

Edgar Filing: BAY NATIONAL CORP - Form 10-Q

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

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

At November 14, 2008, the issuer had 2,153,101 shares of Common Stock outstanding.

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respectively

Additional paid in capital	17,942,053	17,788,833
(Accumulated deficit) retained earnings	(1,930,849)	2,110,343
 Total Stockholders' Equity	 16,032,735	 19,920,552
 Total Liabilities and Stockholders' Equity	 \$ 274,122,978	 \$ 256,535,859

See accompanying notes to consolidated financial statements.

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NET (LOSS) INCOME \$ (1,778,760) \$ 261,145 \$ (4,041,192) \$ 1,502,241

Per Share Data:

Net (Loss) Income (basic) (1) \$ (.83) \$.12 \$ (1.88) \$.70
 Net (Loss) Income (diluted) (1) \$ (.83) \$.12 \$ (1.88) \$.68

Weighted Average shares outstanding (basic) (1) 2,151,825 2,135,688 2,144,519 2,131,671
 Effect of Dilution – Stock options and Restricted shares (1) - 77,052 - 79,433

Weighted Average shares outstanding (diluted) (1) 2,151,825 2,212,740 2,144,519 2,211,104
 (1) Adjusted to reflect 1.1 stock split in the form of a dividend recorded on June 29, 2007

See accompanying notes to consolidated financial statements.

Supplemental information:

Interest paid	\$ 5,072,088	\$ 6,886,338
Income taxes paid	\$ 353,894	\$ 1,430,168
Accrued director fees paid in common stock	\$ 67,835	\$ -
Amount transferred from loans to other real estate owned	\$ 5,262,512	\$ 1,048,012
Amount transferred from loans held for sale to loans	\$ 972,144	\$ -

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Nine Months Ended September 30, 2008 and 2007
(Unaudited)

1. GENERAL

Organization

Bay National Corporation (the "Company") was incorporated on June 3, 1999 under the laws of the State of Maryland to operate as a bank holding company of a national bank with the name Bay National Bank (the "Bank"). On May 12, 2000, the Company purchased all the shares of common stock issued by the Bank. The Bank commenced operations on May 12, 2000 after successfully meeting the conditions of the Office of the Comptroller of the Currency (the "OCC") to receive its charter authorizing it to commence operations as a national bank, obtaining the approval of the Federal Deposit Insurance Corporation to insure its deposit accounts, and meeting certain other regulatory requirements.

Basis of Presentation

The accompanying consolidated financial statements include the activity of Bay National Corporation and its wholly owned subsidiary, Bay National Bank. All significant intercompany transactions and balances have been eliminated in consolidation.

The foregoing consolidated financial statements are unaudited; however, in the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. The balances as of December 31, 2007 have been derived from audited financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in Bay National Corporation's 2007 Annual Report on Form 10-K. There have been no significant changes to the Company's accounting policies as disclosed in the 2007 Annual Report. The results shown in this interim report are not necessarily indicative of results to be expected for the full year 2008 or any other interim period.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry.

Reclassifications

Certain reclassifications have been made to amounts previously reported to conform to the current presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

2. REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting and other factors.

The Company incurred compensation expense of \$2,064 associated with vested stock options for the nine-month period ending September 30, 2008. The unrecognized compensation cost related to unvested stock option awards was \$7,044 at September 30, 2008 based upon a weighted average fair value of \$2.75.

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September 30, 2008, the Company realized non-interest income of \$203,218 and \$613,460, respectively, as compared to \$148,086 and \$521,292 for the same periods ended September 30, 2007. Gains on the sale of mortgage loans of \$73,387 and \$214,024 comprised 36.1% and 34.9% of the total for the three-month and nine-month periods ended September 30, 2008, respectively. This compares to gains on the sale of mortgage loans of \$91,442 and \$351,934, or 61.7% and 67.5%, of total non-interest income for the three-month and nine-month periods ended September 30, 2007.

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Ratio of rate
sensitive assets to
rate
sensitive
liabilities

159.84% 20.60% 251.12% 131.61%

The Company has 51.9% of its interest-earning assets and 37.5% of its interest-bearing liabilities in variable rate balances. Interest-earning assets exceed interest-bearing liabilities by \$45.3 million. The majority of this gap is concentrated in items maturing or repricing within five years. This gap is generally reflective of the Company's effort, over the past nine months, to maintain flexibility in the balance sheet in a declining interest rate environment. As rates have dropped over the past nine months, the Company has begun to extend the term on time deposits in order to lock in lower deposit rates for a longer period of time. This analysis indicates that the Company will benefit from increasing market rates of interest. However, since all interest rates and yields do not adjust at the same pace, the gap is only a general indicator of interest rate sensitivity. The analysis of the Company's interest-earning assets and interest-bearing liabilities presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration the fact that changes in interest rates do not affect all assets and liabilities equally. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities.

Management constantly monitors and manages the structure of the Company's balance sheet, seeks to control interest rate exposure, and evaluates pricing strategies. Strategies to better match maturities of interest-earning assets and interest-bearing liabilities include structuring loans with rate floors and ceilings on variable-rate notes and providing for repricing opportunities on fixed-rate notes. Management believes that a lending strategy focusing on variable-rate loans and short-term fixed-rate loans will best facilitate the goal of minimizing interest rate risk. However, management will opportunistically enter into longer term fixed-rate loans and/or investments when, in management's judgment, rates adequately compensate the Company for the interest rate risk. The Company's current investment concentration in Federal funds sold and other overnight investments provides the most flexibility and control over rate sensitivity, since it generally can be restructured more quickly than the loan portfolio. On the liability side, deposit products can be restructured so as to offer incentives to attain the maturity distribution desired; although, competitive factors sometimes make control over deposit maturity difficult.

Capital Resources

The Company had stockholders' equity at September 30, 2008 of \$16.0 million as compared to \$19.9 million at December 31, 2007. The decrease in capital is a result of the operating loss incurred for the nine-months ended September 30, 2008. Management is extremely focused on ensuring that the Company has adequate capital to support projected asset growth over the next 12 months.

Banking regulatory authorities have implemented strict capital guidelines directly related to the credit risk associated with an institution's assets. Banks and bank holding companies are required to maintain capital levels based on their "risk adjusted" assets so that categories of assets with higher "defined" credit risks will require more capital support than assets with lower risks. The Bank has met its capital adequacy requirements to date.

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Regulatory approval is required to pay dividends that exceed the Bank's net profits for the current year plus its retained net profits for the preceding two years. The Bank could not have paid dividends to the Company without approval from bank regulatory agencies at September 30, 2008, and no such payments are currently planned.

Application of Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability must be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for credit losses as the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses. The establishment of allowance factors is a continuing exercise and allowance factors may change over time, resulting in an increase or decrease in the amount of the provision or allowance based upon the same volume and classification of loans. Changes in allowance factors or in management's interpretation of those factors will have a direct impact on the amount of the provision and a corresponding effect on income and assets. Also, errors in management's perception and assessment of the allowance factors could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs, which would adversely affect income and capital.

For additional information regarding the allowance for credit losses, see "Allowance for Credit Losses and Credit Risk Management."

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-Q, Bay National Corporation's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of Bay National Corporation's disclosure controls and procedures. Based upon that evaluation, Bay National Corporation's Chief Executive Officer and Chief Financial Officer concluded that Bay National Corporation's disclosure controls and procedures are effective as of September 30, 2008. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Bay National Corporation in the reports that it files or submits under the Securities Exchange Act of 1934 ("Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

In addition, there were no changes in Bay National Corporation's internal control over financial reporting (as defined in Rule 13a-15 under the Exchange Act) during the quarter ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect, Bay National Corporation's internal control over financial reporting.

Information Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Exchange Act. Forward-looking statements also may be included in other statements that we make. All statements that are not descriptions of historical facts are forward-looking statements. Forward-looking statements often use words such as "believe," "expect," "plan," "may," "will," "should," "project," "contemplate," "anticipate," "forecast," "intend" or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

The statements presented herein with respect to, among other things, the Company's plans, objectives, expectations and intentions, including statements regarding long-term growth, market expansion, earnings during the remainder of 2008 or beyond such time, loan, asset and business growth, benefits resulting from previous staff reductions, future sources of income, the impact or worsening economic conditions on the Company, future realization of deferred tax asset, operating results and profitability, liquidity, allowance for credit losses, interest rate sensitivity, retention of deposits, and financial and other goals, as well as statements with respect to the future status of our loan portfolio are forward-looking. These statements are based on the Company's beliefs and assumptions, and on information available to it as of the date of this filing, and involve risks and uncertainties. These risks and uncertainties include, among others, those discussed in this report on Form 10-Q; the Company's dependence on key personnel; risks related to the Bank's choice of loan portfolio; continuing declines in the real estate market in the Company's markets and in the economy generally; risks related to the Bank's lending limit; risks of a competitive market; the impact of any new or amended government regulations on operating results; and the effects of developments in technology. For a more complete discussion of these risks and uncertainties, see the discussion under the caption "Risk Factors" in Bay National Corporation's Form 10-K for the year ended December 31, 2007. The Company's actual results and the actual outcome of our expectations and strategies could differ materially from those anticipated or estimated because of these risks and uncertainties and you should not put undue reliance on any forward-looking statements. All forward-looking statements speak only as of the date of this filing, and the Company undertakes no obligation to update the forward-looking statements to reflect factual assumptions, circumstances or events that have changed after the forward-looking statements are made.

Item 6. Exhibits.

- (a) Exhibits.
 - 31.1 Rule 13a-14(a) Certification of Chief Executive Officer
 - 31.2 Rule 13a-14(a) Certification of Chief Financial Officer
 - 32 Rule 13a-14(b) Certification of Chief Executive Officer and Chief Financial Officer

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.

Bay National Corporation

Date: November 14, 2008

By: /s/ Hugh W. Mohler
Hugh W. Mohler, President
(Principal Executive Officer)

Date: November 14, 2008

By: /s/ Mark A. Semanie
Mark A. Semanie, Treasurer
(Principal Accounting and Financial
Officer)