of 4.13% and mature between June and September 2008. During the second quarter 2008, $100,000 of such deposits matured.

NOTE 5 LOANS

Loans consist of the following:

		June 30, 2008	December 31, 2007
Real estate commercial		$ 5,324,162	$ 3,003,274
Construction and land development		2,904,619	399,732
Commercial and industrial		1,018,414	188,684
Real estate residential		2,045,911	190,557
Consumer		249,449	29,407
Gross loans		11,542,555	3,811,654
Less:	Allowance for loan losses	(134,500)	(47,396)
	Deferred loan fees and expenses, net	(23,118)	3,188
Loans, net		$ 11,384,937	$ 3,767,446

During the first six months of 2008, no loans were impaired, transferred to foreclosed properties or past due.

In the ordinary course of business, and only if consistent with permissible exceptions to Section 402 of the Sarbanes- Oxley Act of 2002, the Bank may make loans to directors, executive officers, principal stockholders (holders of more than five percent of the outstanding common shares) and the businesses with which they are associated. In the Company s opinion, all loans and loan commitments to such parties are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons.

The following table details loans receivable from related parties as of June 30, 2008:

		2008
Balance at January 1, 2008	$	
New loans		811,000
Payments		6,733
Balance at June 30, 2008	$	804,267

There were no loans receivable from related parties at December 31, 2007.

Table of Contents

NOTE 6 ALLOWANCE FOR LOAN LOSSES

Activity in the allowance is summarized as follows:

		2008		2007
Allowance at January 1,	$	47,396	$	
Loans charged off				
Recoveries on loans previously charged off				
Provision for loan losses		87,104		
Allowance at June 30,	$	134,500	$	

NOTE 7 DEPOSITS

Deposits are summarized as follows:

	June 30, 2008			December 31, 2007		
		Amount	% of Total		Amount	% of Total
Noninterest-bearing demand	$	511,849	3%	$	147,407	3%
Interest-bearing demand		5,319,135	29		315,373	6
Money market accounts		6,600,700	36		1,271,665	26
Savings accounts		120,159			12,547	
Certificates of deposits, less than $100,000		1,598,778	9		352,388	7
Certificates of deposits, greater than $100,000		4,285,798	23		2,900,000	58
Total deposits	$	18,436,419	100%	$	4,999,380	100%

In the ordinary course of business, certain officers, directors, stockholders, and employees of the Bank have deposits with the Bank. In the Bank s opinion, all deposit relationships with such parties are made on substantially the same terms including interest rates and maturities, as those prevailing at the time for comparable transactions with other persons. The balance of related party deposits at June 30, 2008 and December 31, 2007 was approximately $2.5 million and $2.1 million, respectively.

NOTE 8 STOCK-BASED COMPENSATION

The Company s 2007 Stock Incentive Plan (the Plan) was approved by the Company s Board of Directors (the Board) with an effective date of September 10, 2007 and was approved by the Company s stockholders at the annual meeting held on June 17, 2008. Under the terms of the Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also officers or employees, may only be granted nonqualified stock options. The Board reserved 510,734 shares of common stock for issuance under the Plan. The Plan provides for options to purchase shares of common stock at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and generally vest over four years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company recognized stock-based compensation cost of approximately $62,000 and $125,000 during the three and six months ended June 30, 2008, respectively. The Company recognized stock-based compensation cost of $0 during both the three and six months ended June 30, 2007. No tax benefit related to stock-based compensation will be recognized until the Company is profitable.

The Company accounts for its stock-based compensation under the provisions of SFAS 123R. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model. No options were granted during the first quarter 2008 and 1,250 options were granted during the second quarter 2008. No options were granted during the six months ended June 30, 2007.

No options were exercised or vested and 500 options were forfeited during the six months ended June 30, 2008. During this same period, the Company recognized expense for approximately 49,000 options, representing a pro-rata amount of the options that will vest at the end of year one. As of June 30, 2008, there was approximately $807,000

Table of Contents

of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 3.23 years.

The following is a summary of the Company s non-vested options at June 30, 2008:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2008	397,846	$ 2.74
Granted	1,250	2.13
Vested		
Forfeited	(500)	2.75
Non-vested at June 30, 2008	398,596	$ 2.73

NOTE 9 NONINTEREST EXPENSE

The following table details the items comprising Other general and administrative expenses:

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Marketing and promotions	$ 58,739	$ 64,500	$ 125,897	$ 72,129
Data processing	51,742	411	98,652	430
Printing, stationery and supplies	23,462	26,324	32,898	46,225
Regulatory and reporting fees	15,548	881	29,304	881
Travel and entertainment	8,040	13,837	12,682	23,304
Telephone/communication	6,104	8,239	13,287	11,497
Insurance	4,373	2,065	9,118	3,510
Dues and memberships	2,961		8,011	
Training and education	2,758		5,243	
Postage and shipping	2,465	4,901	4,416	6,219
Temporary staffing		33,294		63,987
Miscellaneous	13,084	7,692	16,980	8,546
Total	$ 189,276	$ 162,144	$ 356,488	$ 236,728

NOTE 10 INCOME TAXES

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset account recognized in the accompanying statements of financial condition:

Table of Contents

	June 30, 2008	December 31, 2007
Deferred tax assets:		
Start-up and organizational expenses	$ 1,251,436	$ 1,295,346
Net operating loss carryforward	681,674	283,720
Allowance for loan losses	20,480	7,235
Other	80,636	71,070
Total deferred tax assets	2,034,226	1,657,371
Deferred liabilities:		
Federal Home Loan Bank stock dividend	(926)	
Tax over book depreciation	(9,000)	(1,895)
Total deferred tax liabilities	(9,926)	(1,895)
Net deferred tax assets	2,024,300	1,655,476
Valuation allowance	(2,024,300)	(1,655,476)
Net deferred taxes	$	$

The Company has provided a 100% valuation allowance for its net deferred tax asset due to uncertainty of realization during the carryforward period. The Company has net operating loss carryforwards of approximately $1.8 million for federal income tax purposes. Federal net operating loss carry forwards, to the extent not used, will expire beginning in 2027.

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate of 35% to pretax income from continuing operations for the six months ended June 30, 2008 and the twelve months ended December 31, 2007 due to the following:

	June 30, 2008	December 31, 2007
Computed expected tax benefit	$ (386,937)	$ (851,948)
Change in income taxes resulting from:		
Change in valuation allowance	368,824	881,024
Other	18,113	(29,076)
Income tax provision	$	$

NOTE 11 COMMITMENTS AND CONTINGENCIES

The Company is a party to credit related 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 commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Company s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At June 30, 2008 and December 31, 2007 the following financial instruments were outstanding whose contract amounts represent credit risk:

	June 30, 2008	December 31, 2007
Financial instruments whose contractual amounts represent credit risk:		
Commitments to extend credit	$ 4,095,655	$ 2,522,059
Letters of credit		9,000
Total commitments	$ 4,095,655	$ 2,531,059

Table of Contents

Total commitments of $4.1 million were outstanding at June 30, 2008 and consisted of $4.0 million at variable rates and $145,000 at fixed rates. Total commitments of $2.5 million were outstanding at December 31, 2007 and consisted of $2.4 million at variable rates and $88,000 at fixed rates.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the commitments do not necessarily represent future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management s credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and income producing commercial properties.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

NOTE 12 FAIR VALUE MEASUREMENTS (SFAS 157 DISCLOSURE)

Effective January 1, 2008, the Company determines the fair market values of its financial instruments based on the fair value hierarchy established in SFAS No. 157, *Fair Value Measurements* (SFAS 157), which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs, as follows, that may be used to measure fair value.

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company carries its available-for-sale securities at fair value. Fair value measurement is obtained from independent pricing services which utilize observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds terms and conditions, among other things. As of June 30, 2008, all of the Company s available-for-sale securities, $30.5 million, were valued using Level 2 inputs.

15

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis presents the Company s consolidated financial condition as of June 30, 2008 and results of operations for the three and six months ended June 30, 2008 and 2007, respectively. The discussion should be read in conjunction with the financial statements and the notes related thereto which appear elsewhere in this Quarterly Report on Form 10-Q.

EXECUTIVE OVERVIEW

We are a Delaware corporation that was incorporated on January 12, 2006 to organize and serve as the holding company for Solera National Bank, a national bank that opened for business on September 10, 2007. Solera National Bank is a full-service commercial bank headquartered in Lakewood, Colorado serving the Denver metropolitan area. Our main banking office is located at 319 S. Sheridan Blvd., Lakewood, Colorado 80226. Our telephone number is (303) 209-8600.

We offer a broad range of commercial and consumer banking services to small and medium-sized businesses, licensed professionals and individuals who are particularly responsive to the personalized service that Solera National Bank provides to its customers. We believe that local ownership and control allows the Bank to serve customers more efficiently and effectively. Solera National Bank competes on the basis of providing a unique and personalized banking experience combined with a full range of services, customized and tailored to fit the individual needs of its clients. Solera National Bank serves the entire market area and, in addition, has a special niche focus on the local Hispanic population due to the significant growth of this demographic.

As of June 30, 2008, the Company had, on a consolidated basis, total assets of $48.6 million, net loans of $11.4 million, total deposits of $18.4 million, and stockholders equity of $19.6 million. In 2007, the Company completed an initial public offering of its common stock, issuing 2,553,671 shares at a price of $10.00 per share. The gross proceeds received from the offering were approximately $25.5 million.

Results of Operations for the Three Months Ended June 30, 2008

The following discussion focuses on the Company s financial condition and results of operations for the three months ended June 30, 2008. The Company s principal operations for the three months ended June 30, 2008 consisted of the operations of Solera National Bank, which opened for business September 10, 2007. The following discussion is limited and does not include a discussion of the comparison to prior financial results for the three months ended June 30, 2007, since the Bank was not open for business during the second quarter of 2007. As such, a discussion of the comparison to prior financial results is not meaningful to an understanding of our current business and, therefore, has been omitted from this Report.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income, principally from loan and investment security portfolios, and interest expense, principally on customer deposits and borrowings. Net interest income is our principal source of earnings. Changes in net interest income result from changes in volume, spread and margin. Volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities. Spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Margin refers to net interest income divided by average interest-earning assets, and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities.

Net interest income was $352,000 in the second quarter of 2008. Our annualized net interest margin was 3.55% for the three months ended June 30, 2008.

Total interest income was $497,000 for the second quarter of 2008 consisting primarily of interest on investment securities of $322,000, interest and fees on loans of $141,000 and dividends on bank stocks of $10,000. Average net loans were $9.1 million, and other average interest-earning assets were $30.6 million, consisting primarily of average available-for-sale securities of $26.9 million, average federal funds sold of $3.0 million and average certificates of deposits with banks of $682,000.

Table of Contents

Total interest expense was $145,000 in the second quarter of 2008. This consisted primarily of interest expense on certificates of deposit over $100,000 of $47,000, interest expense on Federal Home Loan bank advances of $42,000 and interest expense on money market accounts of $40,000.

Provision for Loan Losses

We determine a provision for loan losses that we consider sufficient to maintain an allowance to absorb probable losses inherent in our portfolio as of the balance sheet date. For additional information concerning this determination, see the section of this discussion and analysis captioned *Allowance for Loan Losses.*

In the second quarter of 2008, our provision for loan losses was $50,000 relating to the growth of our loan portfolio and the estimated probable losses inherent within the portfolio due to uncertainties in economic conditions. There were no loans specifically reserved for under the SFAS 114 Component of the loan loss reserve. Furthermore, there were no charge-offs or non-performing loans during the second quarter of 2008.

Noninterest Income

The noninterest income for the quarter ended June 30, 2008 was $22,000, consisting primarily of deposit service charges and fees of $12,000. Additionally, the Company earned $5,000 in sublease income for offices within the Bank s main office building that are leased to third parties and $6,000 in net gains on investment securities sold during the second quarter.

Noninterest Expense

Our total noninterest expense was $857,000 for the quarter ended June 30, 2008. This consisted of salaries and benefits of $481,000, occupancy expenses of $113,000, primarily for lease expense for the bank s main office building, and professional fees of $73,000, for external audit, legal and consulting fees. The Company employed 18 full-time equivalent employees as of June 30, 2008.

Other general and administrative expenses totaled $189,000 for the quarter ended June 30, 2008 and consisted of marketing and promotional expenses of $59,000 as the Bank continued to raise community awareness of the Bank s products and services. Data processing fees were $52,000 and include the costs to operate the Bank s primary banking software. Printing, stationery and supplies were $23,000 primarily associated with the printing of the Annual Report and Proxy statement for the first annual meeting of shareholders. Regulatory and reporting fees were $16,000 primarily attributable to bank assessment fees paid to the Office of the Comptroller of the Currency, the Federal Reserve Bank, and the Federal Deposit Insurance Corporation as well as fees associated with filing reports with the Securities and Exchange Commission. Other expenses of $39,000 included $8,000 for travel and entertainment, $6,000 for telephone and communication lines, $4,000 for insurance, $3,000 for dues and memberships, $3,000 for training and education, $2,000 for postage and shipping, and $13,000 for other miscellaneous expenses.

Income Taxes

No federal or state tax expense has been recorded for the quarter ended June 30, 2008, based upon net operating losses. Since it is uncertain that the Company will become profitable, the deferred tax benefit accumulated to date has a full valuation allowance so that the net deferred tax benefit at June 30, 2008 is $0.

Results of Operations for the Six Months Ended June 30, 2008

The following discussion focuses on the Company s financial condition and results of operations for the six months ended June 30, 2008. The Company s principal operations for the six months ended June 30, 2008 consisted of the operations of Solera National Bank, which opened for business September 10, 2007. The following discussion is limited and does not include a discussion of the comparison to prior financial results for the six months ended June 30, 2007, since the Bank was not open for business during the first six months of 2007. As such, a discussion of the comparison to prior financial results is not meaningful to an understanding of our current business and, therefore, has been omitted from this Report.

Table of Contents

Net Interest Income and Net Interest Margin

Net interest income was $628,000 for the six months ended June 30, 2008. Our annualized net interest margin was 3.68% for the same period.

Total interest income was $866,000 for the six months ended June 30, 2008 consisting primarily of interest on investment securities of $553,000 and interest on loans of $229,000. During this period, average net loans were $7.2 million and other average interest-earning assets were $27.3 million.

Total interest expense was $238,000 in the first six months of 2008. This consisted primarily of interest expense on certificates of deposit over $100,000 of $97,000, interest expense on money market accounts of $72,000, and $51,000 for interest on other borrowings.

Provision for Loan Losses

During the first six months of 2008, our provision for loan losses was $87,000 relating to the growth of our loan portfolio and the estimated probable losses inherent within the portfolio due to uncertainties in economic conditions. There were no loans specifically reserved for under the SFAS 114 Component of the loan loss reserve. Furthermore, there were no charge-offs or non-performing loans during this period.

Noninterest Income

The noninterest income for the six months ended June 30, 2008 was $71,000, consisting primarily of gains on the sale of investment securities of $45,000. Additionally, the Company earned $17,000 in deposit service charges and fees, and $9,000 in sublease income for an office within the Bank s main office building that is leased to a third party.

Noninterest Expense

Our total noninterest expense was $1.7 million for the six months ended June 30, 2008. This consisted of salaries and benefits of $985,000, occupancy expenses of $231,000, primarily for rental expense for the bank s main office building, and professional fees of $146,000 for external audit, legal and consulting fees.

Other general and administrative expenses totaled $356,000 for the six months ended June 30, 2008 and consisted of marketing and promotional expenses of $126,000 as management focused on raising awareness in the community of the Bank s products and services. Data processing fees were $99,000 and include the costs to run the Bank s main banking software. Printing, stationery and supplies were $33,000 and include the costs to print the Annual Report and Proxy statement. The remainder of the expenses included regulatory and reporting fees of $29,000, travel and entertainment expenses of $13,000, telephone and communication expenses of $13,000, insurance expenses of $9,000, dues and memberships of $8,000, training and education of $5,000, postage and shipping of $4,000 and other miscellaneous office expenses of $17,000.

Financial Condition

Customer deposits, Federal Home Loan Bank advances, and proceeds from the initial public offering completed in 2007 were primarily invested in loans, investment securities and federal funds sold, resulting in total assets as of June 30, 2008 of $48.6 million.

As of June 30, 2008, stockholders equity was $19.6 million, as a result of the initial public offering, partially offset by the inception-to-date losses from start-up activities and current operations.

Short-Term Investments and Interest-bearing Deposits in Other Financial Institutions

At June 30, 2008, Solera National Bank had $2.8 million in federal funds sold and $598,000 in interest-bearing deposits with other financial institutions. These short-term investments and interest-bearing deposits allow Solera National Bank to meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested.

Table of Contents

Federal Home Loan Bank and Federal Reserve Bank Stock

At June 30, 2008, the Bank had a total of $995,000 invested in bank stocks carried at amortized cost consisting of $493,000 in Federal Reserve Bank stock and $502,000 in Federal Home Loan Bank stock. These investments allow Solera National Bank to conduct business with these entities. As of June 30, 2008, the Federal Reserve Bank stock is yielding an average of 6.0% and the Federal Home Loan Bank stock is yielding an average interest rate of 4.2%.

Investment Securities

Our investment portfolio serves as a source of interest income and, secondarily, as a source of liquidity and a management tool for our interest rate sensitivity. We manage our investment portfolio according to a written investment policy established by our Board of Directors.

At June 30, 2008, Solera National Bank s securities consisted of available-for-sale securities of $30.6 million. The following table provides additional detail on the Company s investment securities as of June 30, 2008 and December 31, 2007:

	June 30, 2008		December 31, 2007	
	Estimated Fair Value	Weighted Average Yield	Estimated Fair Value	Weighted Average Yield
Securities available-for-sale				
U.S. government agencies	$ 4,160,785	5.08%	$ 3,508,333	5.09%
State and municipal	1,059,645	5.43	1,117,262	5.43
Mortgage-backed securities	25,333,211	5.19	9,235,186	5.34
Total securities available-for-sale	$ 30,553,641	5.18%	$ 13,860,781	5.29%

Loan Portfolio

Our primary focus is income from interest on loans. The following table presents the composition of our loan portfolio by category as of the dates indicated:

	June 30, 2008		December 31, 2007	
	Amount	% of Total	Amount	% of Total
Real estate commercial	$ 5,324,162	46%	$ 3,003,274	79%
Construction and land development	2,904,619	25	399,732	10
Commercial and industrial	1,018,414	9	188,684	5
Real estate residential	2,045,911	18	190,557	5
Consumer	249,449	2	29,407	1
Gross loans	11,542,555	100%	3,811,654	100%

Less:	Allowance for loan losses	(134,500)	(47,396)
	Deferred loan fees and expenses, net	(23,118)	3,188
Loans, net		$ 11,384,937	$ 3,767,446

As of June 30, 2008, net loans were $11.4 million, a 202%, or $7.6 million increase from $3.8 million at December 31, 2007. Net loans as a percentage of total assets were 23% as of June 30, 2008, compared to 14% at December 31, 2007.

The real estate commercial loan portfolio consists primarily of lines of credit or term loans to businesses that are secured by real estate. At June 30, 2008, there were $5.3 million real estate commercial loans in the loan portfolio, an increase of 77%, or $2.3 million from $3.0 million at December 31, 2007.

The construction and land development loan portfolio is comprised of construction loans for owner-occupied construction and development loans for property being constructed and sold to third parties. At June 30, 2008,

Table of Contents

construction and land development loans totaled $2.9 million, an increase of $2.5 million from $400,000 at December 31, 2007.

The commercial and industrial loan portfolio consists of loans to businesses primarily for working capital lines of credit. At June 30, 2008, commercial and industrial loans totaled $1.0 million, an $830,000 increase from $189,000 at December 31, 2007.

The real estate residential loan portfolio consists of residential second mortgage loans, home equity loans and lines of credit and home improvement loans. At June 30, 2008, $2.0 million was outstanding for residential real estate loans, an increase of $1.9 million from $191,000 outstanding at December 31, 2007.

The consumer and other loan portfolio consists of personal lines of credit, loans to acquire personal assets such as automobiles and boats and overdraft protection balances for our deposit customers. As of June 30, 2008, there were $249,000 consumer and other loans in the loan portfolio, an increase of $220,000 from December 31, 2007.

Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. The Bank s loan portfolio generally consists of loans to borrowers within Colorado. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, the Bank s loan portfolio consists primarily of real estate loans secured by real estate located in Colorado, making the value of the portfolio more susceptible to declines in real estate values and other changes in economic conditions in Colorado. Also, since the Bank s loan portfolio is in the initial stages, it contains only 62 funded loans, with the four largest loans comprising approximately 52% of the portfolio s gross value. However, management expects this concentration to diminish over time as the Bank s loan portfolio continues to grow. No single borrower can be approved for a loan over the Bank s current legal lending limit of approximately $2.5 million. This regulatory requirement helps to ensure the Bank s exposure to one individual customer is limited.

Management may renew loans at maturity when requested by a customer whose financial strength appears to support such a renewal or when such a renewal appears to be in the best interest of Solera National Bank. Solera National Bank requires payment of accrued interest in such instances and may adjust the rate of interest, require a principal reduction, or modify other terms of the loan at the time of renewal.

Loan terms vary according to loan type. The following table shows the contractual maturity distribution of loans as of June 30, 2008:

	As of June 30, 2008					
		Over 1 Year through 5 Years		Over 5 Years		
	One Year or Less	Fixed Rate	Floating or Adjustable Rate	Fixed Rate	Floating or Adjustable Rate	Total
Real estate commercial	$	$ 2,989,649	$ 1,334,513	$ 1,000,000	$	$ 5,324,162
Construction and land development	560,000	920,000	1,424,619			2,904,619
Commercial and industrial	869,011	3,243	146,160			1,018,414

Real estate residential		40,000		47,308	1,958,603	2,045,911
Consumer	231,499	17,950				249,449
Gross loans	$ 1,660,510	$ 3,970,842	$ 2,905,292	$ 1,047,308	$ 1,958,603	$ 11,542,555

Nonperforming Loans, Leases and Assets

Nonperforming assets consist of loans and leases on nonaccrual status, loans 90 days or more past due and still accruing interest, loans that have been restructured resulting in a reduction or deferral of interest or principal, OREO, and other repossessed assets. As of June 30, 2008, there were no nonperforming assets.

A potential problem loan is defined as a loan where information about possible credit problems of the borrower is known, causing management to have serious doubts as to the ability of the borrower to comply with the present loan payment terms and which may result in the inclusion of such loan in one of the nonperforming asset categories. An

Table of Contents

internally classified loan list is maintained that helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans classified as special mention are those that contain a weakness that, if left unattended, could develop into a problem affecting the ultimate collectibility of the loan. Loans classified as substandard are those loans with clear and defined weaknesses, such as highly leveraged positions, unfavorable financial ratios, uncertain repayment resources or poor financial condition, which may jeopardize recoverability of the loan. Loans classified as doubtful are those loans that have characteristics similar to substandard loans, but also have an increased risk that 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 may include some loans that are past due at least 90 days, are on nonaccrual status or have been restructured. Loans classified as loss are those loans that are in the process of being charged-off. Solera National Bank had no loans classified in these categories at June 30, 2008.

Allowance for Loan Losses

Implicit in Solera National Bank s lending activities is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made and the creditworthiness of the borrower over the term of the loan. To reflect the currently perceived risk of loss associated with the loan portfolio, additions are made to the allowance for loan losses in the form of direct charges against income to ensure that the allowance is available to absorb possible loan losses. The factors that influence the amount include, among others, the remaining collateral and/or financial condition of the borrowers, historical loan loss, changes in the size and composition of the loan portfolio, and general economic conditions.

The amount of the allowance equals the cumulative total of the provisions made from time to time, reduced by loan charge-offs and increased by recoveries of loans previously charged-off. Until management has adequate historical data upon which to base the estimate of the allowance for loan losses, information regarding the ability of the borrower to repay the loan, current economic conditions and other pertinent factors will be considered. The allowance was $134,500, or 1.17% of outstanding principal as of June 30, 2008.

Credit and loan decisions are made by management and the Board of Directors in conformity with loan policies established by the Board of Directors. Solera National Bank s practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower s failure to meet repayment terms, the borrower s deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan s classification as a loss by regulatory examiners, or other reasons. During the six months ended June 30, 2008, there were no charge-offs.

Non-earning Assets

Premises, leasehold improvements and equipment totaled $910,000 at June 30, 2008. Due to the Bank s growth, management has decided to re-occupy property that was abandoned in July 2007. Management anticipates the re-occupancy to occur on approximately September 1, 2008 with the space to be used for administrative purposes. Upon re-occupying the space, the remaining lease abandonment liability will be reversed resulting in a credit to rent expense during the third quarter 2008. Subsequently, rent expense will increase for the monthly rental expense associated with occupying the premises. At the present time, management anticipates occupying the premises for the remainder of the lease term, which expires in August 2011, and will determine prior to the expiration of the lease whether to renew for an additional 5-year term.

Off-Balance Sheet Arrangements

Neither the Company nor Solera National Bank has any material off-balance sheet arrangements.

Table of Contents

Borrowings

During the second quarter 2008, the Bank borrowed $10.0 million from the Federal Home Loan Bank of Topeka (FHLB) in order to finance the purchase of investment securities. The FHLB advances mature between April 16, 2009 and June 20, 2013. The advances have a weighted-average fixed interest rate of 3.73%.

The Bank has also established an unsecured Fed Funds line-of-credit with Bankers Bank of the West and First Tennessee as well as a secured Fed Funds line with Bankers Bank of the West. As of June 30, 2008, the Company had $0 outstanding on these lines.

Loan Commitments

At June 30, 2008, the Company had $4.1 million in outstanding loan origination commitments. Management believes Solera National Bank has sufficient funds available to meet current origination and other lending commitments.

Capital Resources and Capital Adequacy Requirements

The risk-based capital regulations established and administered by the banking regulatory agencies are applicable to Solera National Bank. Risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under the regulations, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. Under the prompt corrective action regulations, to be adequately capitalized a bank must maintain minimum ratios of total capital to risk-weighted assets of 8.0%, Tier 1 capital to risk-weighted assets of 4.0%, and Tier 1 capital to total average assets of 4.0%. Failure to meet these capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on Solera National Bank s financial statements.

As of June 30, 2008, Solera National Bank was categorized as well-capitalized. A well-capitalized institution must maintain a minimum ratio of total capital to risk-weighted assets of at least 10.0%, a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, and a minimum ratio of Tier 1 capital to total average assets of at least 5.0% and must not be subject to any written order, agreement, or directive requiring it to meet or maintain a specific capital level.

The following table summarizes the ratios of the Bank and the regulatory minimum capital requirements at June 30, 2008:

As of June 30, 2008 ($ in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Problems	
	Amount	%	Amount	%	Amount	%
Total Capital (to risk-weighted assets)	$ 16,033	75.4%	$ 1,701	>8.0%	$ 2,127	>10.0%
Tier 1 capital (to risk-weighted assets)	$ 15,899	74.8%	$ 851	>4.0%	$ 1,276	>6.0%
Tier 1 capital (to average assets)	$ 15,899	38.4%	$ 1,657	>4.0%	$ 2,071	>5.0%

Table of Contents

Liquidity

The primary source of liquidity for the Company will be dividends paid by Solera National Bank. Solera National Bank is currently restricted from paying dividends without regulatory approval that will not be granted until the accumulated deficit has been eliminated.

Solera National Bank s liquidity is monitored by its staff, the Asset Liability Committee and the Board of Directors, who will review historical funding requirements, current liquidity position, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded commitments.

Solera National Bank s primary sources of funds will be retail and commercial deposits, loan and securities repayments, other short-term borrowings, and other funds provided by operations. While scheduled loan repayments and maturing investments are relatively predictable, deposit flows and early loan prepayments are more influenced by interest rates, general economic conditions, and competition. Solera National Bank will maintain investments in liquid assets based upon management s assessment of (1) the need for funds, (2) expected deposit flows, (3) yields available on short-term liquid assets, and (4) objectives of the asset/liability management program.

As loan demand increases, greater pressure will be exerted on Solera National Bank s liquidity. However, it is management s intention to maintain a conservative loan to deposit ratio in the range of 80 - 90% over time. Given this goal, Solera National Bank will not aggressively pursue lending opportunities if sufficient funding sources (*e.g.*, deposits, Federal Funds, etc.) are not available, nor will Solera National Bank seek to attract transient volatile, non-local deposits with above market interest rates. As of June 30, 2008, the loan to deposit ratio was 62%.

Solera National Bank had cash and cash equivalents of $3.8 million, or 8% of total Bank assets, at June 30, 2008. Management feels Solera National Bank should have more than adequate liquidity to meet anticipated future funding needs.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, the Company is not required to provide the information required by this Item.

ITEM 4(T). CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Management is responsible for maintaining effective disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, management evaluated the effectiveness and operation of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, both the Company s Principal Executive Officer and Principal Accounting and Chief Financial Officer have concluded that the Company s disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that are filed or submitted under the Exchange Act are recorded, processed, summarized and reported to management within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in internal controls over financial reporting during the Company s last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal controls over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

As a smaller reporting company, the Company is not required to provide the information required by this Item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 17, 2008, the Company held its annual meeting of stockholders. At that meeting, the security holders voted on the following items:

1. Election of directors. The following fifteen directors, comprising the entire board of directors on that date, were reelected as directors of the Company to serve until the next annual meeting of stockholders:

Name	Term

		Votes Cast For Election	Votes Withheld
Norma R. Akers	1 year	1,667,440	850
Rob L. Alvarado	1 year	1,664,940	3,350
Maria G. Arias	1 year	1,664,940	3,350
Douglas Crichfield	1 year	1,641,346	26,944
Paul M. Ferguson	1 year	1,656,056	12,234
James C. Foster	1 year	1,664,940	3,350
Robert M. Gallegos	1 year	1,664,940	3,350
Steve D. Gutterman	1 year	1,657,440	10,850
Ronald E. Montoya	1 year	1,664,940	3,350
Ray L. Nash	1 year	1,657,440	10,850
Joel S. Rosenstein	1 year	1,649,440	18,850
Basil Sabbah	1 year	1,649,440	18,850
F. Stanley Sena	1 year	1,664,940	3,350
Mark R. Smith	1 year	1,664,940	3,350
Kent C. Veio	1 year	1,649,940	18,350

2. Stockholders voted to approve the 2007 Stock Incentive Plan. The results of the vote were as follows: votes cast for the proposal were 1,514,953; votes cast against the proposal were 81,231; and abstentions were 21,856.

3. Stockholders voted to ratify the selection of McGladrey & Pullen, LLP as Solera National Bancorp s independent registered public accounting firm for the fiscal year ending December 31, 2008. The results of the vote were as follows: votes cast for the proposal were 1,651,196; votes cast against the proposal were 13,594; and abstentions were 3,500.

Table of Contents

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

31.1 Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.*
31.2 Certification of Principal Accounting and Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.*
32.1 Certification pursuant to Rule 13a-14(b) of the Securities Exchange Act and 18 U.S.C. §1350.*

---

* Filed herewith.

Table of Contents

SOLERA NATIONAL BANCORP, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	SOLERA NATIONAL BANCORP, INC. *(Registrant)*
Date: August 14, 2008	/s/ Paul M. Ferguson Paul M. Ferguson President (Principal Executive Officer)
	/s/ Robert J. Fenton Robert J. Fenton Vice President, Secretary & Treasurer (Principal Accounting and Chief Financial Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1	Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act
31.2	Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act
32.1	Certification pursuant to Rule 13a-14(b) of the Securities Exchange Act and 18 U.S.C. §1350