UNITED STATES DEPARTMENT OF THE TREASURY
1500 PENNSYLVANIA AVENUE, NW
WASHINGTON, D.C. 20220

Dear Ladies and Gentlemen:

The company set forth on the signature page hereto (the "*Company*") intends to issue in a private placement the number of shares of a series of its preferred stock set forth on Schedule A hereto (the "*Preferred Shares*") and a warrant to purchase the number of shares of a series of its preferred stock set forth on Schedule A hereto (the "*Warrant*" and, together with the Preferred Shares, the "*Purchased Securities*") and the United States Department of the Treasury (the "*Investor*") intends to purchase from the Company the Purchased Securities.

The purpose of this letter agreement is to confirm the terms and conditions of the purchase by the Investor of the Purchased Securities. Except to the extent supplemented or superseded by the terms set forth herein or in the Schedules hereto, the provisions contained in the Securities Purchase Agreement – Standard Terms attached hereto as Exhibit A (the "*Securities Purchase Agreement*") are incorporated by reference herein. Terms that are defined in the Securities Purchase Agreement are used in this letter agreement as so defined. In the event of any inconsistency between this letter agreement and the Securities Purchase Agreement, the terms of this letter agreement shall govern.

Each of the Company and the Investor hereby confirms its agreement with the other party with respect to the issuance by the Company of the Purchased Securities and the purchase by the Investor of the Purchased Securities pursuant to this letter agreement and the Securities Purchase Agreement on the terms specified on Schedule A hereto.

This letter agreement (including the Schedules hereto), the Securities Purchase Agreement (including the Annexes thereto), the Disclosure Schedules and the Warrant constitute the entire agreement, and supersede all other prior agreements, understandings, representations and warranties, both written and oral, between the parties, with respect to the subject matter hereof. This letter agreement constitutes the "Letter Agreement" referred to in the Securities Purchase Agreement.

This letter agreement may be executed in any number of separate counterparts, each such counterpart being deemed to be an original instrument, and all such counterparts will together constitute the same agreement. Executed signature pages to this letter agreement may be delivered by facsimile and such facsimiles will be deemed as sufficient as if actual signature pages had been delivered.

* * *

In witness whereof, this letter agreement has been duly executed and delivered by the duly authorized representatives of the parties hereto as of the date written below.

UNITED STATES DEPARTMENT OF THE TREASURY

By: ______________________________

Name:

Title:

COMPANY: GrandSouth Bancorporation

By: Ronald K. Earnest

Name: Ronald K. Earnest

Title: President

Date: January 9, 2009

In witness whereof, this letter agreement has been duly executed and delivered by the duly authorized representatives of the parties hereto as of the date written below.

UNITED STATES DEPARTMENT OF THE TREASURY

By: ______________________________

Name: **Neel Kashkari**

Title: **Interim Assistant Secretary For Financial Stability**

COMPANY: GrandSouth Bancorporation

By: ______________________________

Name: Ronald K. Earnest

Title: President

Date: January 9, 2009

EXHIBIT A
(Non-Exchange-Traded QFIs, excluding S Corps
and Mutual Organizations)

SECURITIES PURCHASE AGREEMENT

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SECURITIES PURCHASE AGREEMENT – STANDARD TERMS

Recitals:

WHEREAS, the United States Department of the Treasury (the "*Investor*") may from time to time agree to purchase shares of preferred stock and warrants from eligible financial institutions which elect to participate in the Troubled Asset Relief Program Capital Purchase Program ("*CPP*");

WHEREAS, an eligible financial institution electing to participate in the CPP and issue securities to the Investor (referred to herein as the "*Company*") shall enter into a letter agreement (the "*Letter Agreement*") with the Investor which incorporates this Securities Purchase Agreement – Standard Terms;

WHEREAS, the Company agrees to expand the flow of credit to U.S. consumers and businesses on competitive terms to promote the sustained growth and vitality of the U.S. economy;

WHEREAS, the Company agrees to work diligently, under existing programs, to modify the terms of residential mortgages as appropriate to strengthen the health of the U.S. housing market;

WHEREAS, the Company intends to issue in a private placement the number of shares of the series of its Preferred Stock ("*Preferred Stock*") set forth on <u>Schedule A</u> to the Letter Agreement (the "*Preferred Shares*") and a warrant to purchase the number of shares of the series of its Preferred Stock ("*Warrant Preferred Stock*") set forth on <u>Schedule A</u> to the Letter Agreement (the "*Warrant*" and, together with the Preferred Shares, the "*Purchased Securities*") and the Investor intends to purchase (the "*Purchase*") from the Company the Purchased Securities; and

WHEREAS, the Purchase will be governed by this Securities Purchase Agreement – Standard Terms and the Letter Agreement, including the schedules thereto (the "*Schedules*"), specifying additional terms of the Purchase. This Securities Purchase Agreement – Standard Terms (including the Annexes hereto) and the Letter Agreement (including the Schedules thereto) are together referred to as this "Agreement". All references in this Securities Purchase Agreement – Standard Terms to "Schedules" are to the Schedules attached to the Letter Agreement.

NOW, THEREFORE, in consideration of the premises, and of the representations, warranties, covenants and agreements set forth herein, the parties agree as follows:

Article I
Purchase; Closing

1.1 <u>Purchase</u>. On the terms and subject to the conditions set forth in this Agreement, the Company agrees to sell to the Investor, and the Investor agrees to purchase from the Company, at the Closing (as hereinafter defined), the Purchased Securities for the price set forth on <u>Schedule A</u> (the "*Purchase Price*").

1.2 Closing.

(a) On the terms and subject to the conditions set forth in this Agreement, the closing of the Purchase (the "*Closing*") will take place at the location specified in Schedule A, at the time and on the date set forth in Schedule A or as soon as practicable thereafter, or at such other place, time and date as shall be agreed between the Company and the Investor. The time and date on which the Closing occurs is referred to in this Agreement as the "*Closing Date*".

(b) Subject to the fulfillment or waiver of the conditions to the Closing in this Section 1.2, at the Closing the Company will deliver the Preferred Shares and the Warrant, in each case as evidenced by one or more certificates dated the Closing Date and bearing appropriate legends as hereinafter provided for, in exchange for payment in full of the Purchase Price by wire transfer of immediately available United States funds to a bank account designated by the Company on Schedule A.

(c) The respective obligations of each of the Investor and the Company to consummate the Purchase are subject to the fulfillment (or waiver by the Investor and the Company, as applicable) prior to the Closing of the conditions that (i) any approvals or authorizations of all United States and other governmental, regulatory or judicial authorities (collectively, "*Governmental Entities*") required for the consummation of the Purchase shall have been obtained or made in form and substance reasonably satisfactory to each party and shall be in full force and effect and all waiting periods required by United States and other applicable law, if any, shall have expired and (ii) no provision of any applicable United States or other law and no judgment, injunction, order or decree of any Governmental Entity shall prohibit the purchase and sale of the Purchased Securities as contemplated by this Agreement.

(d) The obligation of the Investor to consummate the Purchase is also subject to the fulfillment (or waiver by the Investor) at or prior to the Closing of each of the following conditions:

(i) (A) the representations and warranties of the Company set forth in (x) Section 2.2(g) of this Agreement shall be true and correct in all respects as though made on and as of the Closing Date, (y) Sections 2.2(a) through (f) shall be true and correct in all material respects as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct in all material respects as of such other date) and (z) Sections 2.2(h) through (v) (disregarding all qualifications or limitations set forth in such representations and warranties as to "materiality", "Company Material Adverse Effect" and words of similar import) shall be true and correct as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct as of such other date), except to the extent that the failure of such representations and warranties referred to in this Section 1.2(d)(i)(A)(z) to be so true and correct, individually or in the aggregate, does not have and would not reasonably be expected to have a Company Material Adverse Effect and (B) the Company shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Closing;

(ii) the Investor shall have received a certificate signed on behalf of the Company by a senior executive officer certifying to the effect that the conditions set forth in Section 1.2(d)(i) have been satisfied;

(iii) the Company shall have duly adopted and filed with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity the amendments to its certificate or articles of incorporation, articles of association, or similar organizational document ("*Charter*") in substantially the forms attached hereto as Annex A and Annex B (the "*Certificates of Designations*") and such filing shall have been accepted;

(iv) (A) the Company shall have effected such changes to its compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) (collectively, "*Benefit Plans*") with respect to its Senior Executive Officers (and to the extent necessary for such changes to be legally enforceable, each of its Senior Executive Officers shall have duly consented in writing to such changes), as may be necessary, during the period that the Investor owns any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant, in order to comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 ("*EESA*") as implemented by guidance or regulation thereunder that has been issued and is in effect as of the Closing Date, and (B) the Investor shall have received a certificate signed on behalf of the Company by a senior executive officer certifying to the effect that the condition set forth in Section 1.2(d)(iv)(A) has been satisfied;

(v) each of the Company's Senior Executive Officers shall have delivered to the Investor a written waiver in the form attached hereto as Annex C releasing the Investor from any claims that such Senior Executive Officers may otherwise have as a result of the issuance, on or prior to the Closing Date, of any regulations which require the modification of, and the agreement of the Company hereunder to modify, the terms of any Benefit Plans with respect to its Senior Executive Officers to eliminate any provisions of such Benefit Plans that would not be in compliance with the requirements of Section 111(b) of the EESA as implemented by guidance or regulation thereunder that has been issued and is in effect as of the Closing Date;

(vi) the Company shall have delivered to the Investor a written opinion from counsel to the Company (which may be internal counsel), addressed to the Investor and dated as of the Closing Date, in substantially the form attached hereto as Annex D;

(vii) the Company shall have delivered certificates in proper form or, with the prior consent of the Investor, evidence of shares in book-entry form, evidencing the Preferred Shares to Investor or its designee(s); and

(viii) the Company shall have duly executed the Warrant in substantially the form attached hereto as Annex E and delivered such executed Warrant to the Investor or its designee(s).

1.3 Interpretation. When a reference is made in this Agreement to "Recitals," "Articles," "Sections," or "Annexes" such reference shall be to a Recital, Article or Section of, or Annex to, this Securities Purchase Agreement – Standard Terms, and a reference to "Schedules" shall be to a Schedule to the Letter Agreement, in each case, unless otherwise indicated. The terms defined in the singular have a comparable meaning when used in the plural, and vice versa. References to "herein", "hereof", "hereunder" and the like refer to this Agreement as a whole and not to any particular section or provision, unless the context requires otherwise. The table of contents and headings contained in this Agreement are for reference purposes only and are not part of this Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed followed by the words "without limitation." No rule of construction against the draftsperson shall be applied in connection with the interpretation or enforcement of this Agreement, as this Agreement is the product of negotiation between sophisticated parties advised by counsel. All references to "$" or "dollars" mean the lawful currency of the United States of America. Except as expressly stated in this Agreement, all references to any statute, rule or regulation are to the statute, rule or regulation as amended, modified, supplemented or replaced from time to time (and, in the case of statutes, include any rules and regulations promulgated under the statute) and to any section of any statute, rule or regulation include any successor to the section. References to a "*business day*" shall mean any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

Article II
Representations and Warranties

2.1 Disclosure.

(a) On or prior to the Signing Date, the Company delivered to the Investor a schedule ("*Disclosure Schedule*") setting forth, among other things, items the disclosure of which is necessary or appropriate either in response to an express disclosure requirement contained in a provision hereof or as an exception to one or more representations or warranties contained in Section 2.2.

(b) "*Company Material Adverse Effect*" means a material adverse effect on (i) the business, results of operation or financial condition of the Company and its consolidated subsidiaries taken as a whole; *provided*, *however*, that Company Material Adverse Effect shall not be deemed to include the effects of (A) changes after the date of the Letter Agreement (the "*Signing Date*") in general business, economic or market conditions (including changes generally in prevailing interest rates, credit availability and liquidity, currency exchange rates and price levels or trading volumes in the United States or foreign securities or credit markets), or any outbreak or escalation of hostilities, declared or undeclared acts of war or terrorism, in each case generally affecting the industries in which the Company and its subsidiaries operate, (B) changes or proposed changes after the Signing Date in generally accepted accounting principles in the United States ("*GAAP*") or regulatory accounting requirements, or authoritative interpretations thereof, or (C) changes or proposed changes after the Signing Date in securities, banking and other laws of general applicability or related policies or interpretations of Governmental Entities (in the case of each of these clauses (A), (B) and (C), other than changes or occurrences to the extent that such changes or occurrences have or would reasonably be expected to have a materially disproportionate adverse effect on the Company and its consolidated subsidiaries taken as a whole relative to comparable U.S. banking or financial services organizations); or (ii) the ability of the Company to consummate the Purchase and other transactions contemplated by this Agreement and the Warrant and perform its obligations hereunder or thereunder on a timely basis.

(c) "*Previously Disclosed*" means information set forth on the Disclosure Schedule, provided, however, that disclosure in any section of such Disclosure Schedule shall apply only to the indicated section of this Agreement except to the extent that it is reasonably apparent from the face of such disclosure that such disclosure is relevant to another section of this Agreement.

2.2 Representations and Warranties of the Company. Except as Previously Disclosed, the Company represents and warrants to the Investor that as of the Signing Date and as of the Closing Date (or such other date specified herein):

(a) Organization, Authority and Significant Subsidiaries. The Company has been duly incorporated and is validly existing and in good standing under the laws of its jurisdiction of organization, with the necessary power and authority to own its properties and conduct its business in all material respects as currently conducted, and except as has not, individually or in the aggregate, had and would not reasonably be expected to have a Company Material Adverse Effect, has been duly qualified as a foreign corporation for the transaction of business and is in good standing under the laws of each other jurisdiction in which it owns or leases properties or conducts any business so as to require such qualification; each subsidiary of the Company that would be considered a "significant subsidiary" within the meaning of Rule 1-02(w) of Regulation S-X under the Securities Act of 1933 (the "*Securities Act*"), has been duly organized and is validly existing in good standing under the laws of its jurisdiction of organization. The Charter and bylaws of the Company, copies of which have been provided to the Investor prior to the Signing Date, are true, complete and correct copies of such documents as in full force and effect as of the Signing Date.

(b) Capitalization. The authorized capital stock of the Company, and the outstanding capital stock of the Company (including securities convertible into, or exercisable or exchangeable for, capital stock of the Company) as of the most recent fiscal month-end preceding the Signing Date (the "*Capitalization Date*") is set forth on Schedule B. The outstanding shares of capital stock of the Company have been duly authorized and are validly issued and outstanding, fully paid and nonassessable, and subject to no preemptive rights (and were not issued in violation of any preemptive rights). As of the Signing Date, the Company does not have outstanding any securities or other obligations providing the holder the right to acquire its Common Stock ("*Common Stock*") that is not reserved for issuance as specified on Schedule B, and the Company has not made any other commitment to authorize, issue or sell any Common Stock. Since the Capitalization Date, the Company has not issued any shares of Common Stock, other than (i) shares issued upon the exercise of stock options or delivered under other equity-based awards or other convertible securities or warrants which were issued and outstanding on the Capitalization Date and disclosed on Schedule B and (ii) shares disclosed on Schedule B. Each holder of 5% or more of any class of capital stock of the Company and such holder's primary address are set forth on Schedule B.

(c) Preferred Shares. The Preferred Shares have been duly and validly authorized, and, when issued and delivered pursuant to this Agreement, such Preferred Shares will be duly and validly issued and fully paid and non-assessable, will not be issued in violation of any preemptive rights, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(d) The Warrant and Warrant Shares. The Warrant has been duly authorized and, when executed and delivered as contemplated hereby, will constitute a valid and legally binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity ("*Bankruptcy Exceptions*"). The shares of Warrant Preferred Stock issuable upon exercise of the Warrant (the "*Warrant Shares*") have been duly authorized and reserved for issuance upon exercise of the Warrant and when so issued in accordance with the terms of the Warrant will be validly issued, fully paid and non-assessable, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(e) Authorization, Enforceability.

(i) The Company has the corporate power and authority to execute and deliver this Agreement and the Warrant and to carry out its obligations hereunder and thereunder (which includes the issuance of the Preferred Shares, Warrant and Warrant Shares). The execution, delivery and performance by the Company of this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of the Company and its stockholders, and no further approval or authorization is required on the part of the Company. This Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms, subject to the Bankruptcy Exceptions.

(ii) The execution, delivery and performance by the Company of this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby and compliance by the Company with the provisions hereof and thereof, will not (A) violate, conflict with, or result in a breach of any provision of, or constitute a default (or an event which, with notice or lapse of time or both, would constitute a default) under, or result in the termination of, or accelerate the performance required by, or result in a right of termination or acceleration of, or result in the creation of, any lien, security interest, charge or encumbrance upon any of the properties or assets of the Company or any subsidiary of the Company (each a "*Company Subsidiary*" and, collectively, the "*Company Subsidiaries*") under any of the terms, conditions or provisions of (i) its organizational documents or (ii) any note, bond, mortgage, indenture, deed of trust, license, lease, agreement or other instrument or obligation to which the Company or any Company Subsidiary is a party or by which it or any Company Subsidiary may be bound, or to which the Company or any Company Subsidiary or any of the properties or assets of the Company or any Company Subsidiary may be subject, or (B) subject to compliance with the statutes and regulations referred to in the next paragraph, violate any statute, rule or regulation or any judgment, ruling, order, writ, injunction or decree applicable to the Company or any Company Subsidiary or any of their respective properties or assets except, in the case of clauses (A)(ii) and (B), for those occurrences that, individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

(iii) Other than the filing of the Certificates of Designations with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity, such filings and approvals as are required to be made or obtained under any state "blue sky" laws and such as have been made or obtained, no notice to, filing with, exemption or review by, or authorization, consent or approval of, any Governmental Entity is required to be made or obtained by the Company in connection with the consummation by the Company of the Purchase except for any such notices, filings, exemptions, reviews, authorizations, consents and approvals the failure of which to make or obtain would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(f) Anti-takeover Provisions and Rights Plan. The Board of Directors of the Company (the "*Board of Directors*") has taken all necessary action to ensure that the transactions contemplated by this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby, including the exercise of the Warrant in accordance with its terms, will be exempt from any anti-takeover or similar provisions of the Company's Charter and bylaws, and any other provisions of any applicable "moratorium", "control share", "fair price", "interested stockholder" or other anti-takeover laws and regulations of any jurisdiction.

(g) No Company Material Adverse Effect. Since the last day of the last completed fiscal period for which financial statements are included in the Company Financial Statements (as defined below), no fact, circumstance, event, change, occurrence, condition or development has occurred that, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect.

(h) Company Financial Statements. The Company has Previously Disclosed each of the consolidated financial statements of the Company and its consolidated subsidiaries for each of the last three completed fiscal years of the Company (which shall be audited to the extent audited financial statements are available prior to the Signing Date) and each completed quarterly period since the last completed fiscal year (collectively the "*Company Financial Statements*"). The Company Financial Statements present fairly in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the dates indicated therein and the consolidated results of their operations for the periods specified therein; and except as stated therein, such financial statements (A) were prepared in conformity with GAAP applied on a consistent basis (except as may be noted therein) and (B) have been prepared from, and are in accordance with, the books and records of the Company and the Company Subsidiaries.

(i) Reports.

(i) Since December 31, 2006, the Company and each Company Subsidiary has filed all reports, registrations, documents, filings, statements and submissions, together with any amendments thereto, that it was required to file with any Governmental Entity (the foregoing, collectively, the "*Company Reports*") and has paid all fees and assessments due and payable in connection therewith, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. As of their respective dates of filing, the Company Reports complied in all material respects with all statutes and applicable rules and regulations of the applicable Governmental Entities.

(ii) The records, systems, controls, data and information of the Company and the Company Subsidiaries are recorded, stored, maintained and operated under means (including any electronic, mechanical or photographic process, whether computerized or not) that are under the exclusive ownership and direct control of the Company or the Company Subsidiaries or their accountants (including all means of access thereto and therefrom), except for any non-exclusive ownership and non-direct control that would not reasonably be expected to have a material adverse effect on the system of internal accounting controls described below in this Section 2.2(i)(ii). The Company (A) has implemented and maintains adequate disclosure controls and procedures to ensure that material information relating to the Company, including the consolidated Company Subsidiaries, is made known to the chief executive officer and the chief financial officer of the Company by others within those entities, and (B) has disclosed, based on its most recent evaluation prior to the Signing Date, to the Company's outside auditors and the audit committee of the Board of Directors (x) any significant deficiencies and material weaknesses in the design or operation of internal controls that are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information and (y) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

(j) No Undisclosed Liabilities. Neither the Company nor any of the Company Subsidiaries has any liabilities or obligations of any nature (absolute, accrued, contingent or otherwise) which are not properly reflected or reserved against in the Company Financial Statements to the extent required to be so reflected or reserved against in accordance with GAAP, except for (A) liabilities that have arisen since the last fiscal year end in the ordinary and usual course of business and consistent with past practice and (B) liabilities that, individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

(k) Offering of Securities. Neither the Company nor any person acting on its behalf has taken any action (including any offering of any securities of the Company under circumstances which would require the integration of such offering with the offering of any of the Purchased Securities under the Securities Act, and the rules and regulations of the Securities and Exchange Commission (the "*SEC*") promulgated thereunder), which might subject the offering, issuance or sale of any of the Purchased Securities to Investor pursuant to this Agreement to the registration requirements of the Securities Act.

(l) Litigation and Other Proceedings. Except (i) as set forth on Schedule C or (ii) as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, there is no (A) pending or, to the knowledge of the Company, threatened, claim, action, suit, investigation or proceeding, against the Company or any Company Subsidiary or to which any of their assets are subject nor is the Company or any Company Subsidiary subject to any order, judgment or decree or (B) unresolved violation, criticism or exception by any Governmental Entity with respect to any report or relating to any examinations or inspections of the Company or any Company Subsidiaries.

(m) Compliance with Laws. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have all permits, licenses, franchises, authorizations, orders and approvals of, and have made all filings, applications and registrations with, Governmental Entities that are required in order to permit them to own or lease their properties and assets and to carry on their business as presently conducted and that are material to the business of the Company or such Company Subsidiary. Except as set forth on Schedule D, the Company and the Company Subsidiaries have complied in all respects and are not in default or violation of, and none of them is, to the knowledge of the Company, under investigation with respect to or, to the knowledge of the Company, have been threatened to be charged with or given notice of any violation of, any applicable domestic (federal, state or local) or foreign law, statute, ordinance, license, rule, regulation, policy or guideline, order, demand, writ, injunction, decree or judgment of any Governmental Entity, other than such noncompliance, defaults or violations that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. Except for statutory or regulatory restrictions of general application or as set forth on Schedule D, no Governmental Entity has placed any restriction on the business or properties of the Company or any Company Subsidiary that would, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(n) Employee Benefit Matters. Except as would not reasonably be expected to have, either individually or in the aggregate, a Company Material Adverse Effect: (A) each "employee benefit plan" (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("*ERISA*")) providing benefits to any current or former employee, officer or director of the Company or any member of its "*Controlled Group*" (defined as any organization which is a member of a controlled group of corporations within the meaning of Section 414 of the Internal Revenue Code of 1986, as amended (the "*Code*")) that is sponsored, maintained or contributed to by the Company or any member of its Controlled Group and for which the Company or any member of its Controlled Group would have any liability, whether actual or contingent (each, a "*Plan*") has been maintained in compliance with its terms and with the requirements of all applicable statutes, rules and regulations, including ERISA and the Code; (B) with respect to each Plan subject to Title IV of ERISA (including, for purposes of this clause (B), any plan subject to Title IV of ERISA that the Company or any member of its Controlled Group previously maintained or contributed to in the six years prior to the Signing Date), (1) no "reportable event" (within the meaning of Section 4043(c) of ERISA), other than a reportable event for which the notice period referred to in Section 4043(c) of ERISA has been waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (2) no "accumulated funding deficiency" (within the meaning of Section 302 of ERISA or Section 412 of the Code), whether or not waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (3) the fair market value of the assets under each Plan exceeds the present value of all benefits accrued under such Plan (determined based on the assumptions used to fund such Plan) and (4) neither the Company nor any member of its Controlled Group has incurred in the six years prior to the Signing Date, or reasonably expects to incur, any liability under Title IV of ERISA (other than contributions to the Plan or premiums to the PBGC in the ordinary course and without default) in respect of a Plan (including any Plan that is a "multiemployer plan", within the meaning of Section 4001(c)(3) of ERISA); and (C) each Plan that is intended to be qualified under Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service with respect to its qualified status that has not been revoked, or such a determination letter has been timely applied for but not received by the Signing Date, and nothing has occurred, whether by action or by failure to act, which could reasonably be expected to cause the loss, revocation or denial of such qualified status or favorable determination letter.

(o) Taxes. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) the Company and the Company Subsidiaries have filed all federal, state, local and foreign income and franchise Tax returns required to be filed through the Signing Date, subject to permitted extensions, and have paid all Taxes due thereon, and (ii) no Tax deficiency has been determined adversely to the Company or any of the Company Subsidiaries, nor does the Company have any knowledge of any Tax deficiencies. "*Tax*" or "*Taxes*" means any federal, state, local or foreign income, gross receipts, property, sales, use, license, excise, franchise, employment, payroll, withholding, alternative or add on minimum, ad valorem, transfer or excise tax, or any other tax, custom, duty, governmental fee or other like assessment or charge of any kind whatsoever, together with any interest or penalty, imposed by any Governmental Entity.

(p) Properties and Leases. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have good and marketable title to all real properties and all other properties and assets owned by them, in each case free from liens, encumbrances, claims and defects that would affect the value thereof or interfere with the use made or to be made thereof by them. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries hold all leased real or personal property under valid and enforceable leases with no exceptions that would interfere with the use made or to be made thereof by them.

(q) Environmental Liability. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(i) there is no legal, administrative, or other proceeding, claim or action of any nature seeking to impose, or that would reasonably be expected to result in the imposition of, on the Company or any Company Subsidiary, any liability relating to the release of hazardous substances as defined under any local, state or federal environmental statute, regulation or ordinance, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980, pending or, to the Company's knowledge, threatened against the Company or any Company Subsidiary;

(ii) to the Company's knowledge, there is no reasonable basis for any such proceeding, claim or action; and

(iii) neither the Company nor any Company Subsidiary is subject to any agreement, order, judgment or decree by or with any court, Governmental Entity or third party imposing any such environmental liability.

(r) Risk Management Instruments. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, all derivative instruments, including, swaps, caps, floors and option agreements, whether entered into for the Company's own account, or for the account of one or more of the Company Subsidiaries or its or their customers, were entered into (i) only in the ordinary course of business, (ii) in accordance with prudent practices and in all material respects with all applicable laws, rules, regulations and regulatory policies and (iii) with counterparties believed to be financially responsible at the time; and each of such instruments constitutes the valid and legally binding obligation of the Company or one of the Company Subsidiaries, enforceable in accordance with its terms, except as may be limited by the Bankruptcy Exceptions. Neither the Company or the Company Subsidiaries, nor, to the knowledge of the Company, any other party thereto, is in breach of any of its obligations under any such agreement or arrangement other than such breaches that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(s) Agreements with Regulatory Agencies. Except as set forth on Schedule E, neither the Company nor any Company Subsidiary is subject to any material cease-and-desist or other similar order or enforcement action issued by, or is a party to any material written agreement, consent agreement or memorandum of understanding with, or is a party to any commitment letter or similar undertaking to, or is subject to any capital directive by, or since December 31, 2006, has adopted any board resolutions at the request of, any Governmental Entity (other than the Appropriate Federal Banking Agencies with jurisdiction over the Company and the Company Subsidiaries) that currently restricts in any material respect the conduct of its business or that in any material manner relates to its capital adequacy, its liquidity and funding policies and practices, its ability to pay dividends, its credit, risk management or compliance policies or procedures, its internal controls, its management or its operations or business (each item in this sentence, a "*Regulatory Agreement*"), nor has the Company or any Company Subsidiary been advised since December 31, 2006 by any such Governmental Entity that it is considering issuing, initiating, ordering, or requesting any such Regulatory Agreement. The Company and each Company Subsidiary are in compliance in all material respects with each Regulatory Agreement to which it is party or subject, and neither the Company nor any Company Subsidiary has received any notice from any Governmental Entity indicating that either the Company or any Company Subsidiary is not in compliance in all material respects with any such Regulatory Agreement. "*Appropriate Federal Banking Agency*" means the "appropriate Federal banking agency" with respect to the Company or such Company Subsidiaries, as applicable, as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)).

(t) Insurance. The Company and the Company Subsidiaries are insured with reputable insurers against such risks and in such amounts as the management of the Company reasonably has determined to be prudent and consistent with industry practice. The Company and the Company Subsidiaries are in material compliance with their insurance policies and are not in default under any of the material terms thereof, each such policy is outstanding and in full force and effect, all premiums and other payments due under any material policy have been paid, and all claims thereunder have been filed in due and timely fashion, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(u) Intellectual Property. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) the Company and each Company Subsidiary owns or otherwise has the right to use, all intellectual property rights, including all trademarks, trade dress, trade names, service marks, domain names, patents, inventions, trade secrets, know-how, works of authorship and copyrights therein, that are used in the conduct of their existing businesses and all rights relating to the plans, design and specifications of any of its branch facilities ("*Proprietary Rights*") free and clear of all liens and any claims of ownership by current or former employees, contractors, designers or others and (ii) neither the Company nor any of the Company Subsidiaries is materially infringing, diluting, misappropriating or violating, nor has the Company or any or the Company Subsidiaries received any written (or, to the knowledge of the Company, oral) communications alleging that any of them has materially infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by any other person. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, to the Company's knowledge, no other person is infringing, diluting, misappropriating or violating, nor has the Company or any or the Company Subsidiaries sent any written communications since January 1, 2006 alleging that any person has infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by the Company and the Company Subsidiaries.

(v) Brokers and Finders. No broker, finder or investment banker is entitled to any financial advisory, brokerage, finder's or other fee or commission in connection with this Agreement or the Warrant or the transactions contemplated hereby or thereby based upon arrangements made by or on behalf of the Company or any Company Subsidiary for which the Investor could have any liability.

Article III
Covenants

3.1 Commercially Reasonable Efforts. Subject to the terms and conditions of this Agreement, each of the parties will use its commercially reasonable efforts in good faith to take, or cause to be taken, all actions, and to do, or cause to be done, all things necessary, proper or desirable, or advisable under applicable laws, so as to permit consummation of the Purchase as promptly as practicable and otherwise to enable consummation of the transactions contemplated hereby and shall use commercially reasonable efforts to cooperate with the other party to that end.

3.2 Expenses. Unless otherwise provided in this Agreement or the Warrant, each of the parties hereto will bear and pay all costs and expenses incurred by it or on its behalf in connection with the transactions contemplated under this Agreement and the Warrant, including fees and expenses of its own financial or other consultants, investment bankers, accountants and counsel.

3.3 Sufficiency of Authorized Warrant Preferred Stock; Exchange Listing.

(a) During the period from the Closing Date until the date on which the Warrant has been fully exercised, the Company shall at all times have reserved for issuance, free of preemptive or similar rights, a sufficient number of authorized and unissued Warrant Shares to effectuate such exercise.

(b) If the Company lists its Common Stock on any national securities exchange, the Company shall, if requested by the Investor, promptly use its reasonable best efforts to cause the Preferred Shares and Warrant Shares to be approved for listing on a national securities exchange as promptly as practicable following such request.

3.4 Certain Notifications Until Closing. From the Signing Date until the Closing, the Company shall promptly notify the Investor of (i) any fact, event or circumstance of which it is aware and which would reasonably be expected to cause any representation or warranty of the Company contained in this Agreement to be untrue or inaccurate in any material respect or to cause any covenant or agreement of the Company contained in this Agreement not to be complied with or satisfied in any material respect and (ii) except as Previously Disclosed, any fact, circumstance, event, change, occurrence, condition or development of which the Company is aware and which, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect; *provided*, *however*, that delivery of any notice pursuant to this Section 3.4 shall not limit or affect any rights of or remedies available to the Investor; *provided*, *further*, that a failure to comply with this Section 3.4 shall not constitute a breach of this Agreement or the failure of any condition set forth in Section 1.2 to be satisfied unless the underlying Company Material Adverse Effect or material breach would independently result in the failure of a condition set forth in Section 1.2 to be satisfied.

3.5 Access, Information and Confidentiality.

(a) From the Signing Date until the date when the Investor holds an amount of Preferred Shares having an aggregate liquidation value of less than 10% of the Purchase Price, the Company will permit the Investor and its agents, consultants, contractors and advisors (x) acting through the Appropriate Federal Banking Agency, or otherwise to the extent necessary to evaluate, manage, or transfer its investment in the Company, to examine the corporate books and make copies thereof and to discuss the affairs, finances and accounts of the Company and the Company Subsidiaries with the principal officers of the Company, all upon reasonable notice and at such reasonable times and as often as the Investor may reasonably request and (y) to review any information material to the Investor's investment in the Company provided by the Company to its Appropriate Federal Banking Agency. Any investigation pursuant to this Section 3.5 shall be conducted during normal business hours and in such manner as not to interfere unreasonably with the conduct of the business of the Company, and nothing herein shall require the Company or any Company Subsidiary to disclose any information to the Investor to the extent (i) prohibited by applicable law or regulation, or (ii) that such disclosure would reasonably be expected to cause a violation of any agreement to which the Company or any Company Subsidiary is a party or would cause a risk of a loss of privilege to the Company or any Company Subsidiary (*provided* that the Company shall use commercially reasonable efforts to make appropriate substitute disclosure arrangements under circumstances where the restrictions in this clause (ii) apply).

(b) From the Signing Date until the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole, the Company will deliver, or will cause to be delivered, to the Investor:

(i) as soon as available after the end of each fiscal year of the Company, and in any event within 90 days thereafter, a consolidated balance sheet of the Company as of the end of such fiscal year, and consolidated statements of income, retained earnings and cash flows of the Company for such year, in each case prepared in accordance with GAAP and setting forth in each case in comparative form the figures for the previous fiscal year of the Company, and which shall be audited to the extent audited financial statements are available; and

(ii) as soon as available after the end of the first, second and third quarterly periods in each fiscal year of the Company, a copy of any quarterly reports provided to other stockholders of the Company or Company management.

(c) The Investor will use reasonable best efforts to hold, and will use reasonable best efforts to cause its agents, consultants, contractors and advisors to hold, in confidence all non-public records, books, contracts, instruments, computer data and other data and information (collectively, "*Information*") concerning the Company furnished or made available to it by the Company or its representatives pursuant to this Agreement (except to the extent that such information can be shown to have been (i) previously known by such party on a non-confidential basis, (ii) in the public domain through no fault of such party or (iii) later lawfully acquired from other sources by the party to which it was furnished (and without violation of any other confidentiality obligation)); *provided* that nothing herein shall prevent the Investor from disclosing any Information to the extent required by applicable laws or regulations or by any subpoena or similar legal process.

(d) The Investor's information rights pursuant to Section 3.5(b) may be assigned by the Investor to a transferee or assignee of the Purchased Securities or the Warrant Shares or with a liquidation preference or, in the case of the Warrant, the liquidation preference of the underlying shares of Warrant Preferred Stock, no less than an amount equal to 2% of the initial aggregate liquidation preference of the Preferred Shares.

Article IV
Additional Agreements

4.1 Purchase for Investment. The Investor acknowledges that the Purchased Securities and the Warrant Shares have not been registered under the Securities Act or under any state securities laws. The Investor (a) is acquiring the Purchased Securities pursuant to an exemption from registration under the Securities Act solely for investment with no present intention to distribute them to any person in violation of the Securities Act or any applicable U.S. state securities laws, (b) will not sell or otherwise dispose of any of the Purchased Securities or the Warrant Shares, except in compliance with the registration requirements or exemption provisions of the Securities Act and any applicable U.S. state securities laws, and (c) has such knowledge and experience in financial and business matters and in investments of this type that it is capable of evaluating the merits and risks of the Purchase and of making an informed investment decision.

4.2 Legends.

(a) The Investor agrees that all certificates or other instruments representing the Warrant will bear a legend substantially to the following effect:

"THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD

OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS.

THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID."

(b) In addition, the Investor agrees that all certificates or other instruments representing the Preferred Shares and the Warrant Shares will bear a legend substantially to the following effect:

"THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE NOT SAVINGS ACCOUNTS, DEPOSITS OR OTHER OBLIGATIONS OF A BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY.

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS. EACH PURCHASER OF THE SECURITIES REPRESENTED BY THIS INSTRUMENT IS NOTIFIED THAT THE SELLER MAY BE RELYING ON THE EXEMPTION FROM SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER. ANY TRANSFEREE OF THE SECURITIES REPRESENTED BY THIS INSTRUMENT BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT), (2) AGREES THAT IT WILL NOT OFFER, SELL OR OTHERWISE TRANSFER THE SECURITIES REPRESENTED BY THIS INSTRUMENT EXCEPT (A) PURSUANT TO A REGISTRATION STATEMENT WHICH IS THEN EFFECTIVE UNDER THE SECURITIES ACT, (B) FOR SO LONG AS THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER

TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (C) TO THE ISSUER OR (D) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID."

(c) In the event that any Purchased Securities or Warrant Shares (i) become registered under the Securities Act or (ii) are eligible to be transferred without restriction in accordance with Rule 144 or another exemption from registration under the Securities Act (other than Rule 144A), the Company shall issue new certificates or other instruments representing such Purchased Securities or Warrant Shares, which shall not contain the applicable legends in Sections 4.2(a) and (b) above; *provided* that the Investor surrenders to the Company the previously issued certificates or other instruments.

4.3 Certain Transactions. The Company will not merge or consolidate with, or sell, transfer or lease all or substantially all of its property or assets to, any other party unless the successor, transferee or lessee party (or its ultimate parent entity), as the case may be (if not the Company), expressly assumes the due and punctual performance and observance of each and every covenant, agreement and condition of this Agreement to be performed and observed by the Company.

4.4 Transfer of Purchased Securities and Warrant Shares; Restrictions on Exercise of the Warrant. Subject to compliance with applicable securities laws, the Investor shall be permitted to transfer, sell, assign or otherwise dispose of ("*Transfer*") all or a portion of the Purchased Securities or Warrant Shares at any time, and the Company shall take all steps as may be reasonably requested by the Investor to facilitate the Transfer of the Purchased Securities and the Warrant Shares; *provided* that the Investor shall not Transfer any Purchased Securities or Warrant Shares if such transfer would require the Company to be subject to the periodic reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "*Exchange Act*"). In furtherance of the foregoing, the Company shall provide reasonable cooperation to facilitate any Transfers of the Purchased Securities or Warrant Shares, including, as is reasonable under the circumstances, by furnishing such information concerning the Company and its business as a proposed transferee may reasonably request (including such information as is required by Section 4.5(k)) and making management of the Company reasonably available to respond to questions of a proposed transferee in accordance with customary practice, subject in all cases to the proposed transferee agreeing to a customary confidentiality agreement.

4.5 Registration Rights.

(a) Unless and until the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, the Company shall have no obligation to comply with the provisions of this Section 4.5 (other than Section 4.5(b)(iv)-(vi)); *provided* that the Company covenants and agrees that it shall comply with this Section 4.5 as soon as practicable after the date that it becomes subject to such reporting requirements.

(b) Registration.

(i) Subject to the terms and conditions of this Agreement, the Company covenants and agrees that as promptly as practicable after the date that the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act (and in any event no later than 30 days thereafter), the Company shall prepare and file with the SEC a Shelf Registration Statement covering all Registrable Securities (or otherwise designate an existing Shelf Registration Statement filed with the SEC to cover the Registrable Securities), and, to the extent the Shelf Registration Statement has not theretofore been declared effective or is not automatically effective upon such filing, the Company shall use reasonable best efforts to cause such Shelf Registration Statement to be declared or become effective and to keep such Shelf Registration Statement continuously effective and in compliance with the Securities Act and usable for resale of such Registrable Securities for a period from the date of its initial effectiveness until such time as there are no Registrable Securities remaining (including by refiling such Shelf Registration Statement (or a new Shelf Registration Statement) if the initial Shelf Registration Statement expires). Notwithstanding the foregoing, if the Company is not eligible to file a registration statement on Form S-3, then the Company shall not be obligated to file a Shelf Registration Statement unless and until requested to do so in writing by the Investor.

(ii) Any registration pursuant to Section 4.5(b)(i) shall be effected by means of a shelf registration on an appropriate form under Rule 415 under the Securities Act (a "*Shelf Registration Statement*"). If the Investor or any other Holder intends to distribute any Registrable Securities by means of an underwritten offering it shall promptly so advise the Company and the Company shall take all reasonable steps to facilitate such distribution, including the actions required pursuant to Section 4.5(d); *provided* that the Company shall not be required to facilitate an underwritten offering of Registrable Securities unless the expected gross proceeds from such offering exceed (i) 2% of the initial aggregate liquidation preference of the Preferred Shares if such initial aggregate liquidation preference is less than $2 billion and (ii) $200 million if the initial aggregate liquidation preference of the Preferred Shares is equal to or greater than $2 billion. The lead underwriters in any such distribution shall be selected by the Holders of a majority of the Registrable Securities to be distributed; *provided* that to the extent appropriate and permitted under applicable law, such Holders shall consider the qualifications of any broker-dealer Affiliate of the Company in selecting the lead underwriters in any such distribution.

(iii) The Company shall not be required to effect a registration (including a resale of Registrable Securities from an effective Shelf Registration Statement) or an underwritten offering pursuant to Section 4.5(b): (A) with respect to securities that are not Registrable Securities; or (B) if the Company has notified the Investor and all other Holders that in the good faith judgment of the Board of Directors, it would be materially detrimental to the Company or its securityholders for such registration or underwritten offering to be effected at such time, in which event the Company shall have the right to defer such registration for a period of not more than 45 days after receipt of the request of the Investor or any other Holder; *provided* that such right to delay a registration or underwritten offering shall be exercised by the Company (1) only if the Company has generally exercised (or is concurrently exercising) similar black-out rights against holders of similar securities that have registration rights and (2) not more than three times in any 12-month period and not more than 90 days in the aggregate in any 12-month period.

(iv) If during any period when an effective Shelf Registration Statement is not available, the Company proposes to register any of its equity securities, other than a registration pursuant to Section 4.5(b)(i) or a Special Registration, and the registration form to be filed may be used for the registration or qualification for distribution of Registrable Securities, the Company will give prompt written notice to the Investor and all other Holders of its intention to effect such a registration (but in no event less than ten days prior to the anticipated filing date) and will include in such registration all Registrable Securities with respect to which the Company has received written requests for inclusion therein within ten business days after the date of the Company's notice (a "*Piggyback Registration*"). Any such person that has made such a written request may withdraw its Registrable Securities from such Piggyback Registration by giving written notice to the Company and the managing underwriter, if any, on or before the fifth business day prior to the planned effective date of such Piggyback Registration. The Company may terminate or withdraw any registration under this Section 4.5(b)(iv) prior to the effectiveness of such registration, whether or not Investor or any other Holders have elected to include Registrable Securities in such registration.

(v) If the registration referred to in Section 4.5(b)(iv) is proposed to be underwritten, the Company will so advise Investor and all other Holders as a part of the written notice given pursuant to Section 4.5(b)(iv). In such event, the right of Investor and all other Holders to registration pursuant to Section 4.5(b) will be conditioned upon such persons' participation in such underwriting and the inclusion of such person's Registrable Securities in the underwriting if such securities are of the same class of securities as the securities to be offered in the underwritten offering, and each such person will (together with the Company and the other persons distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting by the Company; *provided* that the Investor (as opposed to other Holders) shall not be required to indemnify any person in connection with any registration. If any participating person disapproves of the terms of the underwriting, such person may elect to withdraw therefrom by written notice to the Company, the managing underwriters and the Investor (if the Investor is participating in the underwriting).

(vi) If either (x) the Company grants "piggyback" registration rights to one or more third parties to include their securities in an underwritten offering under the Shelf Registration Statement pursuant to Section 4.5(b)(ii) or (y) a Piggyback Registration under Section 4.5(b)(iv) relates to an underwritten offering on behalf of the Company, and in either case the managing underwriters advise the Company that in their reasonable opinion the number of securities requested to be included in such offering exceeds the number which can be sold without adversely affecting the marketability of such offering (including an adverse effect on the per share offering price), the Company will include in such offering only such number of securities that in the reasonable opinion of such managing underwriters can be sold without adversely affecting the marketability of the offering (including an adverse effect on the per share offering price), which securities will be so included in the following order of priority: (A) first, in the case of a Piggyback Registration under Section 4.5(b)(iv), the securities the Company proposes to sell, (B) then the Registrable Securities of the Investor and all other Holders who have requested inclusion of Registrable Securities pursuant to Section 4.5(b)(ii) or Section 4.5(b)(iv), as applicable, *pro rata* on the basis of the aggregate number of such securities or shares owned by each such person and (C) lastly, any other securities of the Company that have been requested to be so included, subject to the terms of this Agreement; *provided, however,* that if the Company has, prior to the Signing Date, entered into an agreement with respect to its securities that is inconsistent with the order of priority contemplated hereby then it shall apply the order of priority in such conflicting agreement to the extent that it would otherwise result in a breach under such agreement.

(c) Expenses of Registration. All Registration Expenses incurred in connection with any registration, qualification or compliance hereunder shall be borne by the Company. All Selling Expenses incurred in connection with any registrations hereunder shall be borne by the holders of the securities so registered *pro rata* on the basis of the aggregate offering or sale price of the securities so registered.

(d) Obligations of the Company. Whenever required to effect the registration of any Registrable Securities or facilitate the distribution of Registrable Securities pursuant to an effective Shelf Registration Statement, the Company shall, as expeditiously as reasonably practicable:

(i) Prepare and file with the SEC a prospectus supplement or post-effective amendment with respect to a proposed offering of Registrable Securities pursuant to an effective registration statement, subject to Section 4.5(d), keep such registration statement effective and keep such prospectus supplement current until the securities described therein are no longer Registrable Securities.

(ii) Prepare and file with the SEC such amendments and supplements to the applicable registration statement and the prospectus or prospectus supplement used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement.

(iii) Furnish to the Holders and any underwriters such number of copies of the applicable registration statement and each such amendment and supplement thereto (including in each case all exhibits) and of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned or to be distributed by them.

(iv) Use its reasonable best efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders or any managing underwriter(s), to keep such registration or qualification in effect for so long as such registration statement remains in effect, and to take any other action which may be reasonably necessary to enable such seller to consummate the disposition in such jurisdictions of the securities owned by such Holder; *provided* that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions.

(v) Notify each Holder of Registrable Securities at any time when a prospectus relating thereto is required to be delivered under the Securities Act of the happening of any event as a result of which the applicable prospectus, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing.

(vi) Give written notice to the Holders:

(A) when any registration statement filed pursuant to Section 4.5(a) or any amendment thereto has been filed with the SEC (except for any amendment effected by the filing of a document with the SEC pursuant to the Exchange Act) and when such registration statement or any post-effective amendment thereto has become effective;

(B) of any request by the SEC for amendments or supplements to any registration statement or the prospectus included therein or for additional information;

(C) of the issuance by the SEC of any stop order suspending the effectiveness of any registration statement or the initiation of any proceedings for that purpose;

(D) of the receipt by the Company or its legal counsel of any notification with respect to the suspension of the qualification of the applicable Registrable Securities for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose;

(E) of the happening of any event that requires the Company to make changes in any effective registration statement or the prospectus related to the registration statement in order to make the statements therein not misleading (which notice shall be accompanied by an instruction to suspend the use of the prospectus until the requisite changes have been made); and

(F) if at any time the representations and warranties of the Company contained in any underwriting agreement contemplated by Section 4.5(d)(x) cease to be true and correct.

(vii) Use its reasonable best efforts to prevent the issuance or obtain the withdrawal of any order suspending the effectiveness of any registration statement referred to in Section 4.5(d)(vi)(C) at the earliest practicable time.

(viii) Upon the occurrence of any event contemplated by Section 4.5(d)(v) or 4.5(d)(vi)(E), promptly prepare a post-effective amendment to such registration statement or a supplement to the related prospectus or file any other required document so that, as thereafter delivered to the Holders and any underwriters, the prospectus will not contain an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. If the Company notifies the Holders in accordance with Section 4.5(d)(vi)(E) to suspend the use of the prospectus until the requisite changes to the prospectus have been made, then the Holders and any underwriters shall suspend use of such prospectus and use their reasonable best efforts to return to the Company all copies of such prospectus (at the Company's expense) other than permanent file copies then in such Holders' or underwriters' possession. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

(ix) Use reasonable best efforts to procure the cooperation of the Company's transfer agent in settling any offering or sale of Registrable Securities, including with respect to the transfer of physical stock certificates into book-entry form in accordance with any procedures reasonably requested by the Holders or any managing underwriter(s).

(x) If an underwritten offering is requested pursuant to Section 4.5(b)(ii), enter into an underwriting agreement in customary form, scope and substance and take all such other actions reasonably requested by the Holders of a majority of the Registrable Securities being sold in connection therewith or by the managing underwriter(s), if any, to expedite or facilitate the underwritten disposition of such Registrable Securities, and in connection therewith in any underwritten offering (including making members of management and executives of the Company available to participate in "road shows", similar sales events and other marketing activities), (A) make such representations and warranties to the Holders that are selling stockholders and the managing underwriter(s), if any, with respect to the business of the Company and its subsidiaries, and the Shelf Registration Statement, prospectus and documents, if any, incorporated or deemed to be incorporated by reference therein, in each case, in customary form, substance and scope, and, if true, confirm the same if and when requested, (B) use its reasonable best efforts to furnish the underwriters with opinions of counsel to the Company, addressed to the managing underwriter(s), if any, covering the matters customarily covered in such opinions requested in underwritten offerings, (C) use its reasonable best efforts to obtain "cold comfort" letters from the independent certified public accountants of the Company (and, if necessary, any other independent certified public accountants of any business acquired by the Company for which financial statements and financial data are included in the Shelf Registration Statement) who have certified the financial statements included in such Shelf Registration Statement, addressed to each of the managing underwriter(s), if any, such letters to be in customary form and covering matters of the type customarily covered in "cold comfort" letters, (D) if an underwriting agreement is entered into, the same shall contain indemnification provisions and procedures customary in underwritten offerings (provided that the Investor shall not be obligated to provide any indemnity), and (E) deliver such documents and certificates as may be reasonably requested by the Holders of a majority of the Registrable Securities being sold in connection therewith, their counsel and the managing underwriter(s), if any, to evidence the continued validity of the representations and warranties made pursuant to clause (i) above and to evidence compliance with any customary conditions contained in the underwriting agreement or other agreement entered into by the Company.

(xi) Make available for inspection by a representative of Holders that are selling stockholders, the managing underwriter(s), if any, and any attorneys or accountants retained by such Holders or managing underwriter(s), at the offices where normally kept, during reasonable business hours, financial and other records, pertinent corporate documents and properties of the Company, and cause the officers, directors and employees of the Company to supply all information in each case reasonably requested (and of the type customarily provided in connection with due diligence conducted in connection with a registered public offering of securities) by any such representative, managing underwriter(s), attorney or accountant in connection with such Shelf Registration Statement.

(xii) Use reasonable best efforts to cause all such Registrable Securities to be listed on each national securities exchange on which similar securities issued by the Company are then listed or, if no similar securities issued by the Company are then listed on any national securities exchange, use its reasonable best efforts to cause all such

Registrable Securities to be listed on such securities exchange as the Investor may designate.

(xiii) If requested by Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith, or the managing underwriter(s), if any, promptly include in a prospectus supplement or amendment such information as the Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith or managing underwriter(s), if any, may reasonably request in order to permit the intended method of distribution of such securities and make all required filings of such prospectus supplement or such amendment as soon as practicable after the Company has received such request.

(xiv) Timely provide to its security holders earning statements satisfying the provisions of Section 11(a) of the Securities Act and Rule 158 thereunder.

(e) Suspension of Sales. Upon receipt of written notice from the Company that a registration statement, prospectus or prospectus supplement contains or may contain an untrue statement of a material fact or omits or may omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading or that circumstances exist that make inadvisable use of such registration statement, prospectus or prospectus supplement, the Investor and each Holder of Registrable Securities shall forthwith discontinue disposition of Registrable Securities until the Investor and/or Holder has received copies of a supplemented or amended prospectus or prospectus supplement, or until the Investor and/or such Holder is advised in writing by the Company that the use of the prospectus and, if applicable, prospectus supplement may be resumed, and, if so directed by the Company, the Investor and/or such Holder shall deliver to the Company (at the Company's expense) all copies, other than permanent file copies then in the Investor and/or such Holder's possession, of the prospectus and, if applicable, prospectus supplement covering such Registrable Securities current at the time of receipt of such notice. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

(f) Termination of Registration Rights. A Holder's registration rights as to any securities held by such Holder (and its Affiliates, partners, members and former members) shall not be available unless such securities are Registrable Securities.

(g) Furnishing Information.

(i) Neither the Investor nor any Holder shall use any free writing prospectus (as defined in Rule 405) in connection with the sale of Registrable Securities without the prior written consent of the Company.

(ii) It shall be a condition precedent to the obligations of the Company to take any action pursuant to Section 4.5(d) that Investor and/or the selling Holders and the underwriters, if any, shall furnish to the Company such information regarding themselves, the Registrable Securities held by them and the intended method of disposition of such securities as shall be required to effect the registered offering of their Registrable Securities.

(h) Indemnification.

(i) The Company agrees to indemnify each Holder and, if a Holder is a person other than an individual, such Holder's officers, directors, employees, agents, representatives and Affiliates, and each Person, if any, that controls a Holder within the meaning of the Securities Act (each, an "*Indemnitee*"), against any and all losses, claims, damages, actions, liabilities, costs and expenses (including reasonable fees, expenses and disbursements of attorneys and other professionals incurred in connection with investigating, defending, settling, compromising or paying any such losses, claims, damages, actions, liabilities, costs and expenses), joint or several, arising out of or based upon any untrue statement or alleged untrue statement of material fact contained in any registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto or any documents incorporated therein by reference or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto); or any omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; *provided*, that the Company shall not be liable to such Indemnitee in any such case to the extent that any such loss, claim, damage, liability (or action or proceeding in respect thereof) or expense arises out of or is based upon (A) an untrue statement or omission made in such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto), in reliance upon and in conformity with information regarding such Indemnitee or its plan of distribution or ownership interests which was furnished in writing to the Company by such Indemnitee for use in connection with such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto, or (B) offers or sales effected by or on behalf of such Indemnitee "by means of" (as defined in Rule 159A) a "free writing prospectus" (as defined in Rule 405) that was not authorized in writing by the Company.

(ii) If the indemnification provided for in Section 4.5(h)(i) is unavailable to an Indemnitee with respect to any losses, claims, damages, actions, liabilities, costs or expenses referred to therein or is insufficient to hold the Indemnitee harmless as contemplated therein, then the Company, in lieu of indemnifying such Indemnitee, shall contribute to the amount paid or payable by such Indemnitee as a result of such losses, claims, damages, actions, liabilities, costs or expenses in such proportion as is appropriate to reflect the relative fault of the Indemnitee, on the one hand, and the Company, on the other hand, in connection with the statements or omissions which resulted in such losses, claims, damages, actions, liabilities, costs or expenses as well as any other relevant equitable considerations. The relative fault of the Company, on the one hand, and of the Indemnitee, on the other hand, shall be determined by reference to, among other factors, whether the untrue statement of a material fact or omission to state a material fact relates to information supplied by the Company or by the Indemnitee and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission; the Company and each Holder agree that it would not be just and equitable if contribution pursuant to this Section 4.5(h)(ii) were determined by *pro rata* allocation or by any other method of allocation that does not take account of the equitable considerations referred to in Section 4.5(h)(i). No Indemnitee guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from the Company if the Company was not guilty of such fraudulent misrepresentation.

(i) Assignment of Registration Rights. The rights of the Investor to registration of Registrable Securities pursuant to Section 4.5(b) may be assigned by the Investor to a transferee or assignee of Registrable Securities with a liquidation preference or, in the case of the Warrant, the liquidation preference of the underlying shares of Warrant Preferred Stock, no less than an amount equal to (i) 2% of the initial aggregate liquidation preference of the Preferred Shares if such initial aggregate liquidation preference is less than $2 billion and (ii) $200 million if the initial aggregate liquidation preference of the Preferred Shares is equal to or greater than $2 billion; *provided*, *however*, the transferor shall, within ten days after such transfer, furnish to the Company written notice of the name and address of such transferee or assignee and the number and type of Registrable Securities that are being assigned.

(j) Clear Market. With respect to any underwritten offering of Registrable Securities by the Investor or other Holders pursuant to this Section 4.5, the Company agrees not to effect (other than pursuant to such registration or pursuant to a Special Registration) any public sale or distribution, or to file any Shelf Registration Statement (other than such registration or a Special Registration) covering any preferred stock of the Company or any securities convertible into or exchangeable or exercisable for preferred stock of the Company, during the period not to exceed ten days prior and 60 days following the effective date of such offering or such longer period up to 90 days as may be requested by the managing underwriter for such underwritten offering. The Company also agrees to cause such of its directors and senior executive officers to execute and deliver customary lock-up agreements in such form and for such time period up to 90 days as may be requested by the managing underwriter. "*Special Registration*" means the registration of (A) equity securities and/or options or other rights in respect thereof solely registered on Form S-4 or Form S-8 (or successor form) or (B) shares of equity securities and/or options or other rights in respect thereof to be offered to directors, members of management, employees, consultants, customers, lenders or vendors of the Company or Company Subsidiaries or in connection with dividend reinvestment plans.

(k) Rule 144; Rule 144A. With a view to making available to the Investor and Holders the benefits of certain rules and regulations of the SEC which may permit the sale of the Registrable Securities to the public without registration, the Company agrees to use its reasonable best efforts to:

(i) make and keep public information available, as those terms are understood and defined in Rule 144(c)(1) or any similar or analogous rule promulgated under the Securities Act, at all times after the Signing Date;

(ii) (A) file with the SEC, in a timely manner, all reports and other documents required of the Company under the Exchange Act, and (B) if at any time the Company is not required to file such reports, make available, upon the request of any Holder, such information necessary to permit sales pursuant to Rule 144A (including the information required by Rule 144A(d)(4) under the Securities Act);

(iii) so long as the Investor or a Holder owns any Registrable Securities, furnish to the Investor or such Holder forthwith upon request: a written statement by the Company as to its compliance with the reporting requirements of Rule 144 under the Securities Act, and of the Exchange Act; a copy of the most recent annual or quarterly report of the Company; and such other reports and documents as the Investor or Holder may reasonably request in availing itself of any rule or regulation of the SEC allowing it to sell any such securities to the public without registration; and

(iv) take such further action as any Holder may reasonably request, all to the extent required from time to time to enable such Holder to sell Registrable Securities without registration under the Securities Act.

(l) As used in this Section 4.5, the following terms shall have the following respective meanings:

(i) "*Holder*" means the Investor and any other holder of Registrable Securities to whom the registration rights conferred by this Agreement have been transferred in compliance with Section 4.5(h) hereof.

(ii) "*Holders' Counsel*" means one counsel for the selling Holders chosen by Holders holding a majority interest in the Registrable Securities being registered.

(iii) "*Register*," "*registered*," and "*registration*" shall refer to a registration effected by preparing and (A) filing a registration statement or amendment thereto in compliance with the Securities Act and applicable rules and regulations thereunder, and the declaration or ordering of effectiveness of such registration statement or amendment thereto or (B) filing a prospectus and/or prospectus supplement in respect of an appropriate effective registration statement on Form S-3.

(iv) "*Registrable Securities*" means (A) all Preferred Shares, (B) the Warrant (subject to Section 4.5(q)) and (C) any equity securities issued or issuable directly or indirectly with respect to the securities referred to in the foregoing clauses (A) or (B) by way of conversion, exercise or exchange thereof, including the Warrant Shares, or share dividend or share split or in connection with a combination of shares, recapitalization, reclassification, merger, amalgamation, arrangement, consolidation or other reorganization, *provided* that, once issued, such securities will not be Registrable Securities when (1) they are sold pursuant to an effective registration statement under the Securities Act, (2) except as provided below in Section 4.5(p), they may be sold pursuant to Rule 144 without limitation thereunder on volume or manner of sale, (3) they shall have ceased to be outstanding or (4) they have been sold in a private transaction in which the transferor's rights under this Agreement are not assigned to the transferee of the securities. No Registrable Securities may be registered under more than one registration statement at any one time.

(v) "*Registration Expenses*" mean all expenses incurred by the Company in effecting any registration pursuant to this Agreement (whether or not any registration or prospectus becomes effective or final) or otherwise complying with its obligations under this Section 4.5, including all registration, filing and listing fees, printing expenses, fees and disbursements of counsel for the Company, blue sky fees and expenses, expenses incurred in connection with any "road show", the reasonable fees and disbursements of Holders' Counsel, and expenses of the Company's independent accountants in connection with any regular or special reviews or audits incident to or required by any such registration, but shall not include Selling Expenses.

(vi) "*Rule 144*", "*Rule 144A*", "*Rule 159A*", "*Rule 405*" and "*Rule 415*" mean, in each case, such rule promulgated under the Securities Act (or any successor provision), as the same shall be amended from time to time.

(vii) "*Selling Expenses*" mean all discounts, selling commissions and stock transfer taxes applicable to the sale of Registrable Securities and fees and disbursements of counsel for any Holder (other than the fees and disbursements of Holders' Counsel included in Registration Expenses).

(m) At any time, any holder of Securities (including any Holder) may elect to forfeit its rights set forth in this Section 4.5 from that date forward; *provided*, that a Holder forfeiting such rights shall nonetheless be entitled to participate under Section 4.5(b)(iv) – (vi) in any Pending Underwritten Offering to the same extent that such Holder would have been entitled to if the holder had not withdrawn; and *provided*, *further*, that no such forfeiture shall terminate a Holder's rights or obligations under Section 4.5(g) with respect to any prior registration or Pending Underwritten Offering. "*Pending Underwritten Offering*" means, with respect to any Holder forfeiting its rights pursuant to this Section 4.5(m), any underwritten offering of Registrable Securities in which such Holder has advised the Company of its intent to register its Registrable Securities either pursuant to Section 4.5(b)(ii) or 4.5(b)(iv) prior to the date of such Holder's forfeiture.

(n) Specific Performance. The parties hereto acknowledge that there would be no adequate remedy at law if the Company fails to perform any of its obligations under this Section 4.5 and that the Investor and the Holders from time to time may be irreparably harmed by any such failure, and accordingly agree that the Investor and such Holders, in addition to any other remedy to which they may be entitled at law or in equity, to the fullest extent permitted and enforceable under applicable law shall be entitled to compel specific performance of the obligations of the Company under this Section 4.5 in accordance with the terms and conditions of this Section 4.5.

(o) No Inconsistent Agreements. The Company shall not, on or after the Signing Date, enter into any agreement with respect to its securities that may impair the rights granted to the Investor and the Holders under this Section 4.5 or that otherwise conflicts with the provisions hereof in any manner that may impair the rights granted to the Investor and the Holders under this Section 4.5. In the event the Company has, prior to the Signing Date, entered into any agreement with respect to its securities that is inconsistent with the rights granted to the Investor and the Holders under this Section 4.5 (including agreements that are inconsistent with the order of priority contemplated by Section 4.5(b)(vi)) or that may otherwise conflict with the provisions hereof, the Company shall use its reasonable best efforts to amend such agreements to ensure they are consistent with the provisions of this Section 4.5.

(p) Certain Offerings by the Investor. In the case of any securities held by the Investor that cease to be Registrable Securities solely by reason of clause (2) in the definition of "Registrable Securities," the provisions of Sections 4.5(b)(ii), clauses (iv), (ix) and (x)-(xii) of Section 4.5(d), Section 4.5(h) and Section 4.5(j) shall continue to apply until such securities otherwise cease to be Registrable Securities. In any such case, an "underwritten" offering or other disposition shall include any distribution of such securities on behalf of the Investor by one or more broker-dealers, an "underwriting agreement" shall include any purchase agreement entered into by such broker-dealers, and any "registration statement" or "prospectus" shall include any offering document approved by the Company and used in connection with such distribution.

(q) Registered Sales of the Warrant. The Holders agree to sell the Warrant or any portion thereof under the Shelf Registration Statement only beginning 30 days after notifying the Company of any such sale, during which 30-day period the Investor and all Holders of the Warrant shall take reasonable steps to agree to revisions to the Warrant to permit a public distribution of the Warrant, including entering into a warrant agreement and appointing a warrant agent.

4.6 Depositary Shares. Upon request by the Investor at any time following the Closing Date, the Company shall promptly enter into a depositary arrangement, pursuant to customary agreements reasonably satisfactory to the Investor and with a depositary reasonably acceptable to the Investor, pursuant to which the Preferred Shares or the Warrant Shares may be deposited and depositary shares, each representing a fraction of a Preferred Share or Warrant Share, as applicable, as specified by the Investor, may be issued. From and after the execution of any such depositary arrangement, and the deposit of any Preferred Shares or Warrant Shares, as applicable, pursuant thereto, the depositary shares issued pursuant thereto shall be deemed "Preferred Shares", "Warrant Shares" and, as applicable, "Registrable Securities" for purposes of this Agreement.

4.7 Restriction on Dividends and Repurchases.

(a) Prior to the earlier of (x) the third anniversary of the Closing Date and (y) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, declare or pay any dividend or make any distribution on capital stock or other equity securities of any kind of the Company or any Company Subsidiary (other than (i) regular quarterly cash dividends of not more than the amount of the last quarterly cash dividend per share declared or, if lower, announced to its holders of Common Stock an intention to declare, on the Common Stock prior to November 17, 2008, as adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction, (ii) dividends payable solely in shares of Common Stock, (iii) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares, (iv) dividends or distributions by any wholly-owned Company Subsidiary or (v) dividends or distributions by any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008).

(b) During the period beginning on the third anniversary of the Closing Date and ending on the earlier of (i) the tenth anniversary of the Closing Date and (ii) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, (A) pay any per share dividend or distribution on capital stock or other equity securities of any kind of the Company at a per annum rate that is in excess of 103% of the aggregate per share dividends and distributions for the immediately prior fiscal year (other than regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares); *provided* that no increase in the aggregate amount of dividends or distributions on Common Stock shall be permitted as a result of any dividends or distributions paid in shares of Common Stock, any stock split or any similar transaction or (B) pay aggregate dividends or distributions on capital stock or other equity securities of any kind of any Company Subsidiary that is in excess of 103% of the aggregate dividends and distributions paid for the immediately prior fiscal year (other than in the case of this clause (B), (1) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares, (2) dividends or distributions by any wholly-owned Company Subsidiary, (3) dividends or distributions by any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008) or (4) dividends or distributions on newly issued shares of capital stock for cash or other property.

(c) Prior to the earlier of (x) the tenth anniversary of the Closing Date and (y) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, redeem, purchase or acquire any shares of Common Stock or other capital stock or other equity securities of any kind of the Company or any Company Subsidiary, or any trust preferred securities issued by the Company or any Affiliate of the Company, other than (i) redemptions, purchases or other acquisitions of the Preferred Shares and Warrant Shares, (ii) in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice, (iii) the acquisition by the Company or any of the Company Subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Company or any other Company Subsidiary), including as trustees or custodians, (iv) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock or trust preferred securities for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case set forth in this clause (iv), solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock (clauses (ii) and (iii), collectively, the "*Permitted Repurchases*"), (v) redemptions of securities held by the Company or any wholly-owned Company Subsidiary or (vi) redemptions, purchases or other acquisitions of capital stock or other equity securities of any kind of any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008.

(d) Until such time as the Investor ceases to own any Preferred Shares or Warrant Shares, the Company shall not repurchase any Preferred Shares or Warrant Shares from any holder thereof, whether by means of open market purchase, negotiated transaction, or otherwise, other than Permitted Repurchases, unless it offers to repurchase a ratable portion of the Preferred Shares or Warrant Shares, as the case may be, then held by the Investor on the same terms and conditions.

(e) During the period beginning on the tenth anniversary of the Closing and ending on the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, (i) declare or pay any dividend or make any distribution on capital stock or other equity securities of any kind of the Company or any Company Subsidiary; or (ii) redeem, purchase or acquire any shares of Common Stock or other capital stock or other equity securities of any kind of the Company or any Company Subsidiary, or any trust preferred securities issued by the Company or any Affiliate of the Company, other than (A) redemptions, purchases or other acquisitions of the Preferred Shares and Warrant Shares, (B) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares, or (C) dividends or distributions by any wholly-owned Company Subsidiary.

(f) "*Junior Stock*" means Common Stock and any other class or series of stock of the Company the terms of which expressly provide that it ranks junior to the Preferred Shares as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Company. "*Parity Stock*" means any class or series of stock of the Company the terms of which do not expressly provide that such class or series will rank senior or junior to the Preferred Shares as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Company (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

4.8 Executive Compensation. Until such time as the Investor ceases to own any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant, the Company shall take all necessary action to ensure that its Benefit Plans with respect to its Senior Executive Officers comply in all respects with Section 111(b) of the EESA as implemented by any guidance or regulation thereunder that has been issued and is in effect as of the Closing Date, and shall not adopt any new Benefit Plan with respect to its Senior Executive Officers that does not comply therewith. "*Senior Executive Officers*" means the Company's "senior executive officers" as defined in subsection 111(b)(3) of the EESA and regulations issued thereunder, including the rules set forth in 31 C.F.R. Part 30.

4.9 Related Party Transactions. Until such time as the Investor ceases to own any Purchased Securities or Warrant Shares, the Company and the Company Subsidiaries shall not enter into transactions with Affiliates or related persons (within the meaning of Item 404 under the SEC's Regulation S-K) unless (i) such transactions are on terms no less favorable to the Company and the Company Subsidiaries than could be obtained from an unaffiliated third party, and (ii) have been approved by the audit committee of the Board of Directors or comparable body of independent directors of the Company.

4.10 Bank and Thrift Holding Company Status. If the Company is a Bank Holding Company or a Savings and Loan Holding Company on the Signing Date, then the Company shall maintain its status as a Bank Holding Company or Savings and Loan Holding Company, as the case may be, for as long as the Investor owns any Purchased Securities or Warrant Shares. The Company shall redeem all Purchased Securities and Warrant Shares held by the Investor prior to terminating its status as a Bank Holding Company or Savings and Loan Holding Company, as applicable. "*Bank Holding Company*" means a company registered as such with the Board of Governors of the Federal Reserve System (the "*Federal Reserve*") pursuant to 12 U.S.C. §1842 and the regulations of the Federal Reserve promulgated thereunder. "*Savings and Loan Holding Company*" means a company registered as such with the Office of Thrift Supervision pursuant to 12 U.S.C. §1467(a) and the regulations of the Office of Thrift Supervision promulgated thereunder.

4.11 Predominantly Financial. For as long as the Investor owns any Purchased Securities or Warrant Shares, the Company, to the extent it is not itself an insured depository institution, agrees to remain predominantly engaged in financial activities. A company is predominantly engaged in financial activities if the annual gross revenues derived by the company and all subsidiaries of the company (excluding revenues derived from subsidiary depository institutions), on a consolidated basis, from engaging in activities that are financial in nature or are incidental to a financial activity under subsection (k) of Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)) represent at least 85 percent of the consolidated annual gross revenues of the company.

Article V
Miscellaneous

5.1 Termination. This Agreement may be terminated at any time prior to the Closing:

(a) by either the Investor or the Company if the Closing shall not have occurred by the 30th calendar day following the Signing Date; *provided*, *however*, that in the event the Closing has not occurred by such 30th calendar day, the parties will consult in good faith to determine whether to extend the term of this Agreement, it being understood that the parties shall be required to consult only until the fifth day after such 30th calendar day and not be under any obligation to extend the term of this Agreement thereafter; *provided*, *further*, that the right to terminate this Agreement under this Section 5.1(a) shall not be available to any party whose breach of any representation or warranty or failure to perform any obligation under this Agreement shall have caused or resulted in the failure of the Closing to occur on or prior to such date; or

(b) by either the Investor or the Company in the event that any Governmental Entity shall have issued an order, decree or ruling or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated by this Agreement and such order, decree, ruling or other action shall have become final and nonappealable; or

(c) by the mutual written consent of the Investor and the Company.

In the event of termination of this Agreement as provided in this Section 5.1, this Agreement shall forthwith become void and there shall be no liability on the part of either party hereto except that nothing herein shall relieve either party from liability for any breach of this Agreement.

5.2 Survival of Representations and Warranties. All covenants and agreements, other than those which by their terms apply in whole or in part after the Closing, shall terminate as of the Closing. The representations and warranties of the Company made herein or in any certificates delivered in connection with the Closing shall survive the Closing without limitation.

5.3 Amendment. No amendment of any provision of this Agreement will be effective unless made in writing and signed by an officer or a duly authorized representative of each party; *provided* that the Investor may unilaterally amend any provision of this Agreement to the extent required to comply with any changes after the Signing Date in applicable federal statutes. No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise of any other right, power or privilege. The rights and remedies herein provided shall be cumulative of any rights or remedies provided by law.

5.4 Waiver of Conditions. The conditions to each party's obligation to consummate the Purchase are for the sole benefit of such party and may be waived by such party in whole or in part to the extent permitted by applicable law. No waiver will be effective unless it is in a writing signed by a duly authorized officer of the waiving party that makes express reference to the provision or provisions subject to such waiver.

5.5 **Governing Law: Submission to Jurisdiction, Etc. This Agreement will be governed by and construed in accordance with the federal law of the United States if and to**

the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within such State. Each of the parties hereto agrees (a) to submit to the exclusive jurisdiction and venue of the United States District Court for the District of Columbia and the United States Court of Federal Claims for any and all civil actions, suits or proceedings arising out of or relating to this Agreement or the Warrant or the transactions contemplated hereby or thereby, and (b) that notice may be served upon (i) the Company at the address and in the manner set forth for notices to the Company in Section 5.6 and (ii) the Investor in accordance with federal law. To the extent permitted by applicable law, each of the parties hereto hereby unconditionally waives trial by jury in any civil legal action or proceeding relating to this Agreement or the Warrant or the transactions contemplated hereby or thereby.

5.6 Notices. Any notice, request, instruction or other document to be given hereunder by any party to the other will be in writing and will be deemed to have been duly given (a) on the date of delivery if delivered personally, or by facsimile, upon confirmation of receipt, or (b) on the second business day following the date of dispatch if delivered by a recognized next day courier service. All notices to the Company shall be delivered as set forth in Schedule A, or pursuant to such other instruction as may be designated in writing by the Company to the Investor. All notices to the Investor shall be delivered as set forth below, or pursuant to such other instructions as may be designated in writing by the Investor to the Company.

If to the Investor:

United States Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 2312
Washington, D.C. 20220
Attention: Assistant General Counsel (Banking and Finance)
Facsimile: (202) 622-1974

5.7 Definitions

(a) When a reference is made in this Agreement to a subsidiary of a person, the term "*subsidiary*" means any corporation, partnership, joint venture, limited liability company or other entity (x) of which such person or a subsidiary of such person is a general partner or (y) of which a majority of the voting securities or other voting interests, or a majority of the securities or other interests of which having by their terms ordinary voting power to elect a majority of the board of directors or persons performing similar functions with respect to such entity, is directly or indirectly owned by such person and/or one or more subsidiaries thereof.

(b) The term "*Affiliate*" means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of this definition, "*control*" (including, with correlative meanings, the terms "*controlled by*" and "*under common control with*") when used with respect to any person, means the possession, directly or indirectly, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise.

(c) The terms "*knowledge of the Company*" or "*Company's knowledge*" mean the actual knowledge after reasonable and due inquiry of the "*officers*" (as such term is defined in Rule 3b-2 under the Exchange Act, but excluding any Vice President or Secretary) of the Company.

5.8 Assignment. Neither this Agreement nor any right, remedy, obligation nor liability arising hereunder or by reason hereof shall be assignable by any party hereto without the prior written consent of the other party, and any attempt to assign any right, remedy, obligation or liability hereunder without such consent shall be void, except (a) an assignment, in the case of a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Company's stockholders (a "*Business Combination*") where such party is not the surviving entity, or a sale of substantially all of its assets, to the entity which is the survivor of such Business Combination or the purchaser in such sale and (b) as provided in Sections 3.5 and 4.5.

5.9 Severability. If any provision of this Agreement or the Warrant, or the application thereof to any person or circumstance, is determined by a court of competent jurisdiction to be invalid, void or unenforceable, the remaining provisions hereof, or the application of such provision to persons or circumstances other than those as to which it has been held invalid or unenforceable, will remain in full force and effect and shall in no way be affected, impaired or invalidated thereby, so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such determination, the parties shall negotiate in good faith in an effort to agree upon a suitable and equitable substitute provision to effect the original intent of the parties.

5.10 No Third Party Beneficiaries. Nothing contained in this Agreement, expressed or implied, is intended to confer upon any person or entity other than the Company and the Investor any benefit, right or remedies, except that the provisions of Section 4.5 shall inure to the benefit of the persons referred to in that Section.

* * *

ANNEX A

FORM OF CERTIFICATE OF DESIGNATIONS FOR PREFERRED STOCK

[SEE ATTACHED]

ANNEX A

FORM OF [CERTIFICATE OF DESIGNATIONS]

OF

FIXED RATE CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES [●]

OF

[●]

[*Insert name of Issuer*], a **[**corporation/bank/banking association**]** organized and existing under the laws of the **[*Insert jurisdiction of organization*]** (the "Issuer"), in accordance with the provisions of Section[s] **[●]** of the **[*Insert applicable statute*]** thereof, does hereby certify:

The board of directors of the Issuer (the "Board of Directors") or an applicable committee of the Board of Directors, in accordance with the **[[**certificate of incorporation/articles of association**]** and bylaws**]** of the Issuer and applicable law, adopted the following resolution on **[●]** creating a series of **[●]** shares of Preferred Stock of the Issuer designated as "Fixed Rate Cumulative Perpetual Preferred Stock, Series **[●]**".

RESOLVED, that pursuant to the provisions of the **[[**certificate of incorporation/articles of association**]** and the bylaws**]** of the Issuer and applicable law, a series of Preferred Stock, par value $**[●]** per share, of the Issuer be and hereby is created, and that the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, are as follows:

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the "Fixed Rate Cumulative Perpetual Preferred Stock, Series **[●]**" (the "Designated Preferred Stock"). The authorized number of shares of Designated Preferred Stock shall be **[●]**.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this **[**Certificate of Designations**]** to the same extent as if such provisions had been set forth in full herein.

Part. 3. Definitions. The following terms are used in this **[**Certificate of Designations**]** (including the Standard Provisions in Schedule A hereto) as defined below:

(a) "Common Stock" means the common stock, par value $**[●]** per share, of the Issuer.

(b) "Dividend Payment Date" means February 15, May 15, August 15 and November 15 of each year.

(c) "Junior Stock" means the Common Stock, **[*Insert titles of any existing Junior Stock*]** and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.

(d) "Liquidation Amount" means $**[**1,000**]**[1] per share of Designated Preferred Stock.

(e) "Minimum Amount" means $**[*Insert $ amount equal to 25% of the aggregate value of the Designated Preferred Stock issued on the Original Issue Date*]**.

(f) "Parity Stock" means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer's **[*Insert title(s) of existing classes or series of Parity Stock*]**.

(g) "Signing Date" means **[*Insert date of applicable securities purchase agreement*]**.

Part. 4. Certain Voting Matters. **[*To be inserted if the Charter provides for voting in proportion to liquidation preferences*:** Whether the vote or consent of the holders of a plurality, majority or other portion of the shares of Designated Preferred Stock and any Voting Parity Stock has been cast or given on any matter on which the holders of shares of Designated Preferred Stock are entitled to vote shall be determined by the Issuer by reference to the specified liquidation amount of the shares voted or covered by the consent as if the Issuer were liquidated on the record date for such vote or consent, if any, or, in the absence of a record date, on the date for such vote or consent. For purposes of determining the voting rights of the holders of Designated Preferred Stock under Section 7 of the Standard Provisions forming part of this **[**Certificate of Designations**]**, each holder will be entitled to one vote for each $1,000 of liquidation preference to which such holder's shares are entitled.**]** **[*To be inserted if the Charter does not provide for voting in proportion to liquidation preferences:*** Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.**]**

[*Remainder of Page Intentionally Left Blank*]

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[1] If Issuer desires to issue shares with a higher dollar amount liquidation preference, liquidation preference references will be modified accordingly. In such case (in accordance with Section 4.6 of the Securities Purchase Agreement), the issuer will be required to enter into a deposit agreement.

IN WITNESS WHEREOF, **[*Insert name of Issuer*]** has caused this **[**Certificate of Designations**]** to be signed by **[●]**, its **[●]**, this **[●]** day of **[●]**.

[*Insert name of Issuer*]

By: ______________________
Name:
Title:

Schedule A

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) "Applicable Dividend Rate" means (i) during the period from the Original Issue Date to, but excluding, the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 5% per annum and (ii) from and after the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 9% per annum.

(b) "Appropriate Federal Banking Agency" means the "appropriate Federal banking agency" with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(c) "Business Combination" means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer's stockholders.

(d) "Business Day" means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(e) "Bylaws" means the bylaws of the Issuer, as they may be amended from time to time.

(f) "Certificate of Designations" means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(g) "Charter" means the Issuer's certificate or articles of incorporation, articles of association, or similar organizational document.

(h) "Dividend Period" has the meaning set forth in Section 3(a).

(i) "Dividend Record Date" has the meaning set forth in Section 3(a).

(j) "Liquidation Preference" has the meaning set forth in Section 4(a).

(k) "Original Issue Date" means the date on which shares of Designated Preferred Stock are first issued.

(l) "Preferred Director" has the meaning set forth in Section 7(b).

(m) "Preferred Stock" means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.

(n) "Qualified Equity Offering" means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer's Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).

(o) "Standard Provisions" mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.

(p) "Successor Preferred Stock" has the meaning set forth in Section 5(a).

(q) "Voting Parity Stock" means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a rate per annum equal to the Applicable Dividend Rate on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Original Issue Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a "Dividend Period", provided that the initial

Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a "Dividend Record Date"). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the "Minimum Amount" as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the "Successor Preferred Stock") in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Issuer or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least $500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to revesting in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, *however*, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Issuer or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

ANNEX B

FORM OF CERTIFICATE OF DESIGNATIONS
FOR WARRANT PREFERRED STOCK

[SEE ATTACHED]

ANNEX B

FORM OF [CERTIFICATE OF DESIGNATIONS]

OF

FIXED RATE CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES [●]

OF

[●]

[*Insert name of Issuer*], a **[**corporation/bank/banking association**]** organized and existing under the laws of the **[*Insert jurisdiction of organization*]** (the "Issuer"), in accordance with the provisions of Section[s] **[●]** of the **[*Insert applicable statute*]** thereof, does hereby certify:

The board of directors of the Issuer (the "Board of Directors") or an applicable committee of the Board of Directors, in accordance with the **[[**certificate of incorporation/articles of association**]** and bylaws**]** of the Issuer and applicable law, adopted the following resolution on **[●]** creating a series of **[●]** shares of Preferred Stock of the Issuer designated as "Fixed Rate Cumulative Perpetual Preferred Stock, Series **[●]**".

RESOLVED, that pursuant to the provisions of the **[[**certificate of incorporation/articles of association**]** and the bylaws**]** of the Issuer and applicable law, a series of Preferred Stock, par value $**[●]** per share, of the Issuer be and hereby is created, and that the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, are as follows:

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the "Fixed Rate Cumulative Perpetual Preferred Stock, Series **[●]**" (the "Designated Preferred Stock"). The authorized number of shares of Designated Preferred Stock shall be **[●]**.

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this **[**Certificate of Designations**]** to the same extent as if such provisions had been set forth in full herein.

Part. 3. Definitions. The following terms are used in this **[**Certificate of Designations**]** (including the Standard Provisions in Schedule A hereto) as defined below:

(a) "Common Stock" means the common stock, par value $**[●]** per share, of the Issuer.

(b) "Dividend Payment Date" means February 15, May 15, August 15 and November 15 of each year.

(c) "Junior Stock" means the Common Stock, **[*Insert titles of any existing Junior Stock*]** and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.

(d) "Liquidation Amount" means $**[**1,000**]**[1] per share of Designated Preferred Stock.

(e) "Minimum Amount" means $**[*Insert $ amount equal to 25% of the aggregate value of the Designated Preferred Stock issued on the Original Issue Date*]**.

(f) "Parity Stock" means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer's UST Preferred Stock **[**and**]** **[*Insert title(s) of any other classes or series of Parity Stock*]**.

(g) "Signing Date" means **[*Insert date of applicable securities purchase agreement*]**.

(h) "UST Preferred Stock" means the Issuer's Fixed Rate Cumulative Perpetual Preferred Stock, Series **[●]**.

Part. 4. Certain Voting Matters. **[*To be inserted if the Charter provides for voting in proportion to liquidation preferences*:** Whether the vote or consent of the holders of a plurality, majority or other portion of the shares of Designated Preferred Stock and any Voting Parity Stock has been cast or given on any matter on which the holders of shares of Designated Preferred Stock are entitled to vote shall be determined by the Issuer by reference to the specified liquidation amount of the shares voted or covered by the consent as if the Issuer were liquidated on the record date for such vote or consent, if any, or, in the absence of a record date, on the date for such vote or consent. For purposes of determining the voting rights of the holders of Designated Preferred Stock under Section 7 of the Standard Provisions forming part of this **[**Certificate of Designations**]**, each holder will be entitled to one vote for each $1,000 of liquidation preference to which such holder's shares are entitled.**]** **[*To be inserted if the Charter does not provide for voting in proportion to liquidation preferences:*** Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.**]**

[*Remainder of Page Intentionally Left Blank*]

[1] If Issuer desires to issue shares with a higher dollar amount liquidation preference, liquidation preference references will be modified accordingly. In such case (in accordance with Section 4.6 of the Securities Purchase Agreement), the issuer will be required to enter into a deposit agreement.

IN WITNESS WHEREOF, **[*Insert name of Issuer*]** has caused this **[**Certificate of Designations**]** to be signed by **[●]**, its **[●]**, this **[●]** day of **[●]**.

[*Insert name of Issuer*]

By: ______________________
Name:
Title:

Schedule A

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) "Appropriate Federal Banking Agency" means the "appropriate Federal banking agency" with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(b) "Business Combination" means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer's stockholders.

(c) "Business Day" means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(d) "Bylaws" means the bylaws of the Issuer, as they may be amended from time to time.

(e) "Certificate of Designations" means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(f) "Charter" means the Issuer's certificate or articles of incorporation, articles of association, or similar organizational document.

(g) "Dividend Period" has the meaning set forth in Section 3(a).

(h) "Dividend Record Date" has the meaning set forth in Section 3(a).

(i) "Liquidation Preference" has the meaning set forth in Section 4(a).

(j) "Original Issue Date" means the date on which shares of Designated Preferred Stock are first issued.

(k) "Preferred Director" has the meaning set forth in Section 7(b).

(l) "Preferred Stock" means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.

(m) "Qualified Equity Offering" means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer's Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).

(n) "Standard Provisions" mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.

(o) "Successor Preferred Stock" has the meaning set forth in Section 5(a).

(p) "Voting Parity Stock" means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a per annum rate of 9.0% on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Original Issue Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a "Dividend Period", provided that the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a

Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a "Dividend Record Date"). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the later of (i) first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date; and (ii) the date on which all outstanding shares of UST Preferred Stock have been redeemed, repurchased or otherwise acquired by the Issuer. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency and subject to the requirement that all outstanding shares of UST Preferred Stock shall previously have been redeemed, repurchased or otherwise acquired by the Issuer, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the "Minimum Amount" as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the "Successor Preferred Stock") in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Issuer or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of

Manhattan, The City of New York, and having a capital and surplus of at least $500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to revesting in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, *however*, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Issuer or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

ANNEX C

FORM OF WAIVER

In consideration for the benefits I will receive as a result of my employer's participation in the United States Department of the Treasury's TARP Capital Purchase Program, I hereby voluntarily waive any claim against the United States or my employer for any changes to my compensation or benefits that are required to comply with the regulation issued by the Department of the Treasury as published in the Federal Register on October 20, 2008.

I acknowledge that this regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including so-called "golden parachute" agreements) that I have with my employer or in which I participate as they relate to the period the United States holds any equity or debt securities of my employer acquired through the TARP Capital Purchase Program.

This waiver includes all claims I may have under the laws of the United States or any state related to the requirements imposed by the aforementioned regulation, including without limitation a claim for any compensation or other payments I would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on my employment relationship.

ANNEX D

FORM OF OPINION

(a) The Company has been duly incorporated and is validly existing as a corporation in good standing under the laws of the state of its incorporation.

(b) The Preferred Shares have been duly and validly authorized, and, when issued and delivered pursuant to the Agreement, the Preferred Shares will be duly and validly issued and fully paid and non-assessable, will not be issued in violation of any preemptive rights, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock issued on the Closing Date with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(c) The Warrant has been duly authorized and, when executed and delivered as contemplated by the Agreement, will constitute a valid and legally binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity.

(d) The shares of Warrant Preferred Stock issuable upon exercise of the Warrant have been duly authorized and reserved for issuance upon exercise of the Warrant and when so issued in accordance with the terms of the Warrant will be validly issued, fully paid and non-assessable, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(e) The Company has the corporate power and authority to execute and deliver the Agreement and the Warrant and to carry out its obligations thereunder (which includes the issuance of the Preferred Shares, Warrant and Warrant Shares).

(f) The execution, delivery and performance by the Company of the Agreement and the Warrant and the consummation of the transactions contemplated thereby have been duly authorized by all necessary corporate action on the part of the Company and its stockholders, and no further approval or authorization is required on the part of the Company.

(g) The Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity; *provided*, *however*, such counsel need express no opinion with respect to Section 4.5(h) or the severability provisions of the Agreement insofar as Section 4.5(h) is concerned.

ANNEX E

FORM OF WARRANT

[SEE ATTACHED]

FORM OF WARRANT TO PURCHASE PREFERRED STOCK

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS. THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID.

WARRANT
to purchase
____
Shares of Preferred Stock

of ______________________

Issue Date: ________________________

1. Definitions. Unless the context otherwise requires, when used herein the following terms shall have the meanings indicated.

"*Board of Directors*" means the board of directors of the Company, including any duly authorized committee thereof.

"*business day*" means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

"*Charter*" means, with respect to any Person, its certificate or articles of incorporation, articles of association, or similar organizational document.

"*Company*" means the Person whose name, corporate or other organizational form and jurisdiction of organization is set forth in Item 1 of Schedule A hereto.

"*Exchange Act*" means the Securities Exchange Act of 1934, as amended, or any successor statute, and the rules and regulations promulgated thereunder.

"*Exercise Price*" means the amount set forth in Item 2 of Schedule A hereto.

"*Expiration Time*" has the meaning set forth in Section 3.

"*Issue Date*" means the date set forth in Item 3 of Schedule A hereto.

"*Liquidation Amount*" means the amount set forth in Item 4 of Schedule A hereto.

"*Original Warrantholder*" means the United States Department of the Treasury. Any actions specified to be taken by the Original Warrantholder hereunder may only be taken by such Person and not by any other Warrantholder.

"*Person*" has the meaning given to it in Section 3(a)(9) of the Exchange Act and as used in Sections 13(d)(3) and 14(d)(2) of the Exchange Act.

"*Preferred Stock*" means the series of perpetual preferred stock set forth in Item 5 of Schedule A hereto.

"*Purchase Agreement*" means the Securities Purchase Agreement – Standard Terms incorporated into the Letter Agreement, dated as of the date set forth in Item 6 of Schedule A hereto, as amended from time to time, between the Company and the United States Department of the Treasury (the "*Letter Agreement*"), including all annexes and schedules thereto.

"*Regulatory Approvals*" with respect to the Warrantholder, means, to the extent applicable and required to permit the Warrantholder to exercise this Warrant for shares of Preferred Stock and to own such Preferred Stock without the Warrantholder being in violation of applicable law, rule or regulation, the receipt of any necessary approvals and authorizations of, filings and registrations with, notifications to, or expiration or termination of any applicable waiting period under, the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations thereunder.

"*SEC*" means the U.S. Securities and Exchange Commission.

"*Securities Act*" means the Securities Act of 1933, as amended, or any successor statute, and the rules and regulations promulgated thereunder.

"*Shares*" has the meaning set forth in Section 2.

"*Warrantholder*" has the meaning set forth in Section 2.

"*Warrant*" means this Warrant, issued pursuant to the Purchase Agreement.

2. Number of Shares; Exercise Price. This certifies that, for value received, the United States Department of the Treasury or its permitted assigns (the "*Warrantholder*") is entitled, upon the terms and subject to the conditions hereinafter set forth, to acquire from the

Company, in whole or in part, after the receipt of all applicable Regulatory Approvals, if any, up to an aggregate of the number of fully paid and nonassessable shares of Preferred Stock set forth in Item 7 of Schedule A hereto (the "*Shares*"), at a purchase price per share of Preferred Stock equal to the Exercise Price.

3. Exercise of Warrant; Term. Subject to Section 2, to the extent permitted by applicable laws and regulations, the right to purchase the Shares represented by this Warrant is exercisable, in whole or in part by the Warrantholder, at any time or from time to time after the execution and delivery of this Warrant by the Company on the date hereof, but in no event later than 5:00 p.m., New York City time on the tenth anniversary of the Issue Date (the "*Expiration Time*"), by (A) the surrender of this Warrant and Notice of Exercise annexed hereto, duly completed and executed on behalf of the Warrantholder, at the principal executive office of the Company located at the address set forth in Item 8 of Schedule A hereto (or such other office or agency of the Company in the United States as it may designate by notice in writing to the Warrantholder at the address of the Warrantholder appearing on the books of the Company), and (B) payment of the Exercise Price for the Shares thereby purchased, by having the Company withhold, from the shares of Preferred Stock that would otherwise be delivered to the Warrantholder upon such exercise, shares of Preferred Stock issuable upon exercise of the Warrant with an aggregate Liquidation Amount equal in value to the aggregate Exercise Price as to which this Warrant is so exercised.

If the Warrantholder does not exercise this Warrant in its entirety, the Warrantholder will be entitled to receive from the Company within a reasonable time, and in any event not exceeding three business days, a new warrant in substantially identical form for the purchase of that number of Shares equal to the difference between the number of Shares subject to this Warrant and the number of Shares as to which this Warrant is so exercised. Notwithstanding anything in this Warrant to the contrary, the Warrantholder hereby acknowledges and agrees that its exercise of this Warrant for Shares is subject to the condition that the Warrantholder will have first received any applicable Regulatory Approvals.

4. Issuance of Shares; Authorization. Certificates for Shares issued upon exercise of this Warrant will be issued in such name or names as the Warrantholder may designate and will be delivered to such named Person or Persons within a reasonable time, not to exceed three business days after the date on which this Warrant has been duly exercised in accordance with the terms of this Warrant. The Company hereby represents and warrants that any Shares issued upon the exercise of this Warrant in accordance with the provisions of Section 3 will be duly and validly authorized and issued, fully paid and nonassessable and free from all taxes, liens and charges (other than liens or charges created by the Warrantholder, income and franchise taxes incurred in connection with the exercise of the Warrant or taxes in respect of any transfer occurring contemporaneously therewith). The Company agrees that the Shares so issued will be deemed to have been issued to the Warrantholder as of the close of business on the date on which this Warrant and payment of the Exercise Price are delivered to the Company in accordance with the terms of this Warrant, notwithstanding that the stock transfer books of the Company may then be closed or certificates representing such Shares may not be actually delivered on such date. The Company will at all times reserve and keep available, out of its authorized but unissued preferred stock, solely for the purpose of providing for the exercise of this Warrant, the aggregate number of shares of Preferred Stock then issuable upon exercise of this Warrant at any

time. The Company will use reasonable best efforts to ensure that the Shares may be issued without violation of any applicable law or regulation or of any requirement of any securities exchange on which the Shares are listed or traded.

5. No Rights as Stockholders; Transfer Books. This Warrant does not entitle the Warrantholder to any voting rights or other rights as a stockholder of the Company prior to the date of exercise hereof. The Company will at no time close its transfer books against transfer of this Warrant in any manner which interferes with the timely exercise of this Warrant.

6. Charges, Taxes and Expenses. Issuance of certificates for Shares to the Warrantholder upon the exercise of this Warrant shall be made without charge to the Warrantholder for any issue or transfer tax or other incidental expense in respect of the issuance of such certificates, all of which taxes and expenses shall be paid by the Company.

7. Transfer/Assignment.

(A) Subject to compliance with clause (B) of this Section 7, this Warrant and all rights hereunder are transferable, in whole or in part, upon the books of the Company by the registered holder hereof in person or by duly authorized attorney, and a new warrant shall be made and delivered by the Company, of the same tenor and date as this Warrant but registered in the name of one or more transferees, upon surrender of this Warrant, duly endorsed, to the office or agency of the Company described in Section 3. All expenses (other than stock transfer taxes) and other charges payable in connection with the preparation, execution and delivery of the new warrants pursuant to this Section 7 shall be paid by the Company.

(B) The transfer of the Warrant and the Shares issued upon exercise of the Warrant are subject to the restrictions set forth in Section 4.4 of the Purchase Agreement. If and for so long as required by the Purchase Agreement, this Warrant shall contain the legends as set forth in Section 4.2(a) of the Purchase Agreement.

8. Exchange and Registry of Warrant. This Warrant is exchangeable, upon the surrender hereof by the Warrantholder to the Company, for a new warrant or warrants of like tenor and representing the right to purchase the same aggregate number of Shares. The Company shall maintain a registry showing the name and address of the Warrantholder as the registered holder of this Warrant. This Warrant may be surrendered for exchange or exercise in accordance with its terms, at the office of the Company, and the Company shall be entitled to rely in all respects, prior to written notice to the contrary, upon such registry.

9. Loss, Theft, Destruction or Mutilation of Warrant. Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and in the case of any such loss, theft or destruction, upon receipt of a bond, indemnity or security reasonably satisfactory to the Company, or, in the case of any such mutilation, upon surrender and cancellation of this Warrant, the Company shall make and deliver, in lieu of such lost, stolen, destroyed or mutilated Warrant, a new Warrant of like tenor and representing the right to purchase the same aggregate number of Shares as provided for in such lost, stolen, destroyed or mutilated Warrant.

10. Saturdays, Sundays, Holidays, etc. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein shall not be a business day, then such action may be taken or such right may be exercised on the next succeeding day that is a business day.

11. Rule 144 Information. The Company covenants that it will use its reasonable best efforts to timely file all reports and other documents required to be filed by it under the Securities Act and the Exchange Act and the rules and regulations promulgated by the SEC thereunder (or, if the Company is not required to file such reports, it will, upon the request of any Warrantholder, make publicly available such information as necessary to permit sales pursuant to Rule 144 under the Securities Act), and it will use reasonable best efforts to take such further action as any Warrantholder may reasonably request, in each case to the extent required from time to time to enable such holder to, if permitted by the terms of this Warrant and the Purchase Agreement, sell this Warrant without registration under the Securities Act within the limitation of the exemptions provided by (A) Rule 144 under the Securities Act, as such rule may be amended from time to time, or (B) any successor rule or regulation hereafter adopted by the SEC. Upon the written request of any Warrantholder, the Company will deliver to such Warrantholder a written statement that it has complied with such requirements.

12. Adjustments and Other Rights. For so long as the Original Warrantholder holds this Warrant or any portion thereof, if any event occurs that, in the good faith judgment of the Board of Directors of the Company, would require adjustment of the Exercise Price or number of Shares into which this Warrant is exercisable in order to fairly and adequately protect the purchase rights of the Warrants in accordance with the essential intent and principles of the Purchase Agreement and this Warrant, then the Board of Directors shall make such adjustments in the application of such provisions, in accordance with such essential intent and principles, as shall be reasonably necessary, in the good faith opinion of the Board of Directors, to protect such purchase rights as aforesaid.

Whenever the Exercise Price or the number of Shares into which this Warrant is exercisable shall be adjusted as provided in this Section 12, the Company shall forthwith file at the principal office of the Company a statement showing in reasonable detail the facts requiring such adjustment and the Exercise Price that shall be in effect and the number of Shares into which this Warrant shall be exercisable after such adjustment, and the Company shall also cause a copy of such statement to be sent by mail, first class postage prepaid, to each Warrantholder at the address appearing in the Company's records.

13. No Impairment. The Company will not, by amendment of its Charter or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Company, but will at all times in good faith assist in the carrying out of all the provisions of this Warrant and in taking of all such action as may be necessary or appropriate in order to protect the rights of the Warrantholder.

14. Governing Law. This Warrant will be governed by and construed in accordance with the federal law of the United States if and to the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and

to be performed entirely within such State. Each of the Company and the Warrantholder agrees (a) to submit to the exclusive jurisdiction and venue of the United States District Court for the District of Columbia for any civil action, suit or proceeding arising out of or relating to this Warrant or the transactions contemplated hereby, and (b) that notice may be served upon the Company at the address in Section 17 below and upon the Warrantholder at the address for the Warrantholder set forth in the registry maintained by the Company pursuant to Section 8 hereof. To the extent permitted by applicable law, each of the Company and the Warrantholder hereby unconditionally waives trial by jury in any civil legal action or proceeding relating to the Warrant or the transactions contemplated hereby or thereby.

15. Binding Effect. This Warrant shall be binding upon any successors or assigns of the Company.

16. Amendments. This Warrant may be amended and the observance of any term of this Warrant may be waived only with the written consent of the Company and the Warrantholder.

17. Notices. Any notice, request, instruction or other document to be given hereunder by any party to the other will be in writing and will be deemed to have been duly given (a) on the date of delivery if delivered personally, or by facsimile, upon confirmation of receipt, or (b) on the second business day following the date of dispatch if delivered by a recognized next day courier service. All notices hereunder shall be delivered as set forth in Item 9 of Schedule A hereto, or pursuant to such other instructions as may be designated in writing by the party to receive such notice.

18. Entire Agreement. This Warrant, the forms attached hereto and Schedule A hereto (the terms of which are incorporated by reference herein), and the Letter Agreement (including all documents incorporated therein), contain the entire agreement between the parties with respect to the subject matter hereof and supersede all prior and contemporaneous arrangements or undertakings with respect thereto.

[Remainder of page intentionally left blank]

[Form of Notice of Exercise]

Date: _________

TO: **[Company]**

RE: Election to Purchase Preferred Stock

The undersigned, pursuant to the provisions set forth in the attached Warrant, hereby agrees to subscribe for and purchase the number of shares of the Preferred Stock set forth below covered by such Warrant. The undersigned, in accordance with Section 3 of the Warrant, hereby agrees to pay the aggregate Exercise Price for such shares of Preferred Stock in the manner set forth in Section 3(B) of the Warrant. A new warrant evidencing the remaining shares of Preferred Stock covered by such Warrant, but not yet subscribed for and purchased, if any, should be issued in the name set forth below.

Number of Shares of Preferred Stock ________________________

Aggregate Exercise Price: ________________________

Holder: ______________________________
By: ________________________
Name: ________________________
Title: ________________________

IN WITNESS WHEREOF, the Company has caused this Warrant to be duly executed by a duly authorized officer.

Dated: ________________

COMPANY: ________________

By: ___________________________
Name:
Title:

Attest:

By: __________________________________
Name:
Title:

[Signature Page to Warrant]

SCHEDULE A

Item 1
Name:
Corporate or other organizational form:
Jurisdiction of organization:

Item 2
Exercise Price:[1]

Item 3
Issue Date:

Item 4
Liquidation Amount:

Item 5
Series of Perpetual Preferred Stock:

Item 6
Date of Letter Agreement between the Company and the United States Department of the Treasury:

Item 7
Number of shares of Preferred Stock:[2]

Item 8
Company's address:

Item 9
Notice information:

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[1] $0.01 per share or such greater amount as the Charter may require as the par value of the Preferred Stock.

[2] The initial number of shares of Preferred Stock for which this Warrant is exercisable shall include the number of shares required to effect the cashless exercise pursuant to Section 3(B) of this Warrant (e.g., such number of shares of Preferred Stock having an aggregate Liquidation Amount equal in value to the aggregate Exercise Price) such that, following exercise of this Warrant and payment of the Exercise Price in accordance with such Section 3(B), the net number of shares of Preferred Stock delivered to the Warrantholder (and rounded to the nearest whole share) would have an aggregate Liquidation Amount equal to 5% of the aggregate amount invested by the United States Department of the Treasury on the investment date.

SCHEDULE A

ADDITIONAL TERMS AND CONDITIONS

Company Information:

Name of the Company: GrandSouth Corporation

Corporate or other organizational form: Corporation

Jurisdiction of Organization: South Carolina

Appropriate Federal Banking Agency: Federal Deposit Insurance Corporation

Notice Information: GrandSouth Bancorporation
381 Halton Road
Greenville, SC 29607
Attn: President
Facsimile: (864) 770-1081

Terms of the Purchase:

Series of Preferred Stock Purchased: Series T

Per Share Liquidation Preference of Preferred Stock: $1,000.00

Number of Shares of Preferred Stock Purchased: 9,000

Dividend Payment Dates on the Preferred Stock: February 15, May 15, August 15 and November 15

Series of Warrant Preferred Stock: Series W

Number of Warrant Shares: 450.00450

Number of Net Warrant Shares (after net settlement): 450

Exercise Price of the Warrant: $0.01

Purchase Price: $9,000,000.00

Closing:

Location of Closing: To be determined by the parties.

Time of Closing: To be determined by the parties.

Date of Closing: January 9, 2009

Wire Information for Closing:	**ABA Number:**	[redacted]
	Bank:	[redacted]
	Account Name:	[redacted]
	Account Number:	[redacted]
	Beneficiary:	**GrandSouth Bancorporation**

Contact for Confirmation of Wire Information:

[redacted]

SCHEDULE B

CAPITALIZATION

Capitalization Date: December 31, 2008

Common Stock

Par value: None

Total Authorized: 20,000,000 shares

Outstanding: 3,573,695

Subject to warrants, options, convertible securities, etc.: 217,412

Reserved for benefit plans and other issuances: 560,918

Remaining authorized but unissued: 15,647,975

Shares issued after Capitalization Date (other than pursuant to warrants, options, convertible securities, etc. as set forth above): None

Preferred Stock

Par value: None

Total Authorized: None (20,000,000 shares on January 6, 2009)

Outstanding (by series): None

Reserved for issuance: None

Remaining authorized but unissued: None (20,000,000 shares on January 6, 2009)

Holders of 5% or more of any class of capital stock	Primary Address
Mason Y. Garrett	381 Halton Road, Greenville, SC 29607
Ronald K. Earnest	381 Halton Road, Greenville, SC 29607

SCHEDULE C

LITIGATION

List any exceptions to the representation and warranty in Section 2.2(l) of the Securities Purchase Agreement – Standard Terms.

If none, please so indicate by checking the box: ☒.

SCHEDULE D

COMPLIANCE WITH LAWS

List any exceptions to the representation and warranty in the second sentence of Section 2.2(m) of the Securities Purchase Agreement – Standard Terms.

If none, please so indicate by checking the box: ☒.

List any exceptions to the representation and warranty in the last sentence of Section 2.2(m) of the Securities Purchase Agreement – Standard Terms.

If none, please so indicate by checking the box: ☒.

SCHEDULE E

REGULATORY AGREEMENTS

List any exceptions to the representation and warranty in Section 2.2(s) of the Securities Purchase Agreement – Standard Terms.

If none, please so indicate by checking the box: ☒.

SCHEDULE F

DISCLOSURE SCHEDULES

List any information required pursuant to Section 2.1(a) of the Securities Purchase Agreement – Standard Terms.

2.2(g) - The Company expects to increase its allowance for loan and lease losses at the end of the fourth quarter of 2008 by approximately $600,000 in view of recent increases in the level of overall risk in the Company's markets and the general economy, as well as regulatory guidance. The increase will negatively impact the Company's 2008 earnings, which will be negative for the fourth quarter, but positive for the year. The Company's ability to consummate the Purchase and other transactions contemplated by the Agreement and the Warrant and perform its obligations thereunder on a timely basis should not be materially affected.

2.2(h) - Audited Financial Statements for the years ended December 31, 2005, 2006 and 2007 and unaudited Financial Statements for the quarters ended March 31, June 30 and September 30, 2008 are attached. Financial statements for December 31, 2008 are not yet available and will be provided to Treasury as soon as reasonably possible.

If none, please so indicate by checking the box: ☐.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
GrandSouth Bancorporation and Subsidiary
Greenville, South Carolina

We have audited the accompanying consolidated balance sheets of GrandSouth Bancorporation and Subsidiary as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of GrandSouth Bancorporation and Subsidiary as of December 31, 2005 and 2004 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

s/Elliott Davis LLC

Greenville, South Carolina
February 10, 2006

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

<TABLE>
<CAPTION>

	DECEMBER 31, 2005	DECEMBER 31, 2004
ASSETS		
<S>	<C>	<C>
Cash and due from banks	$ 6,628	$ 2,544
Federal funds sold	6,312	3,424
Cash and cash equivalents	12,940	5,968
Investment securities available for sale	28,160	16,351
Other investments, at cost	798	955
Loans, net	197,312	174,165
Property and equipment, net	4,380	3,629
Bank owned life insurance	4,408	4,247
Assets acquired in settlement of loans	630	881
Other assets	3,320	1,734
Total assets	$ 251,948	$ 207,930
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$ 12,321	$ 8,818
Interest bearing	209,340	167,328
Total deposits	221,661	176,146
Federal Home Loan Bank advances	8,500	13,500
Other borrowings	3,900	2,500
Subordinated debentures	-	3,500
Other liabilities	1,759	1,487
Total liabilities	235,820	197,133
COMMITMENTS AND CONTINGENCIES - Notes 10 and 14		
SHAREHOLDERS' EQUITY		
Common stock, no par value, 20,000,000 shares authorized, 3,065,726 and 2,382,357 shares issued and outstanding at December 31, 2005 and 2004 respectively	14,340	10,840
Retained earnings	2,149	-
Accumulated other comprehensive income (loss)	(361)	(43)
Total shareholders' equity	16,128	10,797
Total liabilities and shareholders' equity	$ 251,948	$ 207,930

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands except share and per share data)

<TABLE>
<CAPTION>

	For the years ended December 31,		
	2005	2004	2003
INTEREST INCOME			
<S>	<C>	<C>	<C>
Loans and fees on loans	$ 14,917	$ 9,901	$ 7,992
Investment securities	895	525	557
Federal funds sold and due from banks	311	83	55
Total interest income	16,123	10,509	8,604
INTEREST EXPENSE			
Deposits	5,720	3,250	2,793
Federal Home Loan Bank advances and other borrowings	664	506	382
Subordinated debentures	116	79	74
Total interest expense	6,500	3,835	3,249
Net interest income	9,623	6,674	5,355
PROVISION FOR POSSIBLE LOAN LOSSES	1,125	1,000	1,339
Net interest income after provision for possible loan losses	8,498	5,674	4,016
NONINTEREST INCOME			
Service fees on deposit accounts	311	266	289
Gain on sale of investment securities available for sale	18	-	90
Other	251	135	132
Total noninterest income	580	401	511
NONINTEREST EXPENSES			
Salaries and benefits	3,095	2,163	1,895
Data processing	335	321	351
Insurance	200	85	49
Occupancy and equipment	579	579	517
Printing and supplies	92	76	71
Professional services	290	193	152
Writedowns on assets acquired in settlement of loans	251	68	24
Other operating	720	502	436
Total noninterest expenses	5,562	3,987	3,495
Income before income taxes	3,516	2,088	1,032
INCOME TAX PROVISION	1,155	769	382
Net income	$ 2,361	$ 1,319	$ 650
NET INCOME PER COMMON SHARE			
Basic	$ 0.91	$ 0.55	$ 0.27
Diluted	$ 0.76	$ 0.43	$ 0.22
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING			
Basic	2,582,298	2,382,357	2,382,567
Diluted	3,218,986	3,200,558	3,162,300

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
For the years ended December 31, 2005, 2004 and 2003
(Dollars in thousands except share data)

<TABLE>
<CAPTION>

	Common stock Shares	Common stock Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
<S>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 2002	1,875,329	$ 8,464	$ 660	$ 187	$ 9,311
Net income	-	-	650	-	650
Other comprehensive income - Unrealized holding losses on investment securities (net of income tax benefit of $108)	-	-	-	(184)	(184)
Less reclassification adjustment for gains included in net income (net of income tax expense of $33)	-	-	-	(57)	(57)
Comprehensive income	-	-	-	-	409
Stock dividend (5%)	93,731	625	(625)	-	-
Cash dividend ($.04) per share	-	-	(79)	-	(79)
Stock dividend (10%)	196,910	606	(606)	-	-
Balance, December 31, 2003	2,165,970	9,695	-	(54)	9,641
Net income	-	-	1,319	-	1,319
Other comprehensive income - Unrealized holding gain on investment securities (net of income tax expense of $5)	-	-	-	11	11
Comprehensive income	-	-	-	-	1,330
Cash in lieu of fractional shares	(191)	(1)	-	-	(1)
Cash dividend ($.08) per share	-	-	(173)	-	(173)
Stock dividend (10%)	216,578	1,146	(1,146)	-	-
Balance, December 31, 2004	2,382,357	10,840	-	(43)	10,797
Net income	-	-	2,361	-	2,361
Other comprehensive income - Unrealized holding losses on investment securities (net of income tax effect of $180)	-	-	-	(307)	(307)
Less reclassification adjustment for gains included in net income (net of income tax expense of $7)	-	-	-	(11)	(11)
Comprehensive income	-	-	-	-	2,043
Conversion of subordinated debentures into common stock	683,581	3,500	-	-	3,500
Cash in lieu of fractional shares	(212)	-	(2)	-	(2)
Cash dividend ($.08) per share	-	-	(210)	-	(210)
Balance, December 31, 2005	3,065,726	$ 14,340	$ 2,149	$ (361)	$ 16,128

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

<TABLE>
<CAPTION>

	For the years ended December 31, 2005	2004	2003
OPERATING ACTIVITIES			
<S>	<C>	<C>	<C>
Net income	$ 2,361	$ 1,319	$ 650
Adjustments to reconcile net income to net cash provided by operating activities			
Deferred income tax expense (benefit)	(361)	55	(194)
Provision for possible loan losses	1,125	1,000	1,339
Depreciation	329	385	334
Amortization and accretion (net) of securities available for sale	19	114	127
Gain on sale of investment securities available for sale	(18)	-	(90)
Gain on sale of property and equipment	(1)	(4)	(11)
(Gain) loss on sale of assets acquired in settlement of loans	1	13	(10)
Accretion of bank owned life insurance	(161)	-	-
Write-down of assets acquired in settlement of loans	251	68	24
Increase in other assets	(232)	(534)	(291)
Increase in other liabilities	203	276	592
Net cash provided by operating activities	3,516	2,692	2,470
INVESTING ACTIVITIES			
Purchase of investment securities	(16,046)	(11,027)	(9,796)
Redemption (purchase) of Federal Home Loan Bank stock	157	(375)	(155)
Proceeds from principal paydowns on investment securities	2,769	2,908	5,160
Proceeds from sales and calls of investment securities	962	5,500	7,187
Proceeds from maturity of investment securities	-	-	1,000
Increase in loans, net	(24,582)	(28,271)	(40,295)
Purchase of bank owned life insurance	-	(3,357)	-
Increase in cash surrender value of life insurance	-	(63)	(42)
Proceeds from sale of assets acquired in settlement of loans	309	606	267
Cash equivalents acquired, net of payment for purchase acquisition	(737)	-	-
Proceeds from sale of property and equipment	22	16	23
Purchase of property and equipment	(1,101)	(132)	(246)
Net cash used for investing activities	(38,247)	(34,195)	(36,897)
FINANCING ACTIVITIES			
Proceeds from Federal Home Loan Bank advances	11,000	5,000	3,100
Repayment of Federal Home Loan Bank advances	(16,000)	(3,100)	-
Proceeds from other borrowings	3,900	2,500	-
Repayment of other borrowings	(2,500)	-	-
Net increase in deposits	45,515	29,637	27,148
Dividends paid	(210)	(173)	(79)
Cash paid in lieu of fractional shares	(2)	(1)	-
Net cash provided by financing activities	41,703	33,863	30,169
Net (decrease) increase in cash and cash equivalents	6,972	2,360	(4,258)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	5,968	3,608	7,866
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 12,940	$ 5,968	$ 3,608
SUPPLEMENTAL INFORMATION			
Cash paid for:			
Income taxes	$ 1,225	$ 238	$ 148
Interest	$ 6,632	$ 3,811	$ 3,383

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Dollars in thousands)

<TABLE>
<CAPTION>

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES	For the years ended December 31, 2005	2004	2003
<S>	<C>	<C>	<C>
Change in unrealized gain (loss) on investment securities available for sale, before tax	$ (505)	$ 16	$ (382)
Loans charged-off, net of recoveries	$ 368	$1,052	$ 389
Loans transferred to assets acquired in settlement of loans	$ 310	$1,157	$ 449
Subordinated debentures converted into common stock	$ 3,500	-	-

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees, and operates as one business segment. The Company is regulated by the Federal Reserve Board. The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

Basis of presentation

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

Reclassifications

Certain prior year amounts have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported shareholders' equity or net income.

Acquisition

In May 2005, the Company acquired an auto-financing business with assets valued at $3,236 and recorded $737 in goodwill. This auto-financing business had $2,413 in specialty commercial lines of credit with the Bank. These loans are now on the Bank's books in the auto dealers' names.

Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates.

Concentrations of credit risk

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in the upstate region of South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, Management monitors exposure to credit risk that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices

The Company's investment portfolio consists principally of obligations of the United States of America, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Investment securities

The Bank accounts for investment securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The statement requires investments in equity and debt securities to be classified into one of three categories:

1. Available for sale: These are securities that are not classified as either held to maturity or as trading securities. These securities are reported at fair market value which is determined using quoted market prices. Unrealized gains and losses are reported, net of income taxes, as separate components of shareholders' equity (accumulated other comprehensive income (loss)). Gains or losses on dispositions of securities are based on the difference between the net proceeds and the adjusted carrying amounts of the securities sold using the specific identification method. Premiums and discounts are amortized into interest income by a method that approximates a level yield.

2. Held to maturity: These are securities that the Company has the ability and intent to hold until maturity. These securities are stated at cost, adjusted for amortization of premiums and the accretion of discounts. Premiums and discounts are amortized into interest income by a method that approximates a level yield. The Company has no held to maturity securities.

3. Trading: These are securities that are bought and held principally for the purpose of selling in the near future. Trading securities are reported at fair market value, and related unrealized gains and losses are recognized in the income statement. The Company has no trading securities.

Loans and interest income on loans

Loans are stated at the principal balance outstanding. The allowance for possible loan losses is deducted from total loans in the consolidated balance sheet. Interest income is recognized on an accrual basis over the term of the loan based on the principal amount outstanding.

Loans are generally placed on non-accrual status when principal or interest becomes ninety days past due, or when payment in full is not anticipated. When a loan is placed on non-accrual status, interest accrued but not received is generally reversed against interest income. If collectibility is in doubt, cash receipts on non-accrual loans are not recorded as interest income, but are used to reduce principal. Loans are not returned to accrual status until the borrower demonstrates the ability to pay principal and interest. Loans on non-accrual status as well as real estate acquired through foreclosure or deed taken in lieu of foreclosure are included in non-performing assets.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

Allowance for possible loan losses

The provision for possible loan losses charged to operating expense reflects the amount deemed appropriate by management to establish an adequate reserve to meet the present estimated loss characteristics of the current loan portfolio. Management's estimate is based on periodic and regular evaluation of individual loans, the overall risk characteristics of the various portfolio segments, past experience with losses, and prevailing and anticipated economic conditions. Loans that are determined to be uncollectible are charged against the allowance. Provision for possible loan losses and recoveries on loans previously charged off are added to the allowance.

The Company accounts for impaired loans in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." This standard requires that all lenders value loans at the loan's fair value if it is probable that the lender will be unable to collect all amounts due according to the terms of the loan agreement. Fair value may be determined based upon the present value of expected cash flows, market price of the loan, if available, or value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate.

Under SFAS No. 114, as amended by SFAS No. 118, when the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the reported principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For these accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations, while major improvements are capitalized. Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts, and gain or loss is included in income from operations.

Assets acquired in settlement of loans

Assets acquired in settlement of loans include real estate acquired through foreclosure or deed taken in lieu of foreclosure, and repossessed assets. These assets are recorded at the lower of the carrying value of the loans or the estimated fair value of the related asset, net of estimated selling costs. The excess carrying value, if any, is charged to the allowance for possible loan losses upon transfer. If further reduction in value occurs, charges are included in income from operations.

Goodwill

Goodwill is evaluated for impairment on at least an annual basis by comparing the fair value of its reporting units to their related carrying value. If the carrying value of a reporting unit exceeds its fair value, the Company determines whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeds the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded in an amount equal to that excess. To date, the Company has not had to record any impairment write downs of its goodwill.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

Income taxes

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax return. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

Advertising and public relations expense

Advertising, promotional, and other business development costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailings are expensed in the period in which the direct mailings are sent.

Net income per common share

Net income per common share is computed on the basis of the weighted average number of common shares outstanding in accordance with SFAS No. 128, "Earnings per Share." The treasury stock method is used to compute the effect of stock options and convertible subordinated debentures on the weighted average number of common shares outstanding for diluted earnings per share. On January 21, 2003, the Company declared a five percent stock dividend and on January 22, 2004 and February 28, 2005 the Company declared ten percent stock dividends. Per share and share amounts have been retroactively restated to reflect the stock dividends declared in 2003, 2004 and 2005. The 2005 stock dividend was reflected in the 2004 financial statements.

Statement of cash flows

For purposes of reporting cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and cash equivalents." Cash and cash equivalents have an original maturity of three months or less.

Fair values of financial instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," as amended by SFAS No. 119, requires disclosure of fair value information for financial instruments, whether or not recognized in the consolidated balance sheet, when it is practicable to estimate the fair value. SFAS No. 107 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock. In addition, other nonfinancial instruments such as property and equipment and other assets and liabilities are not subject to the disclosure requirements.

Risks and uncertainties

In the normal course of its business the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment securities portfolios that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Stock-based compensation

The Company has a stock-based employee compensation plan, which is further described in Note 16. The Company accounts for the plan under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and net income per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation. Per share and weighted average shares outstanding have been restated to reflect the ten percent stock dividends declared on January 22, 2004 and February 28, 2005. The 2005 stock dividend was reflected in the 2004 financial statements.

<TABLE>
<CAPTION>

	Years ended December 31,		
	2005	2004	2003
<S>	<C>	<C>	<C>
Net income, as reported	$2,361	$1,319	$ 650
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	124	54	20
Pro forma net income - basic	2,237	1,265	630
Add: Interest savings, net of tax/weighted average incremental shares assumed on conversion of subordinated debentures	73	50	47
Pro forma net income - diluted	$2,310	$1,315	$ 677
Net income per common share:			
Basic - as reported	$ 0.91	$ 0.55	$ 0.27
Basic - pro forma	$ 0.87	$ 0.53	$ 0.26
Diluted - as reported	$ 0.76	$ 0.43	$ 0.22
Diluted - pro forma	$ 0.72	$ 0.41	$ 0.21

</TABLE>

The fair values at date of grant range from $1.38 to $3.56. The fair value of the option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for grants: the risk free interest rate used ranged from 4.00% to 5.89%, the expected volatility ranged from 5.00% to 20.09%, the expected option life was 10 years and the assumed dividend yields ranged from zero to $0.08 per share.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

Recently issued accounting standards

The following is a summary of recent authoritative pronouncements that affect accounting, reporting, and disclosure of financial information by the Company:

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"). SFAS No.123(R) covers a wide range of stock-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. SFAS No. 123(R) will require companies to measure all employee stock-based compensation awards using a fair value method and record such expense in their financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosure related to the income tax and cash flow effects resulting from stock-based payment arrangements. SFAS No. 123(R) is effective for the Company beginning with the first interim reporting period in 2006. The Company is currently evaluating the impact that the adoption of SFAS No. 123(R) will have on its financial position, results of operations and cash flows. The cumulative effect of adoption, if any, will be measured and recognized in the statement of income on the date of adoption.

In April 2005, the Securities and Exchange Commission's Office of the Chief Accountant and its Division of Corporation Finance released Staff Accounting Bulletin ("SAB") No.107 to provide guidance regarding the application of SFAS No. 123(R). SAB No. 107 provides interpretive guidance related to the interaction between SFAS No.123(R) and certain SEC rules and regulations, as well as the staff's views regarding the valuation of stock-based payment arrangements for public companies. SAB No. 107 also reminds public companies of the importance of including disclosures within filings made with the SEC relating to the accounting for stock-based payment transactions, particularly during the transition to SFAS No.123(R).

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections--a replacement of APB Opinion No. 20 and FASB Statement No. 3". SFAS No. 154 establishes retrospective application as the required method for reporting a change in accounting principle, unless it is impracticable, in which case the changes should be applied to the latest practicable date presented. SFAS No. 154 also requires that a correction of an error be reported as a prior period adjustment by restating prior period financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

NOTE 2 - RESTRICTIONS ON CASH AND DUE FROM BANKS

The Bank is required to maintain average reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or on deposit with the Federal Reserve Bank. At December 31, 2005 and 2004 these required reserves were met by vault cash.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 - INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale are as follows:

<TABLE>
<CAPTION>

	December 31, 2005			
	Amortized Cost	Gross unrealized Gains	Gross unrealized Losses	Fair Value
<S>	<C>	<C>	<C>	<C>
U.S. Government Agencies	$14,498	$ -	$ 209	$14,289
State and municipals	463	-	2	461
Mortgage backed	13,772	-	362	13,410
Total investment securities	$28,733	$ -	$ 573	$28,160

<CAPTION>

	December 31, 2004			
	Amortized Cost	Gross unrealized Gains	Gross unrealized Losses	Fair Value
<S>	<C>	<C>	<C>	<C>
U.S. Government Agencies	$ 7,496	$ -	$ 34	$ 7,462
Mortgage backed	8,924	44	79	8,889
Total investment securities	$16,420	$ 44	$ 113	$16,351

</TABLE>

The amortized costs and fair values of securities available for sale at December 31, 2005, by contractual maturity, are shown in the following chart. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair value
Less than one year	$ 3,000	$ 2,967
One to five years	13,547	13,307
Five to ten years	10,175	9,907
After ten years	2,011	1,979
Total investment securities	$28,733	$28,160

Investment securities with an aggregate amortized cost of $1,499 (fair value of $1,465) at December 31, 2005 and $8,207 (fair value of $8,201) at December 31, 2004 were pledged to collateralize public deposits and borrowings.

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NOTE 3 - INVESTMENT SECURITIES, Continued

The following table shows gross unrealized losses and fair value, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2005.

<TABLE>
<CAPTION>

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<S>	<C>	<C>	<C>	<C>	<C>	<C>
U.S. Government Agencies	$ 6,926	$ 75	$ 7,363	$ 134	$14,289	$ 209
State and municipals	461	2	-	-	461	2
Mortgage backed	8,808	143	4,602	219	13,410	362
Total	$16,195	$ 220	$11,965	$ 353	$28,160	$ 573

</TABLE>

Thirteen individual securities were in a continuous loss position for twelve months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

The Bank, as a member institution of the Federal Home Loan Bank of Atlanta ("FHLB"), is required to own capital stock in the FHLB based generally upon the balance of investment securities pledged and FHLB borrowings. FHLB capital stock, with a cost of $798 and $955 at December 31, 2005 and 2004, respectively, is included in other investments in the consolidated balance sheets. No ready market exists for the stock, and it has no quoted market value. However, redemption of the stock has historically been at par value.

NOTE 4 - LOANS

The composition of net loans by major loan category is presented below:

<TABLE>
<CAPTION>

	December 31,	
	2005	2004
<S>	<C>	<C>
Commercial	$ 41,915	$ 33,644
Real estate - construction	39,895	39,170
Real estate - mortgage	110,694	96,984
Consumer	7,858	6,660
Loans, gross	200,362	176,458
Less allowance for possible loan losses	3,050	2,293
	$197,312	$174,165

</TABLE>

At December 31, 2005 and 2004, non-accrual loans totaled $2,551 and $1,497, respectively. The gross interest income that would have been recorded under the original terms of the loans amounted to $96, $168, and $94, in 2005, 2004 and 2003, respectively. The Bank had no loans with payments past due ninety days or more and accruing interest at December 31, 2005 and 2004. Variable rate and fixed rate loans totaled $141,172 and $59,190, respectively, at December 31, 2005.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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NOTE 4 - LOANS, Continued

The following is a summary of the activity within the allowance for possible loan losses for the periods presented:

<TABLE>
<CAPTION>

	For the years ended December 31, 2005	2004	2003
<S>	<C>	<C>	<C>
Balance, beginning of year	$ 2,293	$ 2,345	$ 1,395
Provision for possible loan losses	1,125	1,000	1,339
Loans charged against the allowance, net of recoveries	(368)	(1,052)	(389)
Balance, end of year	$ 3,050	$ 2,293	$ 2,345

</TABLE>

The following is a summary of impaired loans for the periods reported:

	At December 31, 2005	2004
Impaired loans:		
No valuation allowance required	$ 280	$2,196
Valuation allowance required	2,160	1,161
Total impaired loans	$2,440	$3,357
Valuation allowance	$ 630	$ 305

<TABLE>
<CAPTION>

	For the years ended December 31, 2005	2004	2003
<S>	<C>	<C>	<C>
Average recorded investment in impaired loans	$3,388	$3,4062	$ -
Interest income recognized on impaired loans	172	102	-

</TABLE>

NOTE 5 - PROPERTY AND EQUIPMENT

Components of property and equipment included in the balance sheet are as follows:

	December 31, 2005	2004
Land and land improvements	$ 1,104	$ 567
Building and leasehold improvements	2,752	2,891
Construction in process	335	-
Furniture and equipment	1,353	1,293
Vehicles	251	133
	5,795	4,884
Accumulated depreciation	(1,415)	(1,255)
Total property and equipment	$ 4,380	$ 3,629

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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NOTE 5 - PROPERTY AND EQUIPMENT, Continued

Construction in process consists of capitalized costs related to the construction of the Anderson branch office. Depreciation expense for the years ended December 31, 2005, 2004 and 2003 amounted to $329, $385, and $334, respectively. Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation for the principal items follow:

<TABLE>
<CAPTION>

Type of Asset	Life in Years	Depreciation Method
<S>	<C>	<C>
Software	3	Straight-line
Furniture and equipment	5 to 7	Straight-line
Buildings and improvements	5 to 40	Straight-line
Vehicles	3	Straight-line

</TABLE>

NOTE 6 - DEPOSITS

The following is a detail of deposit accounts:

	December 31, 2005	December 31, 2004
Noninterest bearing	$ 12,321	$ 8,818
Interest bearing:		
NOW accounts	2,941	2,914
Money market accounts	50,905	61,240
Savings	751	742
	66,918	73,714
Time, less than $100,000	80,064	50,222
Time, $100,000 and over	74,679	52,210
	154,743	102,432
Total deposits	$221,661	$176,146

Interest expense on time deposits greater than $100,000 was $2,226, $905, and $519, in 2005, 2004 and 2003, respectively. Brokered deposits as of December 31, 2005 amounted to $30,774.

At December 31, 2005 the scheduled maturities of certificates of deposit are as follows:

2006	$ 136,418
2007	16,150
2008	1,934
2009	129
2010 and thereafter	112
	$ 154,743

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NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

The Bank had advances outstanding from the FHLB totaling $8,500 and $13,500 at December 31, 2005 and 2004, respectively. The advances bear interest at fixed rates ranging from 4.33 percent to 4.38 percent. An advance of $6,500 matures in 2006, and an advance of $2,000 matures in 2011. The advance maturing in 2011 is callable, and may reprice prior to its final maturity date.

Advances are collateralized by qualifying residential 1 - 4 family first mortgages and qualifying commercial loans. During 2005, the maximum amount of advances outstanding was $16,500 and the average amount outstanding during 2005 was $11,392.

NOTE 8 - OTHER BORROWINGS

At December 31, 2005 and 2004, the Company had outstanding $3,900 and $2,500, respectively, in other borrowings from an unrelated bank. The borrowings bear interest at the federal prime rate (7.25 percent at December 31, 2005). The borrowings mature in 2017 and may be repaid before maturity without penalty.

NOTE 9 - SUBORDINATED DEBENTURES

In 2001, the Company issued ten-year variable rate convertible subordinated debentures (the "Debentures"). The Debentures paid interest quarterly at prime minus 2 percent. Under the original terms of the Debenture agreement (the "Terms"), the holders of the Debentures could convert the principal amount of each Debenture into common stock of the Company at the conversion rate of $5.12 (which was based on the approximate fair value at issuance of $6.50, as adjusted for the 2003, 2004 and 2005 stock dividends) of Debenture principal for one share of the Company's stock. Under the Terms, the Company had the option of redeeming the Debentures at any time after December 31, 2005 as a whole or in part and from time to time at predetermined prices. At the Company's request, during the third and fourth quarters of 2005, holders of $3,500 of the Company's Debentures converted their principal to common stock. This conversion was made in advance of the earliest contractual redemption date of January 1, 2006, provided for by the Terms. The Company paid the holders an amount equal to the interest income that would have been earned on the Debentures through January 1, 2006. This interest was paid based on the interest rate in effect at the time of conversion: 4.25% and 4.75% for the third and fourth quarters of 2005, respectively.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

The Company is party to litigation and claims arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company's financial position or results of operations.

The Company has entered into a contract with an architect and contractor to construct the Anderson branch office in the amount of $688. Management estimates the total cost of construction of the Anderson branch office to be approximately $750.

The Company has a ground lease on its main office location, which expires in 2021. The monthly lease payment is $1 for years one through eleven and increases to $2 per month in year sixteen.

The Company leased an office, which it used as a branch until July 2003, under a non-cancelable operating lease, which terminated in October 2004. Monthly lease payments of $3 were due on the lease until cancellation. This office was closed in July 2003, but the lease obligation continued until October 2004.

The Company also leases land upon which it constructed a branch office under a non-cancelable operating lease, which expires in March of 2018. The lease requires monthly lease payments of $0.8. The lease contains four renewal options of five years each with provisions for adjustments to the monthly lease payments. The lease agreement requires the Company to pay all property taxes.

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NOTE 10 - COMMITMENTS AND CONTINGENCIES, Continued

Future minimum lease payments under these operating leases are summarized as follows:

For the year ended ended December 31,	
2006	$ 23
2007	23
2008	23
2009	23
2010	23
Thereafter	241
	$ 356

NOTE 11 - UNUSED LINES OF CREDIT

At December 31, 2005, the Bank had two unused lines of credit to purchase federal funds totaling $7,400 from unrelated banks. These lines of credit are available on a one to fourteen day basis for general corporate purposes of the Bank. The lenders reserve the right to withdraw the line at their option. The Bank had an additional line of credit with the FHLB to borrow up to fifteen percent of the Bank's total assets. At December 31, 2005, the Bank had unused available credit of $29,286. The line of credit agreement requires the Bank to pledge investment securities or qualifying loans as collateral. (See Note 7.)

NOTE 12 - INCOME TAXES

The following summary of the provision for income taxes includes tax deferrals, which arise from temporary differences in the recognition of certain items of revenue and expense for tax and financial reporting purposes for the years ended December 31:

	2005	2004	2003
Income taxes currently payable			
Federal	$ 1,400	$ 649	$ 552
State	116	65	24
	1,516	714	576
Deferred tax provision (benefit)	(361)	55	(194)
Income tax provision	$ 1,155	$ 769	$ 382

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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NOTE 12 - INCOME TAXES, Continued

The income tax effect of cumulative temporary differences at December 31, are as follows:

<TABLE>
<CAPTION>

	Deferred tax asset (liability)	
	2005	2004
<S>	<C>	<C>
Allowance for possible loan losses	$ 699	$ 456
Nonaccrual loan interest	40	14
Unrealized net losses on investment securities available for sale	212	26
Depreciation	(234)	(195)
Amortization	(10)	-
Write down of assets acquired in settlement of loans	86	-
Deferred compensation	88	-
Other	10	(7)
Deferred tax asset	891	294
Less: valuation allowance	(50)	-
Net deferred tax asset	$ 841	$ 294

</TABLE>

The net deferred tax asset is included in other assets in the consolidated balance sheets. The valuation allowance is related to the Company's stand-alone state net operating loss carryforwards.

The provision for income taxes is reconciled to the amount of income tax computed at the federal statutory rate on income before income taxes for the years ended December 31, as follows:

<TABLE>
<CAPTION>

	2005		2004		2003	
	Amount	%	Amount	%	Amount	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Tax expense at statutory rate	$ 1,196	34	$ 710	34	$ 351	34
Increase in taxes resulting from:						
State bank tax (net of federal benefit)	77	2	43	2	24	2
Officers life insurance	(55)	(1)	-	-	-	-
Other	(63)	(2)	16	1	7	1
Income tax provision	$ 1,155	33	$ 769	37	$ 382	37

</TABLE>

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain directors, executive officers and companies with which they are affiliated, are customers of and have banking transactions with the Bank in the ordinary course of business. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable arms-length transactions. A summary of loan transactions with directors, including their affiliates and executive officers are as follows:

	For the years ended December 31,	
	2005	2004
Balance, beginning of year	$ 2,071	$ 1,808
New loans	202	1,688
Less loan payments	(627)	(1,425)
Balance, end of year	$ 1,646	$ 2,071

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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NOTE 13 - RELATED PARTY TRANSACTIONS, Continued

Deposits by directors and their related interests at December 31, 2005 and 2004 approximated $1,216 and $1,883, respectively.

The Company leases land from a relative of a director, shareholder and executive officer of the Company (see Note 10). Lease expenses charged to operations under these agreements approximated $10 in 2005, $40 in 2004, and $46 in 2003.

Of the $3,500 in debentures that were converted into common stock, $1,810 were converted into 353,511 shares of common stock held by related parties.

NOTE 14 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the ordinary course of business, and to meet the financing needs of its customers, the Bank is a party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amount of those instruments reflects the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2005 and 2004, unfunded commitments to extend credit were $45,968 and $27,848, respectively. Variable rate and fixed rate unfunded commitments to extend credit were $29,853 and $16,115, respectively, at December 31, 2005. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. At December 31, 2005 and 2004, there were outstanding letters of credit totaling $332 and $994, respectively.

NOTE 15 - EMPLOYEE BENEFIT PLAN

The Bank sponsors the GrandSouth Bank Profit Sharing Section 401(k) Plan (the "Plan") for the benefit of all eligible employees. The Bank contributes seventy-five percent of the first four percent of the employee's compensation contributed to the Plan. Contributions made to the Plan in 2005, 2004, and 2003 amounted to $56, $40, and $35, respectively.

In 2001, supplemental benefits were approved by the Board of Directors for certain executive officers of the Bank. These benefits are not qualified under the Internal Revenue Code and they are not funded. However, certain funding is provided informally and indirectly by life insurance policies owned by the Bank. The Company recorded net expense related to these benefits of $61, $56, and $29 in 2005, 2004 and 2003, respectively.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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NOTE 16 - STOCK OPTION PLAN

During 1998, the Board of Directors approved a stock option plan for the benefit of the directors, officers and employees. The Board may grant up to 778,330 options (after the shareholders approved an amendment to increase the number of shares in the plan at the 2005 Annual meeting) at an option price per share not less than the fair market value on the date of grant. All options granted to officers and employees vest 20 percent each year for five years and expire 10 years from the grant date. Information on options outstanding and exercisable at December 31, 2005 is disclosed in the table below.

<TABLE>
<CAPTION>

Range of Exercise Prices	Options outstanding: Number Outstanding	Options outstanding: Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options exercisable: Number Exercisable	Options exercisable: Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>
$ 3.58	181,682	2.87	$ 3.58	181,682	$ 3.58
3.94	47,842	5.12	3.94	38,274	3.94
5.51 - 5.71	41,489	6.20	5.68	23,623	5.69
6.69	33,000	8.13	6.69	6,600	6.69
8.50 - 9.5	17,500	10.00	9.04	-	-
10.05	93,358	10.00	10.05	-	-
	414,871			250,179	

</TABLE>

A summary of the status of the plan and changes during the year is presented below:

<TABLE>
<CAPTION>

For the years ended December 31,	2005 Shares	2005 Weighted Average Exercise Price	2004 Shares	2004 Weighted Average Exercise Price	2003 Shares	2003 Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Outstanding at beginning of year	304,013	$4.26	271,013	$3.85	264,660	$3.82
Granted	110,858	9.89	33,000	6.69	6,353	5.51
Exercised	-		-		-	
Forfeited or expired	-		-		-	
Outstanding at end of year	414,871	5.76	304,013	4.26	271,013	3.85
Options exercisable at December 31, .	250,179	3.92	225,712	3.77	207,846	3.69
Shares available for grant	363,459		26,317		59,317	

</TABLE>

Granted shares and per share exercise prices have been restated to reflect the 2003, 2004 and 2005 stock dividends.

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NOTE 17 - COMMON STOCK AND NET INCOME PER COMMON SHARE

Following is a reconciliation of basic net income per share to diluted net income per share for the years ended December 31, 2005, 2004 and 2003.

<TABLE>
<CAPTION>

	Income (numerator)	Shares (denominator)	Per-share amount
For the year ended December 31, 2005			
Basic net income per common share			
<S>	<C>	<C>	<C>
Income available to common shareholders	$ 2,361	2,582,298	$ 0.91
Effect of dilutive instruments:			
Stock options	-	152,728	-
Effect of convertible instruments:			
Interest savings/weighted average incremental shares assumed conversion of subordinated debentures	73	483,960	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 2,434	3,218,986	$ 0.76
For the year ended December 31, 2004			
Basic net income per common share			
Income available to common shareholders	$ 1,319	2,382,357	$ 0.55
Effect of dilutive instruments:			
Stock options	-	134,086	-
Effect of convertible instruments:			
Interest savings/weighted average incremental shares assumed on conversion of subordinated debentures	50	684,115	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 1,369	3,200,558	$ 0.43
For the year ended December 31, 2003			
Basic net income per common share			
Income available to common shareholders	$ 650	2,382,567	$ 0.27
Effect of dilutive instruments:			
Stock options	-	95,896	-
Effect of convertible instruments:			
Interest savings/weighted average incremental shares assumed on conversion of subordinated debentures	47	683,837	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 697	3,162,300	$ 0.22

</TABLE>

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NOTE 18 - RESTRICTIONS ON DIVIDENDS

The ability of the Company to pay cash dividends is dependent upon its receiving cash in the form of dividends from the Bank. South Carolina banking regulations restrict the amount of cash dividends the Bank can pay to the Company.

NOTE 19 - REGULATORY MATTERS

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

In connection with the Company's acquisition of a specialty lender in 2005, the Company committed to the Federal Reserve to increase the amount of its Tier 1 capital to the well capitalized level by June 30, 2006. The conversion of subordinated debentures to common stock in 2005 was in furtherance of this commitment. The Company plans to raise additional Tier 1 capital in 2006 and is exploring several avenues to do so.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. The Company and Bank actual capital amounts and ratios and minimum regulatory amounts and ratios are presented as follows:

<TABLE>
<CAPTION>

	Actual		For capital adequacy purposes Minimum		To be well capitalized under prompt corrective action provisions Minimum	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Company (consolidated):						
As of December 31, 2005						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Total capital (to risk weighted assets)	$18,374	8.8%	$16,787	8.0%	N/A	N/A
Tier 1 capital (to risk weighted assets)	15,747	7.5	8,393	4.0	N/A	N/A
Tier 1 capital (to average assets)	15,747	6.7	9,416	4.0	N/A	N/A
Bank:						
As of December 31, 2005						
Total capital (to risk weighted assets)	$21,145	10.1%	$16,778	8.0%	$20,972	10.0%
Tier 1 capital (to risk weighted assets)	18,518	8.8	8,389	4.0	12,583	6.0
Tier 1 capital (to average assets)	18,518	8.0	9,230	4.0	11,538	5.0
Company (consolidated):						
As of December 31, 2004						
Total capital (to risk weighted assets)	$16,577	9.3%	$14,331	8.0%	N/A	N/A
Tier 1 capital (to risk weighted assets)	10,840	6.1	7,166	4.0	N/A	N/A
Tier 1 capital (to average assets)	10,840	5.6	8,196	4.0	N/A	N/A
Bank:						
As of December 31, 2004						
Total capital (to risk weighted assets)	$18,715	10.5%	$14,312	8.0%	$17,891	10.0%
Tier1 capital (to risk weighted assets)	16,478	9.2	7,156	4.0	10,734	6.0
Tier 1 capital (to average assets)	16,478	8.5	8,196	4.0	10,246	5.0

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments" requires disclosure of fair value information, whether or not recognized in the balance sheets, when it is practical to estimate the fair value. SFAS No. 107 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations that require the exchange of cash or other instruments. Certain items are specifically excluded from the disclosure requirements, including the Bank's common stock, property and equipment and other assets and liabilities.

Fair value approximates carrying value for cash and due from banks and federal funds sold due to the short-term nature of the instrument.

Investment securities available for sale are valued using quoted fair market prices. Other investments at cost are considered to be an appropriate estimate of fair value due to historical redemption of the stock at cost.

Fair value for loans maturing after one year is based on the discounted present value of the estimated future cash flows. Discount rates used in these computations approximate the rates currently offered for similar loans of comparable terms and credit quality.

Fair value for demand deposit accounts is equal to the carrying value. Interest-bearing accounts with no fixed maturity date are valued based on rates offered within the Bank's market using current interest rates on similar instruments. Certificate of deposit accounts maturing within one year are valued at their carrying value. The fair value of certificate of deposit accounts maturing after one year are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The fair values of other borrowings are estimated using currently offered market rates.

The fair values of fixed rate advances from the FHLB are estimated using the discounted cash flow calculation that applies to the Company's current borrowing rate available from the FHLB. The carrying amounts of the variable rate subordinated debentures are reasonable estimates of fair value because they could be repriced frequently.

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

The estimated fair values of the Bank's financial instruments are as follows:

<TABLE>
<CAPTION>

	December 31,			
	2005		2004	
	Carrying Amount	Fair value	Carrying Amount	Fair value
Financial Assets:				
<S>	<C>	<C>	<C>	<C>
Cash and due from banks	$ 6,628	$ 6,628	$ 2,544	$ 2,544
Federal funds sold	6,312	6,312	3,424	3,424
Investment securities available for sale	28,160	28,160	16,351	16,351
Other investments, at cost	798	798	955	955
Loans, gross	200,362	199,796	176,458	176,707
Financial Liabilities:				
Deposits	221,661	221,528	176,146	176,695
Federal Home Loan Bank advances	8,500	8,462	13,500	13,483
Other borrowings	3,900	3,900	2,500	2,500
Subordinated debentures	-	-	3,500	3,500

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 21 - PARENT COMPANY FINANCIAL INFORMATION

Following is condensed financial information of GrandSouth Bancorporation (parent company only):

CONDENSED BALANCE SHEETS

	December 31, 2005	December 31, 2004
ASSETS		
Cash	$ 64	$ 226
Investment in bank subsidiary	18,914	16,435
Due from subsidiary	737	-
Deferred tax asset	374	233
	$20,089	$16,894
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued expenses	$ 61	$ 54
Due to subsidiary	-	43
Note payable	3,900	2,500
Subordinated debentures	-	3,500
Shareholders' equity	16,128	10,797
	$20,089	$16,894

CONDENSED STATEMENTS OF INCOME

<TABLE>
<CAPTION>

	For the years ended December 31, 2005	2004	2003
<S>	<C>	<C>	<C>
REVENUES	$ -	$ -	$ -
EXPENSES			
Interest	320	160	75
Sundry	67	40	36
Loss before equity in undistributed net income of bank subsidiary	(387)	(200)	(111)
EQUITY IN UNDISTRIBUTED NET INCOME OF BANK SUBSIDIARY	2,606	1,445	720
Income before income taxes	2,219	1,245	609
Income tax benefit	142	74	41
Net income	$ 2,361	$ 1,319	$ 650

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 21 - PARENT COMPANY FINANCIAL INFORMATION, Continued

CONDENSED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	For the years ended December 31,		
	2005	2004	2003
OPERATING ACTIVITIES			
Net income	$ 2,361	$ 1,319	$ 650
Adjustments to reconcile net income to net cash used for operating activities			
Deferred income taxes	(132)	(75)	(41)
Accrued expenses and other	7	36	85
Increase in due to (from) subsidiary	(780)	43	-
Equity in undistributed net income of bank subsidiary	(2,606)	(1,445)	(720)
Net cash used for operating activities	(1,150)	(122)	(26)
INVESTING ACTIVITY			
Investment in bank subsidiary	(200)	(2,039)	(17)
FINANCING ACTIVITIES			
Proceeds from note payable	1,400	2,500	-
Payment of cash dividends	(210)	(173)	(79)
Cash paid in lieu of fractional shares	(2)	(1)	-
Net cash provided by (used for) financing activities	1,188	2,326	(79)
Net increase (decrease) in cash	(162)	165	(122)
CASH, BEGINNING OF YEAR	226	61	183
CASH, END OF YEAR	$ 64	$ 226	$ 61

</TABLE>

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
GrandSouth Bancorporation and Subsidiary
Greenville, South Carolina

We have audited the accompanying consolidated balance sheets of GrandSouth Bancorporation and Subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of GrandSouth Bancorporation and Subsidiary as of December 31, 2006 and 2005 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

s/Elliott Davis, LLC

Greenville, South Carolina
March 21, 2007

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

<TABLE>
<CAPTION>

	DECEMBER 31, 2006	DECEMBER 31, 2005
ASSETS		
<S>	<C>	<C>
Cash and due from banks	$ 6,145	$ 6,628
Federal funds sold	13,659	6,312
Cash and cash equivalents	19,804	12,940
Investment securities available for sale	41,646	28,160
Other investments, at cost	504	798
Loans, net	224,338	197,312
Premises and equipment, net	5,120	4,380
Bank owned life insurance	4,576	4,408
Assets acquired in settlement of loans	149	630
Other assets	4,173	3,320
Total assets	$ 300,310	$ 251,948
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$ 15,215	$ 12,321
Interest bearing	253,708	209,340
Total deposits	268,923	221,661
Federal Home Loan Bank advances	-	8,500
Other borrowings	-	3,900
Junior subordinated debentures	8,247	-
Other liabilities	3,670	1,759
Total liabilities	280,840	235,820
COMMITMENTS AND CONTINGENCIES - Notes 10 and 14		
SHAREHOLDERS' EQUITY		
Common stock, no par value, 20,000,000 shares authorized, 3,373,846 and 3,065,726 shares issued and outstanding at December 31, 2006 and 2005 respectively	19,054	14,340
Retained earnings	554	2,149
Accumulated other comprehensive loss	(138)	(361)
Total shareholders' equity	19,470	16,128
Total liabilities and shareholders' equity	$ 300,310	$ 251,948

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands except per share data)

<TABLE>
<CAPTION>

	For the years ended December 31, 2006	2005	2004
INTEREST INCOME			
<S>	<C>	<C>	<C>
Loans and fees on loans	$21,338	$14,917	$ 9,901
Investment securities	1,622	895	525
Other	651	311	83
Total interest income	23,611	16,123	10,509
INTEREST EXPENSE			
Deposits	10,045	5,720	3,250
Federal Home Loan Bank advances and other borrowings	407	664	506
Subordinated debentures	389	116	79
Total interest expense	10,841	6,500	3,835
Net interest income	12,770	9,623	6,674
PROVISION FOR LOAN LOSSES	1,110	1,125	1,000
Net interest income after provision for loan losses	11,660	8,498	5,674
NONINTEREST INCOME			
Service fees on deposit accounts	388	311	266
Gain on sale of investment securities available for sale	-	18	-
Gain on sale of assets acquired in the settlement of loans	119	-	-
Other	252	251	135
Total noninterest income	759	580	401
NONINTEREST EXPENSES			
Salaries and employee benefits	4,628	3,095	2,163
Data processing	408	336	321
Insurance	411	200	85
Net occupancy and expenses of premises and equipment	796	647	668
Printing, postage and supplies	222	140	97
Professional services	347	332	225
Miscellaneous loan expense	153	483	136
Other operating	433	329	292
Total noninterest expenses	7,398	5,562	3,987
Income before income taxes	5,021	3,516	2,088
INCOME TAX PROVISION	1,761	1,155	769
Net income	$ 3,260	$ 2,361	$ 1,319

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME, CONTINUED
(Dollars in thousands except per share data)

<TABLE>
<CAPTION>

	For the years ended December 31,		
	2006	2005	2004
NET INCOME PER COMMON SHARE*			
<S>	<C>	<C>	<C>
Basic	$ 0.97	$ 0.83	$ 0.50
Diluted	$ 0.89	$ 0.69	$ 0.39
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING*			
Basic	3,372,065	2,840,528	2,620,593
Diluted	3,653,849	3,540,885	3,520,614

</TABLE>

*Net income per common share and weighted average number of common shares outstanding for 2005 and 2004 have been restated to reflect the ten percent stock dividend declared in July 2006.

The accompanying notes are an integral part of these consolidated financial statements.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
For the years ended December 31, 2006, 2005 and 2004
(Dollars in thousands except share data)

<TABLE>
<CAPTION>

	Common stock Shares	Common stock Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
<S>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 2003	2,165,970	$ 9,695	$ -	$ (54)	$ 9,641
Net income	-	-	1,319	-	1,319
Other comprehensive income - Unrealized holding gain on investment securities (net of income tax expense of $5)	-	-	-	11	11
Comprehensive income	-	-	-	-	1,330
Cash in lieu of fractional shares	(191)	(1)	(1)		
Cash dividend ($.08) per share	-	-	(173)	-	(173)
Stock dividend (10%)	216,578	1,146	(1,146)	-	-
Balance, December 31, 2004	2,382,357	10,840	-	(43)	10,797
Net income	-	-	2,361	-	2,361
Other comprehensive income - Unrealized holding losses on investment securities (net of income tax benefit of $180)	-	-	-	(307)	(307)
Less reclassification adjustment for gains included in net income (net of income tax expense of $7)				(11)	(11)
Comprehensive income	-	-	-	-	2,043
Conversion of subordinated debentures into common stock	683,581	3,500	-	-	3,500
Cash in lieu of fractional shares	(212)	-	(2)	-	(2)
Cash dividend ($.08) per share	-	-	(210)	-	(210)
Balance, December 31, 2005	3,065,726	14,340	2,149	(361)	16,128
Net income	-	-	3,260	-	3,260
Other comprehensive income - Unrealized holding gains on investment securities (net of income tax effect of $141)	-	-	-	223	223
Comprehensive income	-	-	-	-	3,483
Stock based compensation	-	110	-	-	110
Stock dividend (10%)	306,573	4,592	(4,592)	-	-
Cash in lieu of fractional shares	(407)	-	(5)	-	(5)
Exercise of stock options	1,954	12	-	-	12
Cash dividend ($.08) per share	-	-	(258)	-	(258)
Balance, December 31, 2006	3,373,846	$ 19,054	$ 554	$ (138)	$ 19,470

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

<TABLE>
<CAPTION>

	For the years ended December 31,		
	2006	2005	2004
OPERATING ACTIVITIES			
<S>	<C>	<C>	<C>
Net income	$ 3,260	$ 2,361	$ 1,319
Adjustments to reconcile net income to net cash provided by operating activities			
Deferred income tax expense (benefit)	273	(361)	55
Provision for possible loan losses	1,110	1,125	1,000
Depreciation of premises and equipment	388	329	385
Net amortization (accretion) of investment securities available for sale	(6)	19	114
Gain on sale of investment securities available for sale	-	(18)	-
Gain on sale of property and equipment	(14)	(1)	(4)
(Gain) loss on sale of assets acquired in settlement of loans	(119)	1	13
Accretion of bank owned life insurance	(168)	(161)	-
Stock based compensation	110	-	-
Write-down of assets acquired in settlement of loans	15	251	68
Changes in operating assets and liabilities:			
Increase in other assets	(1,018)	(232)	(534)
Increase in other liabilities	1,903	185	233
Net cash provided by operating activities	5,734	3,498	2,649
INVESTING ACTIVITIES			
Origination of loans, net	(28,300)	(24,582)	(28,271)
Purchase of investment securities available for sale	(21,338)	(16,046)	(11,027)
Proceeds from principal paydowns on investment securities available for sale	3,222	2,769	2,908
Proceeds from sales of investment securities available for sale	-	962	5,500
Proceeds from maturity and calls of investment securities available for sale	5,000	-	-
Redemption (purchase) of Federal Home Loan Bank stock	294	157	(375)
Purchase of bank owned life insurance	-	-	(3,357)
Increase in cash surrender value of life insurance	-	-	(63)
Investment in capital trust	(247)	-	-
Proceeds from sale of assets acquired in settlement of loans	749	309	606
Cash equivalents acquired, net of payment for purchase acquisition	-	(737)	-
Proceeds from sale of premises and equipment	37	22	16
Purchase of premises and equipment	(1,151)	(1,101)	(132)
Net cash used for investing activities	(41,734)	(38,247)	(34,195)
FINANCING ACTIVITIES			
Increase in deposits, net	47,262	45,515	29,637
Proceeds from Federal Home Loan Bank advances	-	11,000	5,000
Repayment of Federal Home Loan Bank advances	(8,500)	(16,000)	(3,100)
Proceeds from issuance of junior subordinated debentures	8,247	-	-
Proceeds from other borrowings	100	3,900	2,500
Repayment of other borrowings	(4,000)	(2,500)	-
Proceeds from exercise of stock options	12	-	-
Dividends paid	(252)	(192)	(130)
Cash paid in lieu of fractional shares	(5)	(2)	(1)
Net cash provided by financing activities	42,864	41,721	33,906
Net increase in cash and cash equivalents	6,864	6,972	2,360

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Dollars in thousands)

<TABLE>
<CAPTION>

	For the years ended December 31,		
	2006	2005	2004
<S>	<C>	<C>	<C>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	12,940	5,968	3,608
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 19,804	$ 12,940	$ 5,968
SUPPLEMENTAL INFORMATION			
Cash paid for:			
Income taxes	$ 1,548	$ 1,225	$ 238
Interest	$ 10,671	$ 6,632	$ 3,811
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES			
Change in unrealized gain (loss) on investment securities available for sale, before tax	$ 364	(505)	$ 16
Loans charged-off, net of recoveries	$ 1,737	$ 368	$ 1,052
Loans transferred to assets acquired in settlement of loans	$ 164	$ 310	$ 1,157
Dividends declared, but unpaid	$ 67	$ 61	$ 43
Subordinated debentures converted into common stock	$ -	$ 3,500	$ -
Stock dividend	$ 4,592	-	$ 1,146

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

(Continued)

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees, and operates as one business segment. The Company is regulated by the Federal Reserve Board. The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation. The GrandSouth Capital Trust 1 (see note 9) is an unconsolidated subsidiary.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

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

Reclassifications
Certain prior year amounts have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported shareholders' equity, comprehensive income, or net income.

Acquisition
In May 2005, the Company acquired an auto-financing business with assets valued at $3,236 and recorded $737 in goodwill. This auto-financing business had $2,413 in specialty commercial lines of credit with the Bank.

Estimates
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates.

Concentrations of credit risk
The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in the upstate region of South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, Management monitors exposure to credit risk that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

The Company's investment portfolio consists principally of obligations of the United States of America, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Investment securities

The Bank accounts for investment securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The statement requires investments in equity and debt securities to be classified into one of three categories:

1. Available for sale: These are securities that are not classified as either held to maturity or as trading securities. These securities are reported at fair market value which is determined using quoted market prices. Unrealized gains and losses are reported, net of income taxes, as separate components of shareholders' equity (accumulated other comprehensive income (loss)). Gains or losses on dispositions of securities are based on the difference between the net proceeds and the adjusted carrying amounts of the securities sold using the specific identification method. Premiums and discounts are amortized into interest income by a method that approximates a level yield.

2. Held to maturity: These are securities that the Company has the ability and intent to hold until maturity. These securities are stated at cost, adjusted for amortization of premiums and the accretion of discounts. Premiums and discounts are amortized into interest income by a method that approximates a level yield. The Company has no held to maturity securities.

3. Trading: These are securities that are bought and held principally for the purpose of selling in the near future. Trading securities are reported at fair market value, and related unrealized gains and losses are recognized in the income statement. The Company has no trading securities.

Loans and interest income on loans

Loans are stated at the principal balance outstanding. The allowance for possible loan losses is deducted from total loans in the consolidated balance sheets. Interest income is recognized on an accrual basis over the term of the loan based on the principal amount outstanding.

Loans are generally placed on non-accrual status when principal or interest becomes ninety days past due, or when payment in full is not anticipated. When a loan is placed on non-accrual status, interest accrued but not received is generally reversed against interest income. If collectibility is in doubt, cash receipts on non-accrual loans are not recorded as interest income, but are used to reduce principal. Loans are not returned to accrual status until the borrower demonstrates the ability to pay principal and interest. Loans on non-accrual status as well as real estate acquired through foreclosure or deed taken in lieu of foreclosure are included in non-performing assets.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

Allowance for loan losses

The provision for loan losses charged to operating expense reflects the amount deemed appropriate by management to establish an adequate reserve to meet the present estimated loss characteristics of the current loan portfolio. Management's estimate is based on periodic and regular evaluation of individual loans, the overall risk characteristics of the various portfolio segments, past experience with losses, and prevailing and anticipated economic conditions. Loans that are determined to be uncollectible are charged against the allowance. Provision for loan losses and recoveries on loans previously charged off are added to the allowance.

The Company accounts for impaired loans in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." This standard requires that all lenders value loans at the loan's fair value if it is probable that the lender will be unable to collect all amounts due according to the terms of the loan agreement. Fair value may be determined based upon the present value of expected cash flows, market price of the loan, if available, or value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate.

Under SFAS No. 114, as amended by SFAS No. 118, when the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the reported principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For these accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

Premises and equipment

Premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations, while major improvements are capitalized. Upon retirement, sale or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts, and gain or loss is included in income from operations.

Assets acquired in settlement of loans

Assets acquired in settlement of loans include real estate acquired through foreclosure or deed taken in lieu of foreclosure, and repossessed assets. These assets are recorded at the lower of the carrying value of the loans or the estimated fair value of the related asset, net of estimated selling costs. The excess carrying value, if any, is charged to the allowance for possible loan losses upon transfer. If further reduction in value occurs, charges are included in income from operations.

Goodwill

Goodwill is included in other assets and is evaluated for impairment on at least an annual basis by comparing the fair value of its reporting units to their related carrying value. If the carrying value of a reporting unit exceeds its fair value, the Company determines whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeds the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded in an amount equal to that excess. To date, the Company has not had to record any impairment of its goodwill.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

Income taxes

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax return. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

Advertising and public relations expense

Advertising, promotional, and other business development costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailings are expensed in the period in which the direct mailings are sent.

Net income per common share

Net income per common share is computed on the basis of the weighted average number of common shares outstanding in accordance with SFAS No. 128, "Earnings per Share." The treasury stock method is used to compute the effect of stock options and convertible subordinated debentures on the weighted average number of common shares outstanding for diluted earnings per share. On January 22, 2004, February 28, 2005 and July 19, 2006, the Company declared ten percent stock dividends. Per share and share amounts have been retroactively restated since the Company's 2005 Annual Report on Form 10-KSB to reflect the stock dividend declared in 2006. The 2005 stock dividend was reflected in the 2004 financial statements.

Statement of cash flows

For purposes of reporting cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and cash equivalents." Cash and cash equivalents have an original maturity of three months or less.

Fair values of financial instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," as amended by SFAS No. 119, requires disclosure of fair value information for financial instruments, whether or not recognized in the consolidated balance sheet, when it is practicable to estimate the fair value. SFAS No. 107 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock. In addition, other nonfinancial instruments such as property and equipment and other assets and liabilities are not subject to the disclosure requirements.

Risks and uncertainties

In the normal course of its business the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment securities portfolios that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Stock-based compensation

The Company has a stock-based employee compensation plan, which is further described in Note 16. Until January 1, 2006, the Company accounted for the plan under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost was reflected in net income prior to 2006, as all stock options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company adopted SFAS 123(R) on January 1, 2006. The following table illustrates the effect on net income and net income per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation in 2005 and 2004, and the actual expense recognized in 2006 under SFAS 123(R). Per share and weighted average shares outstanding have been restated to reflect the ten percent stock dividend declared on July 19, 2006. The February 28, 2005 stock dividend was reflected in the 2004 financial statements.

<TABLE>
<CAPTION>

	Years ended December 31, 2006	2005	2004
<S>	<C>	<C>	<C>
Net income, as reported	$ 3,260	$ 2,361	$ 1,319
Add: Stock-based compensation expense included in net income, net of tax effects	71	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(71)	(124)	(54)
Pro forma net income - basic	3,260	2,237	1,265
Add: Interest savings, net of tax/weighted average incremental shares assumed on conversion of subordinated debentures	-	73	50
Net income (2006) and pro forma net income (2005 and 2004) - diluted	$ 3,260	$ 2,310	$ 1,315
Net income per common share:			
Basic - as reported	$ 0.97	$ 0.83	$ 0.50
Basic - pro forma (2005 and 2004)	$ 0.97	$ 0.79	$ 0.48
Diluted - as reported	$ 0.89	$ 0.69	$ 0.39
Diluted - pro forma (2005 and 2004)	$ 0.89	$ 0.65	$ 0.37

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

The weighted average fair values of the options granted during the years ended December 31, 2006, 2005 and 2004 have been estimated using the Black-Scholes option-pricing model with the following assumptions:

<TABLE>
<CAPTION>

	December 31		
	2006	2005	2004
Assumptions:			
<S>	<C>	<C>	<C>
Dividend yield	0.64%	0.89%	1.32%
Weighted average risk-free interest rate	5.04%	4.24%	5.00%
Weighted average expected volatility	31.14%	20.09%	15.25%
Weighted average expected life in years	8.00	8.00	8.00
Weighted average fair values	$ 5.42	$ 2.79	$ 1.67

</TABLE>

As of December 31, 2006 the Company had 472,038 outstanding options to employees and directors. The table set forth below summarizes stock option activity for the Company's stock compensation plan for the period ended December 31, 2006. The number of shares outstanding, granted and exercised as well as the corresponding weighted average exercise prices have been retroactively restated to reflect all stock dividends since the date the options were granted.

<TABLE>
<CAPTION>

	Stock Options			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Intrinsic Value*
<S>	<C>	<C>		<C>
Outstanding at December 31, 2005	456,392	$ 5.24		
Granted	19,800	$12.50		$ 248
Exercised	(1,954)	$ 5.97		$ 33
Forfeited	(2,200)	$ 8.41		
Outstanding at December 31, 2006	472,038	$ 5.53	4.86	$ 9,195
Exercisable at December 31, 2006	344,014	$ 4.15	3.48	$ 7,173

</TABLE>

*Intrinsic value is calculated in the aggregate for shares granted, outstanding and exercisable by taking the closing price of the Company's common stock as of December 31, 2006, as reported by the OTCBB ($25.00 in this case), less the weighted-average exercise price of the respective category of stock option. That result is then multiplied by the number of shares outstanding. Intrinsic value for shares exercised is the closing price of the stock as reported by the OTCBB on the date of exercise less the actual exercise price of the particular shares exercised. This difference is then multiplied by the number of shares exercised. This intrinsic value is calculated for each exercise during the year and totaled here for all exercises during the year.

The table set forth below summarizes non-vested stock options as of December 31, 2006. The number of non-vested shares outstanding, granted and vested during the year and the weighted average fair values have been retroactively restated to reflect all stock dividends since the date the options were granted.

<TABLE>
<CAPTION>

	Number	Weighted- Average Grant Date Fair Value	Total Fair Value
<S>	<C>	<C>	<C>
Non-vested outstanding at December 31, 2005	161,733	$ 2.38	
Granted	19,800	5.42	
Vested during the year	(51,309)	2.10	$ 108
Forfeited during the year	(2,200)	2.56	
Non-vested outstanding at December 31, 2006	128,024	3.08	

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

The total fair value of options vested during 2005 and 2004 was $40 for each year. As of December 31, 2006, there was $405 total unrecognized compensation cost related to non-vested share-based compensation arrangements, which is expected to be recognized over a weighted average period of 3.92 years. The Company issues authorized but unissued shares to satisfy option exercises.

Recently issued accounting standards

The following is a summary of recent authoritative pronouncements that may affect accounting, reporting, and disclosure of financial information by the Company:

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the Company on January 1, 2008. Earlier adoption is permitted in 2007 if the Company also elects to apply the provisions of SFAS 157, "Fair Value Measurement." The Company is currently analyzing the fair value option provided under SFAS 159.

In September 2006, the SEC issued Staff Accounting Bulleting No. 108 ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, Companies might evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that upon adoption it will have no impact on the reported results of operations or financial conditions.

In September, 2006, The FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4 "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." EITF 06-4 requires employers to recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (plan) or Accounting Principles Board Opinion No. 12, "Omnibus Opinion - 1967" (individual contract) based on the substantive agreement(s) with the employee(s). If the agreement pays a death benefit, then the Company needs to accrue that death benefit. If the agreement requires the Company to keep the split dollar arrangement in force during the retirement period, then the Company has to accrue the cost of maintaining the policy based on the employee(s) actuarial life expectancy. These expenses should be recognized over the employment service period required to vest the benefit. EITF 06-4 is effective for fiscal years beginning after December 15, 2006, but earlier adoption is permitted. Entities should recognize the effects of applying this EITF through either (a)

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES, Continued

a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company is currently analyzing the effect of adoption of EITF 06-4 on its financial position, results of operations and cash flows.

In September of 2006, the FASB issued SFAS 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in conformity with accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements, but rather eliminates inconsistencies found in various prior pronouncements. This statement emphasizes that fair value is a market-based measurement, not an entity-specific measurement. This statement expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged. The Company does not expect the adoption of this statement to have a material effect on its financial statements or on its results of operations.

In June of 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. When a position is taken in a tax return that reduces the amount of income taxes paid to a taxing authority, the enterprise realizes an immediate economic benefit. However, considerable time can elapse before the acceptability of that tax position is determined. FIN 48 requires the affirmative evaluation that it is more likely than not, based on the technical merits of a tax position, that an enterprise is entitled to economic benefits resulting from positions taken in tax returns. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006, but earlier application is encouraged. The Company is currently analyzing the effect of adoption of FIN 48 on its financial position, results of operations and cash flows.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

NOTE 2 - RESTRICTIONS ON CASH AND DUE FROM BANKS

The Bank is required to maintain average reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or on deposit with the Federal Reserve Bank. At December 31, 2006 and 2005 these required reserves were met by vault cash.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale are as follows:

<TABLE>
<CAPTION>

		December 31, 2006		
	Amortized Cost	Gross unrealized Gains	Gross unrealized Losses	Fair Value
<S>	<C>	<C>	<C>	<C>
Government-sponsored enterprises	$22,500	$ 72	$ 103	$22,469
State and municipals	3,332	23	16	3,339
Mortgage backed	16,023	79	264	15,838
Total investment securities	$41,855	$ 174	$ 383	$41,646

</TABLE>

<TABLE>
<CAPTION>

		December 31, 2005		
	Amortized Cost	Gross unrealized Gains	Gross unrealized Losses	Fair Value
<S>	<C>	<C>	<C>	<C>
Government-sponsored enterprises	$14,498	$ -	$ 209	$14,289
State and municipals	463	-	2	461
Mortgage backed	13,772	-	362	13,410
Total investment securities	$28,733	$ -	$ 573	$28,160

</TABLE>

Government-sponsored enterprises include FHLB bonds, FHLMC bonds, FNMA bonds and an FHLB structured note.

The amortized costs and fair values of securities available for sale at December 31, 2006, by contractual maturity, are shown in the following chart. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair value
Less than one year	$ 8,012	$ 7,967
One to five years	15,511	15,463
Five to ten years	10,022	9,847
After ten years	8,310	8,369
Total investment securities	$41,855	$41,646

Investment securities with an aggregate amortized cost of $2,229 (fair value of $2,227) at December 31, 2006 and $1,499 (fair value of $1,465) at December 31, 2005 were pledged to collateralize public deposits and borrowings.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 3 - INVESTMENT SECURITIES, Continued

The following table shows gross unrealized losses and fair value, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006.

<TABLE>
<CAPTION>

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Government-sponsored enterprises	$ -	$ -	$11,404	$ 103	$11,404	$ 103
State and municipals	1,946	16	-	-	1,946	16
Mortgage backed	823	4	9,891	260	10,714	264
Total	$ 2,769	$ 20	$21,295	$ 363	$24,064	$ 383

</TABLE>

The following table shows gross unrealized losses and fair value, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2005.

<TABLE>
<CAPTION>

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Government-sponsored enterprises	$ 6,926	$ 75	$ 7,363	$ 134	$14,289	209
State and municipals	461	2	-	-	461	2
Mortgage backed	8,808	143	4,602	219	13,410	362
Total	$16,195	$ 220	$11,965	353	$28,160	573

</TABLE>

At December 31, 2006, twenty-four individual securities were in a continuous loss position for twelve months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary. All of the twenty-four securities have either a Standard & Poor's AAA or a Moody's Aaa credit rating as quoted by Bloomberg.

The Bank, as a member institution of the FHLB, is required to own capital stock in the FHLB based generally upon the balance of investment securities pledged and FHLB borrowings. FHLB capital stock, with a cost of $504 and $798 at December 31, 2006 and 2005, respectively, is included in other investments in the consolidated balance sheets. The decrease in the Bank's investment in FHLB stock corresponds to the Bank's repayment of the FHLB advances previously outstanding. No ready market exists for the stock, and it has no quoted market value. However, redemption of the stock has historically been at par value.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 4 - LOANS

The composition of net loans by major loan category is presented below:

	December 31, 2006	December 31, 2005
Commercial, financial and agricultural	$ 35,783	$ 41,915
Real estate - construction	65,096	39,895
Real estate - mortgage	120,673	110,694
Installment loans to individuals	5,209	7,858
Loans, gross	226,761	200,362
Less allowance for possible loan losses	2,423	3,050
	$224,338	$197,312

At December 31, 2006 and 2005, non-accrual loans totaled $834 and $2,551, respectively. The gross interest income that would have been recorded under the original terms of the loans amounted to $318, $96, and $168, in 2006, 2005 and 2004, respectively. The Bank had no loans with payments past due ninety days or more and accruing interest at December 31, 2006 and 2005. Variable rate and fixed rate loans totaled $134,582 and $92,179, respectively, at December 31, 2006.

The following is a summary of the activity within the allowance for possible loan losses for the periods presented:

<TABLE>
<CAPTION>

<S>	<C> 2006	<C> 2005	<C> 2004
Balance, beginning of year	$ 3,050	$ 2,293	$ 2,345
Provision for possible loan losses	1,110	1,125	1,000
Loans charged against the allowance, net of recoveries	(1,737)	(368)	(1,052)
Balance, end of year	$ 2,423	$ 3,050	$ 2,293

</TABLE>

The following is a summary of impaired loans for the periods reported:

	At December 31, 2006	At December 31, 2005
Impaired loans:		
No valuation allowance required	$ 790	$ 280
Valuation allowance required	358	2,160
Total impaired loans	$1,148	$2,440
Valuation allowance	$ 199	$ 630

	For the years ended December 31, 2006	2005	2004
Average recorded investment in impaired loans	$2,171	$3,388	$3,406
Interest income recognized on impaired loans	68	172	102

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 5 - PREMISES AND EQUIPMENT

Components of premises and equipment included in the balance sheet are as follows:

	December 31, 2006	December 31, 2005
Land and land improvements	$ 1,214	$ 1,104
Building and leasehold improvements	3,728	2,752
Construction in process	-	335
Furniture and equipment	1,638	1,353
Vehicles	284	251
	6,864	5,795
Accumulated depreciation	(1,744)	(1,415)
Total property and equipment	$ 5,120	$ 4,380

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 amounted to $388, $329, and $385, respectively. Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation for the principal items follow:

<TABLE>
<CAPTION>

Type of Asset	Life in Years	Depreciation Method
<S>	<C>	<C>
Software	3	Straight-line
Furniture and equipment	5 to 7	Straight-line
Buildings and improvements	5 to 40	Straight-line
Vehicles	3	Straight-line

</TABLE>

NOTE 6 - DEPOSITS

The following is a detail of deposit accounts:

	December 31, 2006	December 31, 2005
Noninterest bearing demand	$ 15,215	$ 12,321
Interest bearing:		
Demand accounts	3,224	2,941
Money market accounts	82,538	50,905
Savings	571	751
	101,548	66,918
Time certificates of deposit, less than $100,000	91,165	80,064
Time certificates of deposit, $100,000 and over	76,210	74,679
	167,375	154,743
Total deposits	$268,923	$221,661

Interest expense on time deposits greater than $100,000 was $3,294, $2,226, and $905, in 2006, 2005 and 2004, respectively. Brokered deposits as of December 31, 2006 amounted to $18,393.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 6 - DEPOSITS, Continued

At December 31, 2006 the scheduled maturities of certificates of deposit are as follows:

2007	$ 125,239
2008	36,460
2009	2,176
2010	2,272
2011 and thereafter	1,228
	$ 167,375

NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

<TABLE>
<CAPTION>

<S>	For the Years Ended December 31, 2006 <C>	December 31, 2005 <C>	December 31, 2004 <C>
Outstanding at end of period	$ -	$ 8,500	$13,500
Weighted average rate, end of period	-%	4.34%	3.67%
Maximum amount outstanding at any month end	$ 8,500	$16,500	$15,500
Average amount outstanding during the period	$ 6,905	$11,392	$11,498
Weighted average rate, during the period	4.36%	4.03%	3.70%

</TABLE>

NOTE 8 - OTHER BORROWINGS

At December 31, 2006 and 2005, the Company had outstanding $0 and $3,900, respectively, in other borrowings from an unrelated bank. The Company borrowed an additional $100 under a line of credit during the first quarter of 2006 to bring the line to $4,000 before paying it off on May 11, 2006, with proceeds from the Trust transaction described in note 9.

NOTE 9 - CAPITAL TRUST AND JUNIOR SUBORDINATED DEBENTURES

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I (the "Trust"), and is the sole owner of the $247 in common securities issued by the Trust. On May 10, 2006, the Trust issued $8,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire $8,247 principal amount of the Company's floating rate junior subordinated debt securities due 2036 ("Debentures"). These securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3 month LIBOR plus 185 basis points (7.22% at December 31, 2006). The Company may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under other obligations that are not senior to the Debentures.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Prior to that date, the Debentures are redeemable at par plus a premium of up to 4.40% of par upon the occurrence of certain events that would have a negative tax effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with FASB Interpretation No. 46(R), the Trust is not consolidated in the Company's financial statements.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 10 - COMMITMENTS AND CONTINGENCIES

The Company is party to litigation and claims arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company's financial position or results of operations.

The Company has a ground lease on its main office location, which expires in 2021. The monthly lease payment is $1 for years one through eleven and increases to $2 per month in year sixteen. The Company also leases land upon which it constructed a branch office under a non-cancelable operating lease, which expires in March of 2018. The lease requires monthly lease payments of $0.8. The lease contains four renewal options of five years each with provisions for adjustments to the monthly lease payments. The lease agreement requires the Company to pay all property taxes.

The Company leased an office, which it used as a branch until July 2003, under a non-cancelable operating lease, which terminated in October 2004. Monthly lease payments of $3 were due on the lease until cancellation. This office was closed in July 2003, but the lease obligation continued until October 2004.

Future minimum lease payments under current operating leases are summarized as follows:

For the year ended December 31,	
2007	$ 23
2008	23
2009	23
2010	23
2011	23
Thereafter	218
	$ 333

NOTE 11 - UNUSED LINES OF CREDIT

At December 31, 2006, the Bank had two unused lines of credit to purchase federal funds totaling $9,400 from unrelated banks. These lines of credit are available on a one to fourteen day basis for general corporate purposes of the Bank. The lenders reserve the right to withdraw the line at their option. The Bank had an additional line of credit with the FHLB to borrow up to fifteen percent of the Bank's total assets. At December 31, 2006, the Bank had unused available credit of $45,047 from the FHLB. The line of credit agreement requires the Bank to pledge investment securities or qualifying loans as collateral.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
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(Dollars in thousands except per share data)

NOTE 12 - INCOME TAXES

The following summary of the provision for income taxes includes tax deferrals, which arise from temporary differences in the recognition of certain items of revenue and expense for tax and financial reporting purposes for the years ended December 31:

	2006	2005	2004
Income taxes currently payable			
Federal	$ 1,323	$ 1,400	$ 649
State	165	116	65
	1,488	1,516	714
Deferred tax provision (benefit)	273	(361)	55
Income tax provision	$ 1,761	$ 1,155	$ 769

The income tax effect of cumulative temporary differences at December 31, are as follows:

	Deferred tax asset	
	2006	2005
Allowance for possible loan losses	$ 412	$ 699
Nonaccrual loan interest	57	40
Unrealized net losses on investment securities available for sale	71	212
Write down of assets acquired in settlement of loans	-	86
Deferred compensation	108	88
Other	50	-
Deferred tax asset	698	1,125
Less: valuation allowance	(80)	(50)
	618	1,075
Depreciation	191	234
	191	234
Net deferred tax asset	$ 427	$ 841

The net deferred tax asset is included in other assets in the consolidated balance sheets. The valuation allowance is related to the Company's stand-alone state net operating loss carryforwards.

The provision for income taxes is reconciled to the amount of income tax computed at the federal statutory rate on income before income taxes for the years ended December 31, as follows:

<TABLE>
<CAPTION>

	2006		2005		2004	
	Amount	%	Amount	%	Amount	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Tax expense at statutory rate	$ 1,707	34	$ 1,196	34	$ 710	34
Increase in taxes resulting from:						
State bank tax (net of federal benefit)	107	2	77	2	43	2
Officers life insurance	(57)	(1)	(55)	(1)	-	-
Other	4	-	(63)	(2)	16	1
Income tax provision	$ 1,761	35	$ 1,155	33	$ 769	37

</TABLE>

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain directors, executive officers and companies with which they are affiliated, are customers of and have banking transactions with the Bank in the ordinary course of business. These loans and commitments were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable arms-length transactions. A summary of loan and commitment transactions with directors, including their affiliates and executive officers are as follows:

	For the years ended December 31, 2006	2005
Balance, beginning of year	$ 1,646	$ 2,071
New loans	1,924	202
Less loan payments	(624)	(627)
Balance, end of year	$ 2,946	$ 1,646

Deposits by directors and their related interests at December 31, 2006 and 2005 approximated $1,425 and $1,216, respectively.

The Company leases land from a relative of a director, shareholder and executive officer of the Company (see Note 10). Lease expenses charged to operations under these agreements approximated $9 in 2006, $10 in 2005, and $40 in 2004.

Of the $3,500 of debentures that were converted into common stock in 2005, $1,810 were converted into 353,511 shares of common stock held by related parties.

NOTE 14 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the ordinary course of business, and to meet the financing needs of its customers, the Bank is a party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amount of those instruments reflects the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2006 and 2005, unfunded commitments to extend credit were $71,053 and $45,968, respectively. Variable rate and fixed rate unfunded commitments to extend credit were $42,875 and $28,178, respectively, at December 31, 2006. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. At December 31, 2006 and 2005, there were outstanding letters of credit totaling $1,318 and $332, respectively.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 15 - EMPLOYEE BENEFIT PLAN

The Bank sponsors the GrandSouth Bank Profit Sharing Section 401(k) Plan (the "Plan") for the benefit of all eligible employees. The Bank contributes seventy-five percent of the first four percent of the employee's compensation contributed to the Plan. Contributions made to the Plan in 2006, 2005, and 2004 amounted to $67, $56, and $40, respectively.

In 2001, supplemental benefits were approved by the Board of Directors for certain executive officers of the Bank. These benefits are not qualified under the Internal Revenue Code and they are not funded. However, certain funding is provided informally and indirectly by life insurance policies owned by the Bank. The Company recorded net expense related to these benefits of $61, $61, and $56 in 2006, 2005 and 2004, respectively.

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 16 - STOCK OPTION PLAN

During 1998, the Board of Directors approved a stock option plan for the benefit of the directors, officers and employees. The Board may grant up to 856,028 options (after the shareholders approved an amendment to increase the number of shares in the plan at the 2005 Annual meeting) at an option price per share not less than the fair market value on the date of grant. All options granted to officers and employees vest 20 percent each year for five years and expire 10 years from the grant date. The related compensation expense (see Note 1) is recognized over the vesting period. Information on options outstanding and exercisable at December 31, 2006 is disclosed in the table below.

<TABLE>
<CAPTION>

Range of Exercise Prices	Options outstanding: Number Outstanding	Options outstanding: Weighted Average Remaining Contractual Life	Options outstanding: Weighted Average Exercise Price	Options exercisable: Number Exercisable	Options exercisable: Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>
$ 3.25	199,850	1.88	$ 3.25	199,850	$ 3.25
3.58	52,626	4.12	3.58	52,626	3.58
5.01 - 5.18	44,268	5.18	5.16	44,268	5.16
6.08	36,300	7.14	6.08	21,780	6.08
7.73 - 8.64	16,500	8.44	8.18	4,950	8.03
9.14	102,694	8.64	9.14	20,540	9.14
12.27 - 13.62	19,800	9.35	12.50	-	-
	472,038	4.86	5.53	344,014	4.15

</TABLE>

A summary of the status of the plan and changes during the year is presented below:

<TABLE>
<CAPTION>

For the years ended December 31,

	2006 Shares	2006 Weighted Average Exercise Price	2005 Shares	2005 Weighted Average Exercise Price	2004 Shares	2004 Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Outstanding at beginning of year	456,392	$ 5.24	334,414	$ 3.87	298,114	$ 3.50
Granted	19,800	12.50	121,978	8.99	36,300	6.08
Exercised	(1,954)	5.97	-	-	-	-
Forfeited or expired	(2,200)	8.41	-	-	-	-
Outstanding at end of year	472,038	5.53	456,392	5.24	334,414	3.87
Options exercisable at December 31, ...	344,014	4.15	275,197	3.56	248,283	3.43
Shares available for grant	383,990		399,771		28,949	

</TABLE>

All share and per share values have been retroactively restated for all stock dividends since the date the options were granted. The Company issues authorized but unissued shares to satisfy option exercises.

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 17 - COMMON STOCK AND NET INCOME PER COMMON SHARE

Following is a reconciliation of basic net income per share to diluted net income per share for the years ended December 31, 2006, 2005 and 2004.

<TABLE>
<CAPTION>

	Income (numerator)	Shares (denominator)	Per-share amount
For the year ended December 31, 2006			
<S>	<C>	<C>	<C>
Basic net income per common share			
Income available to common shareholders	$ 3,260	3,372,065	$ 0.97
Effect of dilutive instruments:			
Stock options	-	281,784	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 3,260	3,653,849	$ 0.89
For the year ended December 31, 2005			
Basic net income per common share			
Income available to common shareholders	$ 2,361	2,840,528	$ 0.83
Effect of dilutive instruments:			
Stock options	-	168,001	-
Effect of convertible instruments:			
Interest savings/weighted average incremental shares assumed on conversion of subordinated debentures	73	532,356	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 2,434	3,540,885	$ 0.69
For the year ended December 31, 2004			
Basic net income per common share			
Income available to common shareholders	$ 1,319	2,620,593	$ 0.50
Effect of dilutive instruments:			
Stock options	-	147,495	-
Effect of convertible instruments:			
Interest savings/weighted average incremental shares assumed on conversion of subordinated debentures	50	752,526	-
Diluted net income per common share			
Income available to common shareholders plus assumed exercises of stock options	$ 1,369	3,520,614	$ 0.39

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 18 - RESTRICTIONS ON DIVIDENDS

The ability of the Company to pay cash dividends is dependent upon its receiving cash in the form of dividends from the Bank. South Carolina banking regulations restrict the amount of cash dividends the Bank can pay to the Company. In the event that the interest payments on the junior subordinated debentures (see note 9) are deferred by the Company, the Company would be restricted in its ability to pay dividends on its common stock.

NOTE 19 - REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. The Company and Bank actual capital amounts and ratios and minimum regulatory amounts and ratios are presented as follows:

<TABLE>
<CAPTION>

	Actual		For capital adequacy purposes Minimum		To be well capitalized under prompt corrective action provisions Minimum	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Company (consolidated):						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
As of December 31, 2006						
Total capital (to risk weighted assets)	$30,031	12.3%	$19,576	8.0%	N/A	N/A
Tier 1 capital (to risk weighted assets)	26,079	10.7	9,788	4.0	N/A	N/A
Tier 1 capital (to average assets)	26,079	9.3	11,199	4.0	N/A	N/A
Bank:						
As of December 31, 2006						
Total capital (to risk weighted assets)	$27,623	11.3%	$19,555	8.0%	$24,443	10.0%
Tier 1 capital (to risk weighted assets)	25,200	10.3	9,777	4.0	14,666	6.0
Tier 1 capital (to average assets)	25,200	8.5	11,812	4.0	14,765	5.0
Company (consolidated):						
As of December 31, 2005						
Total capital (to risk weighted assets)	$18,374	8.8%	$16,787	8.0%	N/A	N/A
Tier 1 capital (to risk weighted assets)	15,747	7.5	8,393	4.0	N/A	N/A
Tier 1 capital (to average assets)	15,747	6.7	9,416	4.0	N/A	N/A
Bank:						
As of December 31, 2005						
Total capital (to risk weighted assets)	$21,145	10.1%	$16,778	8.0%	$ 20,972	10.0%
Tier 1 capital (to risk weighted assets)	18,518	8.8	8,389	4.0	12,583	6.0
Tier 1 capital (to average assets)	18,518	8.0	9,230	4.0	11,538	5.0

</TABLE>

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments" requires disclosure of fair value information, whether or not recognized in the balance sheets, when it is practical to estimate the fair value. SFAS No. 107 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations that require the exchange of cash or other instruments. Certain items are specifically excluded from the disclosure requirements, including the Bank's common stock, property and equipment and other assets and liabilities.

Fair value approximates carrying value for cash and due from banks and federal funds sold due to the short-term nature of the instrument.

Investment securities available for sale are valued using quoted fair market prices. Other investments at cost are considered to be an appropriate estimate of fair value due to historical redemption of the stock at cost.

Fair value for loans maturing after one year is based on the discounted present value of the estimated future cash flows. Discount rates used in these computations approximate the rates currently offered for similar loans of comparable terms and credit quality.

Fair value for demand deposit accounts is equal to the carrying value. Interest-bearing accounts with no fixed maturity date are valued based on rates offered within the Bank's market using current interest rates on similar instruments. Certificate of deposit accounts maturing within one year are valued at their carrying value. The fair value of certificate of deposit accounts maturing after one year are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The carrying amounts of the variable rate junior subordinated debentures are reasonable estimates of fair value because they reprice quarterly. The fair values of fixed rate advances from the FHLB are estimated using the discounted cash flow calculation that applies to the Company's current borrowing rate available from the FHLB. The fair values of other borrowings are estimated using currently offered market rates.

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

The estimated fair values of the Company's financial instruments at December 31, are as follows:

<TABLE>
<CAPTION>

	2006		2005	
	Carrying Amount	Fair value	Carrying Amount	Fair value
Financial Assets:				
<S>	<C>	<C>	<C>	<C>
Cash and due from banks	$ 6,145	$ 6,628	$ 6,628	$ 6,628
Federal funds sold	13,659	13,659	6,312	6,312
Investment securities available for sale	41,646	41,646	28,160	28,160
Other investments, at cost	504	504	798	798
Loans, gross	226,761	226,629	200,362	199,796
Financial Liabilities:				
Deposits	268,923	268,737	221,661	221,528
Federal Home Loan Bank advances	-	-	8,500	8,462
Other borrowings	-	-	3,900	3,900
Junior subordinated debentures	8,247	8,247	-	-

</TABLE>

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GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 21 - PARENT COMPANY FINANCIAL INFORMATION

Following is condensed financial information of GrandSouth Bancorporation (parent company only):

CONDENSED BALANCE SHEETS

<TABLE>
<CAPTION>

	December 31, 2006	December 31, 2005
ASSETS		
Cash	$ 350	$ 64
Investment in bank subsidiary	25,799	18,914
Due from subsidiary	848	737
Investment in capital trust	247	-
Deferred tax asset	549	374
	$27,793	$20,089
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued expenses	$ 76	$ 61
Note payable	-	3,900
Junior subordinated debentures	8,247	-
Shareholders' equity	19,470	16,128
	$27,793	$20,089

</TABLE>

CONDENSED STATEMENTS OF INCOME

<TABLE>
<CAPTION>

	For the years ended December 31, 2006	2005	2004
REVENUES	$ 12	$ -	$ -
EXPENSES			
Interest	495	320	160
Sundry	76	67	40
Loss before equity in undistributed net income of bank subsidiary	(559)	(387)	(200)
EQUITY IN UNDISTRIBUTED NET INCOME OF BANK SUBSIDIARY	3,631	2,606	1,445
Income before income taxes	3,072	2,219	1,245
Income tax benefit	188	142	74
Net income	$ 3,260	$ 2,361	$ 1,319

</TABLE>

<PAGE>

GRANDSOUTH BANCORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

NOTE 21 - PARENT COMPANY FINANCIAL INFORMATION, Continued

CONDENSED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	For the years ended December 31, 2006	2005	2004
OPERATING ACTIVITIES			
<S>	<C>	<C>	<C>
Net income	$ 3,260	$ 2,361	$ 1,319
Adjustments to reconcile net income to net cash used for operating activities			
Deferred income taxes	(175)	(132)	(75)
Accrued expenses	28	50	(7)
Stock based compensation	110	-	-
Increase in due to (from) subsidiary	(111)	(841)	43
Equity in undistributed net income of bank subsidiary	(3,631)	(2,606)	(1,445)
Net cash used for operating activities	(519)	(1,168)	(165)
INVESTING ACTIVITY			
Additional investment in bank subsidiary	(3,050)	(200)	(2,039)
Investment in capital trust	(247)	-	-
Net cash used in investing activities	(3,297)	(200)	(2,039)
FINANCING ACTIVITIES			
Proceeds from issuance of junior subordinated debentures	8,247	-	-
Proceeds from note payable	100	1,400	2,500
Repayment of note payable	(4,000)	-	-
Payment of cash dividends	(252)	(192)	(130)
Proceeds from exercise of stock options	12	-	-
Cash paid in lieu of fractional shares	(5)	(2)	(1)
Net cash provided by financing activities	4,102	1,206	2,369
Net increase (decrease) in cash	286	(162)	165
CASH, BEGINNING OF YEAR	64	226	61
CASH, END OF YEAR	$ 350	$ 64	$ 226
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES			
Dividends declared, but unpaid	$ 67	$ 61	$ 43
Subordinated debentures converted into common stock	$ -	$ 3,500	$ -
Stock dividend	$ 4,592	-	$ 1,146

</TABLE>

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Report of Independent Registered Public Accounting Firm

The Shareholders and Board of Directors
of GrandSouth Bancorporation

We have audited the accompanying consolidated balance sheets of GrandSouth Bancorporation and Subsidiary as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of GrandSouth Bancorporation and Subsidiary as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U. S. generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of GrandSouth Bancorporation and Subsidiary's internal control over financial reporting as of December 31, 2007 included in the accompanying Management's Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

/s/ Elliott Davis, LLC

Elliott Davis, LLC
Greenville, South Carolina
March 28, 2008

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Balance Sheets

<TABLE>
<CAPTION>

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 4,585	$ 6,145
Federal funds sold	4,420	13,659
Cash and cash equivalents	9,005	19,804
Securities available-for-sale	59,567	41,646
Other investments, at cost	765	504
Loans, net of allowance for loan losses of $2,943 for 2007 and $2,423 for 2006	259,786	224,338
Premises and equipment, net	4,896	5,120
Bank owned life insurance	4,753	4,576
Assets acquired in settlement of loans	1,752	149
Interest receivable	2,313	1,770
Deferred income taxes	544	427
Goodwill	737	737
Other assets	1,006	1,239
Total assets	$ 345,124	$ 300,310
Liabilities		
Deposits		
Noninterest bearing	$ 15,037	$ 15,215
Interest bearing	290,602	253,708
Total deposits	305,639	268,923
Short-term borrowings	5,000	-
Junior subordinated debentures	8,247	8,247
Interest payable	754	685
Other liabilities	3,017	2,985
Total liabilities	322,657	280,840
Commitments and Contingencies - Note 10		
Shareholders' equity		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 3,381,488 at December 31, 2007 and 3,373,846 at December 31, 2006	19,200	19,054
Retained earnings	3,083	554
Accumulated other comprehensive income (loss)	184	(138)
Total shareholders' equity	22,467	19,470
Total liabilities and shareholders' equity	$ 345,124	$ 300,310

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Income

<TABLE>
<CAPTION>

	Years ended December 31, 2007	2006	2005
	(Dollars in thousands, except per share)		
Interest income			
<S>	<C>	<C>	<C>
Interest and fees on loans	$ 23,826	$ 21,338	$ 14,917
Investment securities			
Taxable	2,052	1,510	843
Nontaxable	351	66	14
Dividends	32	46	38
Other, principally federal funds sold	583	651	311
Total interest income	26,844	23,611	16,123
Interest expense			
Deposits	13,311	10,045	5,720
Short-term borrowings	10	106	205
Junior subordinated debt	599	690	575
Total interest expense	13,920	10,841	6,500
Net interest income	12,924	12,770	9,623
Provision for loan losses	1,045	1,110	1,125
Net interest income after provision for loan losses	11,879	11,660	8,498
Noninterest income			
Service charges on deposit accounts	419	388	311
(Loss) gain on sale of investment securities	(24)	-	18
Gain on sale of assets acquired in settlement of loans	6	119	-
Other	261	252	251
Total noninterest income	662	759	580
Noninterest expenses			
Salaries and employee benefits	4,956	4,628	3,095
Premises and equipment	827	796	647
Data processing	494	408	336
Insurance	492	411	200
Printing, postage and supplies	229	222	140
Professional fees	573	347	332
Miscellaneous loan expense	193	153	483
Other operating	398	433	329
Total noninterest expenses	8,162	7,398	5,562
Income before income taxes	4,379	5,021	3,516
Income tax expense	1,580	1,761	1,155
Net income	$ 2,799	$ 3,260	$ 2,361
Per share*			
Net income	$ 0.83	$ 0.97	$ 0.83
Net income, assuming dilution	0.77	0.89	0.69

</TABLE>

* Per share amounts have been retroactively adjusted to reflect a 10% stock dividend declared July 19, 2006.

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income

<TABLE>
<CAPTION>

	Common Stock Number of Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Dollars in thousands, except per share)				
<S>	<C>	<C>	<C>	<C>	<C>
Balance, January 1, 2005	2,382,357	$ 10,840	$ -	$ (43)	$ 10,797
Comprehensive income:					
Net income	-	-	2,361	-	2,361
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $180	-	-	-	(307)	(307)
Less: Reclassification adjustment for securities gains included in net income, net of income taxes of $7	-	-	-	(11)	(11)
Total other comprehensive income	-	-	-	-	(318)
Total comprehensive income	-	-	-	-	2,043
Conversion of subordinated debentures into common stock, including cash paid in lieu of issuing fractional shares	683,369	3,500	(2)	-	3,498
Cash dividend declared, $.07 per share*	-	-	(210)	-	(210)
Balance, December 31, 2005	3,065,726	14,340	2,149	(361)	16,128
Comprehensive income:					
Net income	-	-	3,260	-	3,260
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $141	-	-	-	223	223
Total other comprehensive income	-	-	-	-	223
Total comprehensive income	-	-	-	-	3,483
Share-based compensation	-	110	-	-	110
Issuance of 10% stock dividend, including cash payment for fractional shares	306,166	4,592	(4,597)	-	(5)
Exercise of stock options	1,954	12	-	-	12
Cash dividend declared, $.08 per share	-	-	(258)	-	(258)
Balance, December 31, 2006	3,373,846	19,054	554	(138)	19,470
Comprehensive income:					
Net income	-	-	2,799	-	2,799
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $157	-	-	-	306	306
Add: Reclassification adjustment for securities losses included in net income, net of income taxes of $8	-	-	-	16	16
Total other comprehensive income	-	-	-	-	322
Total comprehensive income	-	-	-	-	3,121
Share-based compensation	-	121	-	-	121
Exercise of stock options	7,642	25	-	-	25
Cash dividend declared, $.08 per share	-	-	(270)	-	(270)
Balance, December 31, 2007	3,381,488	$ 19,200	$ 3,083	$ 184	$ 22,467

</TABLE>

* Per share amounts have been retroactively restated to reflect a 10% stock dividend declared July 19, 2006.

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows
<TABLE>
<CAPTION>

	2007	2006	2005
	Years Ended December 31, (Dollars in thousands)		
Operating activities			
Net income	$ 2,799	$ 3,260	$ 2,361
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	1,045	1,110	1,125
Writedowns of assets acquired in settlement of loans	-	15	251
Depreciation	380	388	329
Deferred income tax expense (benefit)	(282)	273	(361)
Net securities (accretion) and premium amortization	2	(6)	19
Loss (gain) on sale of available-for-sale securities	24	-	(18)
Gain on sale or other disposition of fixed assets	-	(14)	(1)
(Gain) loss on sale of assets acquired in settlement of loans	(6)	(119)	1
Increase in cash surrender value of bank owned life insurance	(177)	(168)	(161)
Increase in interest receivable	(543)	(325)	(539)
Increase (decrease) in interest payable	69	170	(132)
Decrease (increase) in prepaid expenses and other assets	231	(693)	307
Increase in accrued expenses and other liabilities	32	1,733	317
Share-based compensation expense	121	110	-
Net cash provided by operating activities	3,695	5,734	3,498
Investing activities			
Purchases of available-for-sale securities	(37,310)	(21,338)	(16,046)
Maturities and calls of available-for-sale securities	14,015	5,000	-
Paydowns of available-for-sale mortgage-backed securities	3,386	3,222	2,769
Proceeds from sale of available-for-sale securities	2,449	-	962
Purchases of other investments	(261)	-	-
Proceeds of redemptions of other investments	-	294	157
Investment in capital trust	-	(247)	-
Net increase in loans made to customers	(38,580)	(28,300)	(24,582)
Purchases of premises and equipment	(156)	(1,151)	(1,101)
Proceeds from sale of premises and equipment	-	37	22
Proceeds from sale of assets acquired in settlement of loans	490	749	309
Cash equivalents acquired, net of payment for purchase acquisition	-	-	(737)
Net cash used by investing activities	(55,967)	(41,734)	(38,247)
Financing activities			
Net increase in deposits	36,716	47,262	45,515
Net increase in short-term borrowings	5,000	-	-
Proceeds from Federal Home Loan Bank Advances	-	-	11,000
Repayment of Federal Home Loan Bank Advances	-	(8,500)	(16,000)
Proceeds from issuance of junior subordinated debentures	-	8,247	-
Proceeds from other borrowings	-	100	3,900
Repayment of other borrowings	-	(4,000)	(2,500)
Cash dividends paid	(268)	(252)	(192)
Payment of cash in lieu of fractional shares	-	(5)	(2)
Exercise of stock options	25	12	-
Net cash provided by financing activities	41,473	42,864	41,721
(Decrease) increase in cash and cash equivalents	(10,799)	6,864	6,972
Cash and cash equivalents, beginning	19,804	12,940	5,968
Cash and cash equivalents, ending	$ 9,005	$ 19,804	$ 12,940

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows - continued
<TABLE>
<CAPTION>

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands)		
Supplemental Disclosure of Cash Flow Information			
Cash paid during the period for:			
<S>	<C>	<C>	<C>
Interest	$13,851	$10,671	$ 6,632
Income taxes	1,502	1,548	1,225
Noncash investing and financing activities:			
Transfer of loans to assets acquired in settlement of loans	2,087	164	310
Subordinated debentures converted into common stock	-	-	3,500
Dividends declared but unpaid	69	67	61
Other comprehensive income (loss), before tax	487	364	(505)
Stock dividend	-	4,592	-

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements
GrandSouth Bancorporation

(Dollars in thousands, except per share data)

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

GrandSouth Bancorporation (the "Company") is a South Carolina company organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees, and operates as one business segment. The Company is regulated by the Federal Reserve Board. The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany transactions and accounts have been eliminated in consolidation. The GrandSouth Capital Trust 1 (see Note 9) is an unconsolidated subsidiary.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

Basis of presentation - The accounting and reporting policies conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The Company uses the accrual basis of accounting. In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to the current presentation. Such reclassifications had no effect on previously reported shareholders' equity or net income.

Acquisition - In May 2005, the Company acquired an auto-financing business with assets valued at $3,236 and recorded $737 in goodwill. This auto-financing business had $2,413 in specialty commercial lines of credit with the Bank prior to the acquisition.

Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could differ from those estimates.

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Concentrations of credit risk - The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in the upstate region of South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risks that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g., principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e., balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

The Company's investment portfolio consists principally of obligations of the United States of America, government-sponsored entities and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Investment securities - The Bank accounts for investment securities in accordance with Statement of Financial Accounting Standards ("SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." This statement requires investments in equity and debt securities to be classified into one of three categories:

1. Available-for-sale: These are securities that are not classified as either held-to-maturity or as trading securities. These securities are reported at fair value which is determined using quoted market prices. Unrealized gains and losses are reported, net of income taxes, as separate components of shareholders' equity (accumulated other comprehensive income (loss)). Gains or losses on dispositions of securities are based on the difference between the net proceeds and the adjusted carrying amounts of the securities sold using the specific identification method. Premiums and discounts are amortized into interest income by a method that approximates a level yield.
2. Held-to-maturity: These are securities that the Company has the ability and intent to hold until maturity. These securities are stated at cost, adjusted for the amortization of premiums and the accretion of discounts. Premiums and discounts are included in interest income using a method that approximates a level yield. The Company has no held-to-maturity securities.
3. Trading: These are securities that are bought and held principally for the purpose of selling in the near future. Trading securities are reported at fair value, and related unrealized gains and losses are recognized in the income statement. The Company has no trading securities.

Other investments - Other investments consist of Federal Home Loan Bank stock, a restricted security, and are carried at cost. Management periodically evaluates this stock for impairment and makes any appropriate downward valuation adjustments when necessary.

Loans and interest income on loans- Loans are stated at the principal balance outstanding, increased or reduced by deferred net loan costs or fees. The allowance for loan losses is deducted from total loans in the consolidated balance sheets. Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized as an adjustment of the related loan's yield. Generally, these amounts are amortized over the contractual life of the related loans or commitments. Interest income is recognized on an accrual basis over the term of the loan based on the principal amount outstanding.

Loans are generally placed on nonaccrual status when principal or interest becomes ninety days past due, or when payment in full is not anticipated. When a loan is placed on nonaccrual status, interest accrued but not received is generally reversed against interest income. If collectibility is in doubt, cash receipts on nonaccrual loans are not recorded as interest income, but are used to reduce principal. Loans are not returned to accrual status until the borrower demonstrates the ability to pay principal and interest.

Allowance for loan losses - The provision for loan losses charged to operating expense reflects the amount deemed appropriate by management to establish an adequate allowance to meet the present estimated loss characteristics of the

<PAGE>
current loan portfolio. Management's estimate is based on periodic and regular evaluation of individual loans, the overall risk characteristics of the various portfolio segments, past experience with losses, and prevailing and anticipated economic conditions. Loans that are determined to be uncollectible are charged against the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

The Company accounts for impaired loans in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." This standard requires that all lenders value loans at the loan's fair value if it is probable that the lender will be unable to collect all amounts due in accordance with the terms of the loan agreement. Fair value may be determined based upon the present value of expected cash flows, market price of the loan, if available, or value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate.

Under SFAS No. 114, as amended by SFAS No. 118, when the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the reported principal balance has been reduced to zero, future cash receipts are applied to interest income to the extent that any interest has been foregone. Further cash receipts are recoveries of any amounts previously charged off.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For these accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

Premises and equipment - Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations while major improvements are capitalized. Upon retirement, sale or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts and any gain or loss is included in income from operations.

Bank owned life insurance - The Company has entered into arrangements that provide for deferred compensation for certain officers. Bank owned life insurance policies provide an informal and indirect method for funding those arrangements. The amounts recorded as bank owned life insurance in the consolidated balance sheets represent the cash surrender value of the policies. The deferred compensation liability is included in other liabilities at the present value of the obligation.

Assets acquired in settlement of loans - Assets acquired in settlement of loans include real estate acquired through foreclosure or deed taken in lieu of foreclosure and repossessed assets. These assets are recorded at fair value, less estimated costs to sell, at the date of foreclosure, establishing a new cost basis. Loan losses arising from the acquisition of such property as of that date are charged against the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the new cost basis or fair value, less estimated costs to sell. Revenues and expenses from operations and changes in any subsequent valuation allowance are included in other noninterest income in the Consolidated Statements of Income. The carrying value of foreclosed assets included in the balance sheets was $1,752 and $149 as of December 31, 2007 and 2006, respectively.

Goodwill - Goodwill is evaluated for impairment on at least an annual basis by comparing the fair value of the operating unit(s) from which it arose to their carrying value(s). If the carrying value of an operating unit exceeds its fair value, the Company considers whether the implied fair value of the goodwill, determined using a discounted cash flow analysis, exceeds the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded in an amount equal to that excess. To date, the Company has not recorded any impairments of its goodwill.

Income taxes - The Company uses an asset and liability approach for financial accounting and reporting of deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and income tax bases of assets and liabilities as measured by the currently enacted tax rates which are assumed will be in effect when these differences reverse. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized. Deferred income tax expense or credit is the result of changes in deferred tax assets and liabilities.

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109," during 2007. The Company analyzed its filing positions in all open tax years in each of the federal and state income tax jurisdictions where it is required to file income tax returns and believes that those positions will more likely than not be sustained upon audit by the taxing authorities. The Company anticipates that no audit adjustments by such authorities will result in a material adverse impact on the Company's financial condition, results of operations or cash flows. Therefore,

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no reserves for uncertain income tax adjustments have been recorded pursuant to FIN 48. The adoption of FIN 48 had no effect on the Company's consolidated financial statements.

Advertising and public relations expense - The Company generally expenses advertising and promotion costs as they are incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailings are expensed in the period in which the direct mailings are sent.

Net income per share - Net income per share is computed on the basis of the weighted average number of common shares outstanding in accordance with SFAS No. 128, "Earnings per Share." The treasury stock method is used to compute the effect of stock options and convertible subordinated debentures outstanding during 2005 on the weighted average number of common shares outstanding for diluted earnings per share. On July 19, 2006, the Company declared a ten percent stock dividend. Per share and share amounts have been retroactively restated to reflect the effects of this stock dividend on 2005 amounts.

Statement of cash flows - For purposes of reporting cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and cash equivalents." Cash and cash equivalents have an original maturity of three months or less.

Retirement plan - The Company has a salary reduction profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code as more fully described in Note 14. The Company also sponsors certain supplemental benefits that were provided to certain executive officers by the Board of Directors in 2001, as more fully described in Note 14.

Fair values of financial instruments - SFAS No. 107, "Disclosures About Fair Values of Financial Instruments," requires disclosures of fair value information for financial instruments, whether or not recognized in the consolidated balance sheets, when it is practicable to estimate the fair value. SFAS No. 107 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock and other nonfinancial instruments such as property and equipment and other assets and liabilities. See Note 17 for fair value disclosures.

Risks and uncertainties - In the normal course of business the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities reprice or mature at different times, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment securities portfolios that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company undergoes periodic examinations conducted by the regulatory agencies which may subject it to further changes with respect to asset valuations, amounts of required loan loss allowance, and operating restrictions resulting from the regulators' judgments based on information to them at the time of their examination.

Share-Based Compensation - The Company has a share-based employee compensation plan, which is described more fully in Note 15. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123(R)")" Share-Based Payment." Prior to adoption of SFAS 123(R), the Company accounted for those plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, prior to adoption of SFAS 123(R), no share-based employee compensation cost was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and net income per share as if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation awarded in 2005. Per share amounts and weighted average shares outstanding have been restated to reflect the 10% stock dividend declared as of July 19, 2006.

<PAGE>

<TABLE>
<CAPTION>

<S>	Year ended December 31, 2005 (Dollars in thousands, except per share amounts) <C>
Net income, as reported	$ 2,361
Add: Share-based compensation expense included in net income, net of income tax effects	-
Deduct: Total share-based employee compensation expense determined under fair value based method for all awards, net of related income tax effects	(124)
Pro forma net income - basic	2,237
Add: Interest savings, net of tax, on weighted average incremental shares assumed on conversion of subordinated debentures	73
Pro forma net income	$ 2,310
Net income per common share	
Basic - as reported	$ .83
Basic - pro forma	$ .79
Diluted - as reported	$ .69
Diluted - pro forma	$ .65

</TABLE>

Comprehensive Income - Comprehensive income consists of net income or loss for the current period and other comprehensive income, defined as income, expenses, gains and losses that bypass the consolidated statement of income and are reported directly in a separate component of shareholders' equity. The Company classifies and reports items of other comprehensive income according to their nature, reports total comprehensive income or loss in the consolidated statement of changes in shareholders' equity and displays the accumulated balance of other comprehensive income or loss separately in the shareholders' equity section of the consolidated balance sheet. See Note 16 for further discussion.

NOTE 2 - RESTRICTIONS ON CASH AND DUE FROM BANKS

The Bank is required by regulation to maintain average cash reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or in an account maintained with the Federal Reserve Bank. The average amounts of the cash reserve balances required at December 31, 2007 and 2006 were approximately $287 and $168, respectively.

NOTE 3 - INVESTMENT SECURITIES

The aggregate amortized cost and estimated fair values of securities, as well as gross unrealized gains and losses of securities were as follows:

<PAGE>

<TABLE>
<CAPTION>

	December 31,							
	2007				2006			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
	(Dollars in thousands)							
Available-for-sale								
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Government-sponsored enterprises (GSEs)	$19,250	$ 296	$ 2	$19,544	$22,500	$ 72	$ 103	$22,469
State, county and municipal	13,406	32	149	13,289	3,332	23	16	3,339
Mortgage-backed securities issued by GSEs	26,633	266	165	26,734	16,023	79	264	15,838
Total	$59,289	$ 594	$ 316	$59,567	$41,855	$ 174	$ 383	$41,646

</TABLE>

Securities issued by government-sponsored enterprises include debt instruments issued by the Federal Home Loan Banks, Federal Home Loan Mortgage Company, and the Federal National Mortgage Association. The amortized cost and estimated fair value of securities by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2007	
	Available-for-sale	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due within one year	$ 3,105	$ 3,116
Due after one through five years	13,737	13,898
Due after five through ten years	9,557	9,565
Due after ten years	32,890	32,988
	$59,289	$59,567

The estimated fair values and gross unrealized losses of all of the Company's investment securities whose estimated fair values were less than amortized cost as of December 31, 2007 and 2006 which had not been determined to be other-than-temporarily impaired, are presented below. The securities have been aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position.

<PAGE>
<TABLE>
<CAPTION>

	December 31, 2007					
	Continuously in Unrealized Loss Position for a Period of					
	Less than 12 Months		12 Months or more		Total	
Available-for-sale	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
			(Dollars in thousands)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Government-sponsored enterprises (GSEs)	$ -	$ -	$ 998	$ 2	$ 998	$ 2
State, county and municipal securities	6,955	117	1,634	32	8,589	149
Mortgage-backed securities issued by GSEs	3,021	29	8,579	136	11,600	165
Total	$ 9,976	$ 146	$11,211	$ 170	$21,187	$ 316

</TABLE>
<TABLE>
<CAPTION>

	December 31, 2006					
	Continuously in Unrealized Loss Position for a Period of					
	Less than 12 Months		12 Months or more		Total	
Available-for-sale	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
			(Dollars in thousands)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Government-sponsored enterprises (GSEs)	$ -	$ -	$11,404	$ 103	$11,404	$ 103
State, county and municipal securities	1,946	16	-	-	1,946	16
Mortgage-backed securities issued by GSEs	823	4	9,891	260	10,714	264
Total	$ 2,769	$ 20	$21,295	$ 363	$24,064	$ 383

</TABLE>
At December 31, 2007, 18 securities had been continuously in an unrealized loss position for less than 12 months and 21 securities had been continuously in an unrealized loss position for 12 months or more. The Company does not consider these investments to be other-than-temporarily impaired because the unrealized losses resulted primarily from higher interest rates and there have been no downgrades of the credit ratings of the issuers. The contractual terms of securities issued by government-sponsored enterprises do not permit the issuer to settle the securities at a price less than the face amount of the securities. Although the Company classifies its investment securities as available-for-sale, management has not determined that any specific securities will be disposed of prior to maturity and believes that the Company has both the ability and the intent to hold those investments until a recovery of fair value, including until maturity. Also, there have been no significant adverse changes in the credit ratings of any of the security issuers that would indicate that the Company will be unable to collect all principal and interest amounts according to contractual terms. Substantially all of the issuers of state, county and municipal securities held were rated at least "investment grade" as of December 31, 2007 and 2006.

The Bank is a member of the Federal Home Loan Bank of Atlanta ("FHLB") and, accordingly, is required to own restricted stock in that institution in amounts that may vary from time to time. Because of the restrictions imposed, the stock may not be sold to other parties, but is redeemable by the FHLB at the same price as that at which it was acquired by the Bank. The Company evaluates this security for impairment based on the probability of ultimate recoverability of the recorded amount of the investment. No impairment has been recognized based on this evaluation.

During 2007, the Company sold available-for-sale securities with amortized costs totaling $2,473 for proceeds of $2,449, resulting in gross realized losses of $24. The income tax provision credited to expense applicable to the net realized losses was $8. During 2006, the Company did not sell any available-for-sale securities. During 2005, the Company sold available-for-sale securities with amortized costs totaling $944 for proceeds of $962, resulting in gross realized gains of $20 and gross realized losses of $2. The income tax provision charged to expense applicable to the net realized gains of $18 was $7. There were no transfers of available-for-sale securities to other categories in 2007, 2006 or 2005.

At December 31, 2007 and 2006, securities with a carrying value of $2,199 and $2,227, respectively, were pledged as collateral to secure public deposits and other purposes.

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NOTE 4 - LOANS

Loans consisted of the following:

	December 31, 2007	2006
	(Dollars in thousands)	
Commercial, financial and agricultural	$ 44,640	$ 35,783
Real estate- construction	84,458	65,096
Real estate - mortgage	128,633	120,673
Installment loans to individuals	4,998	5,209
Loans, gross	262,729	226,761
Allowance for possible loan losses	(2,943)	(2,423)
Loans - net	$ 259,786	$ 224,338

At December 31, 2007 and 2006, nonaccrual loans totaled $1,127 and $834, respectively. The gross interest income that would have been recorded under the original terms of the nonaccrual loans was $164, $318 and $96 in 2007, 2006 and 2005, respectively. The average amounts of impaired loans were $1,255, $2,171 and $3,338 for 2007, 2006 and 2005, respectively. Interest income recognized on impaired loans was $34, $68, and $172 in 2007, 2006 and 2005, respectively. The Bank had no loans with payments past due ninety days or more and accruing interest as of December 31, 2007 and 2006. Variable rate and fixed rate loans totaled $147,186 and $115,543, respectively, at December 31, 2007.

Following is a summary of the Company's impaired loans:

	December 31, 2007	2006
	(Dollars in thousands)	
Impaired loans		
No valuation allowance required	$ 184	$ 790
Valuation allowance required	990	358
Total impaired loans	$1,174	$1,148
Allowance for loan losses on impaired loans at year end	$ 391	$ 199

There were no irrevocable commitments to lend additional funds to debtors owing amounts on impaired loans at December 31, 2007.

Transactions in the allowance for loan losses are summarized below:

	Years Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
Balance at January 1	$ 2,423	$ 3,050	$ 2,293
Provision charged to expense	1,045	1,110	1,125
Recoveries	804	442	115
Charge-offs	(1,329)	(2,179)	(483)
Balance at December 31	$ 2,943	$ 2,423	$ 3,050

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NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
Land and land improvements	$ 1,214	$ 1,214
Building and leasehold improvements	3,743	3,728
Furniture and equipment	1,765	1,638
Vehicles	298	284
Total	7,020	6,864
Accumulated depreciation	(2,124)	(1,744)
Premises and equipment, net	$ 4,896	$ 5,120

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was $380, $388, and $329, respectively. Estimated useful lives and methods of depreciation for the principal items follow:

Type of Asset	Life in Years	Depreciation Method
Software	3	Straight-line
Furniture and equipment	5 to 7	Straight-line
Buildings and improvements	5 to 40	Straight-line
Vehicles	3	Straight-line

NOTE 6 - DEPOSITS

A summary of deposits follows:

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
Noninterest bearing demand	$ 15,037	$ 15,215
Interest bearing:		
Demand accounts	5,312	3,224
Money market accounts	99,496	82,538
Savings	607	571
	120,452	101,548
Time certificates of deposit, less than $100,000	101,671	91,165
Time certificates of deposit, $100,000 and over	83,516	76,210
	185,187	167,375
Total deposits	$305,639	$268,923

Interest expense on time deposits greater than $100,000 was $4,182, $3,294, and $2,226 in 2007, 2006 and 2005, respectively. Brokered deposits were $16,857 and $18,393 as of December 31, 2007 and 2006, respectively.

As of December 31, 2007 and 2006, $17 and $27, respectively, of overdrawn demand deposit balances were reclassified as loans.

At December 31, 2007, the scheduled maturities of time deposits are as follows:

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Year	Amount
	(Dollars in thousands)
2008	$ 150,436
2009	23,676
2010	7,703
2011	1,775
2012	1,594
Thereafter	3
Total time deposits	$ 185,187

NOTE 7 - SHORT-TERM BORROWINGS

Short-term borrowings as of December 31, 2007 consist of advances from the Federal Home Loan Bank of Atlanta ("FHLB"), repayable on January 2, 2008. Short-term FHLB advances are secured as discussed in Note 8.

The following table presents information about short-term FHLB advances for each of the years indicated.

<TABLE>
<CAPTION>

	Years Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
<S>	<C>	<C>	<C>
Outstanding at end of period	$ 5,000	$ -	$ 8,500
Weighted average rate, end of period	4.40%	0.00%	4.34%
Maximum amount outstanding at any month end	$ 5,000	$ 8,500	$16,500
Average amount outstanding during the period	$ 169	$ 6,905	$11,392
Weighted average rate during the period	5.92%	4.36%	4.03%

</TABLE>

As of December 31, 2007, the banking subsidiary had unused short-term credit accommodations available from unrelated banks which allow the banking subsidiary to purchase up to $9,400 of federal funds. These lines of credit are available generally on a one to fourteen day basis for general corporate purposes of the Bank and impose various other conditions. The lenders reserve the right to withdraw the lines at their option.

NOTE 8 - LONG-TERM DEBT

At December 31, 2007, the Bank had unused credit availability under the FHLB's blanket lien agreement of up to $19,740 under the FHLB's various credit programs, subject to pledging and other requirements. The amount of eligible collateral instruments available as of December 31, 2007 to secure any additional FHLB borrowings totaled approximately $33,051.

NOTE 9 - CAPITAL TRUST AND JUNIOR SUBORDINATED DEBENTURES

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I, (the "Trust") and is the sole owner of the $247 of common securities issued by the Trust. On May 10, 2006, the Trust issued $8,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire $8,247 principal amount of the Company's floating rate junior subordinated debt securities due in 2036 ("Debentures"). These securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3 month LIBOR plus 185 basis points (6.73% at December 31, 2007). The Company may defer interest payments on the Debentures for up to 20 consecutive quarters, but not beyond the stated maturity of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under obligations that are not senior to the Debentures.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Prior to that date, the Debentures are redeemable at par plus a premium of up to 4.40% of par

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upon the occurrence of certain events that would have a negative tax effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with FASB Interpretation No. 46(R), the Trust is not consolidated in the Company's financial statements.

Junior subordinated debentures consisted of:

<TABLE>
<CAPTION>

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
<S>	<C>	<C>
Junior Subordinated Debt due to Unconsolidated Trust (1), dated May 10, 2006 maturing May 10, 2036, with variable interest rate based on 3-month LIBOR	$8,247	$8,247

</TABLE>

(1) Securities qualify as Tier 1 capital under the regulatory risk-based capital guidelines, subject to certain limitations.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

The Company is party to litigation and claims arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company's financial position or results of operations.

The Company has a ground lease on its main office location, which expires in 2021. The monthly lease payment is $1 for years one through eleven and increases incrementally to $2 per month by year sixteen. The Company also leases land upon which it constructed a branch office under a non-cancelable operating lease which expires in March, 2018. The lease requires monthly lease payments of $0.8 and contains four renewal options of five years each which contain provisions for adjustments to the monthly lease payments. The lease agreement requires the Company to pay all property taxes.

The future minimum lease payments due under the current operating leases are as follows:

Year	Amount (Dollars in thousands)
2008	$ 23
2009	23
2010	23
2011	23
2012	23
Thereafter	195
Total	$ 310

NOTE 11 - INCOME TAXES

The following summary of the provision for income taxes includes tax deferrals, which arise from temporary differences in the recognition of certain items of revenues and expense for tax and financial reporting purposes:

<PAGE>

<TABLE>
<CAPTION>

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands)		
Current			
<S>	<C>	<C>	<C>
Federal	$ 1,717	$ 1,323	$ 1,400
State	145	165	116
Total current	1,862	1,488	1,516
Deferred			
Federal provision (benefit)	(282)	273	(361)
Total income tax expense	$ 1,580	$ 1,761	$ 1,155

</TABLE>

The income tax effects of cumulative temporary differences at December 31, are as follows:

	December 31,	
	2007	2006
	(Dollars in thousands)	
Deferred tax assets		
Allowance for loan losses	$ 628	$ 412
Nonaccrual loan interest	32	57
Unrealized net holding losses on available-for-sale securities	-	71
State net operating loss carryforward	113	80
Writedown of assets acquired in settlement of loans	-	-
Deferred compensation	109	108
Other	147	5
Gross deferred tax assets	1,029	733
Valuation allowance	(113)	(80)
Total	916	653
Deferred tax liabilities		
Unrealized net holding gains on available-for-sale securities	94	-
Accelerated depreciation	171	191
Other	107	35
Gross deferred tax liabilities	372	226
Net deferred income tax assets	$ 544	$ 427

The valuation allowance is related to the Company's stand-alone state net operating loss carryforwards. The portion of the change in net deferred tax assets or liabilities which is related to unrealized holding gains and losses on available-for-sale securities is charged or credited directly to other comprehensive income or loss. The balance of the change in net deferred tax assets is charged or credited to income tax expense. In 2007, 2006 and 2005, $165 was charged, $141 was credited, and $187 was charged, respectively, to other comprehensive income or loss. In 2007, 2006 and 2005, $282 was credited, $273 was charged, and $361 was credited, respectively, to income tax expense.

The provision for income taxes is reconciled to the amount of income tax computed at the federal statutory rate of 34% on income before income taxes as follows:

<PAGE>

<TABLE>
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	Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands)		
Tax expense at statutory rate	$ 1,489	$ 1,707	$ 1,196
State income tax, net of federal income tax benefit	96	107	77
Tax-exempt interest income	(119)	(22)	(5)
Bank-owned life insurance increase	(60)	(57)	(55)
Other, net	174	26	(58)
Total	$ 1,580	$ 1,761	$ 1,155

</TABLE>

NOTE 12 - RELATED PARTY TRANSACTIONS

Certain directors, executive officers and companies with which they are affiliated are customers of and have banking transactions, including loans and commitments to lend, with the Bank in the ordinary course of business. Such transactions are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable arms-length transactions. A summary of loan and commitment transactions with directors and executive officers, including their affiliates, follows:

	Years ended December 31,	
	2007	2006
	(Dollars in thousands)	
Balance, beginning of year	$ 2,946	$ 1,646
New loans	611	1,924
Less - loan payments	(1,130)	(624)
Balance, end of year	$ 2,427	$ 2,946

Deposits of directors and their related interests at December 31, 2007 and 2006 approximated $2,140 and $1,425, respectively.

During the third quarter of 2007, the Company's Chief Executive Officer and Chairman of the Board purchased from the Bank a 100% participation in two nonaccrual loans of an unaffiliated borrower totaling $811. Interest of $33 was collected in connection with the sale of the participation interest. The Bank has made no commitments or entered into any other agreements that would make it contingently liable to repurchase the participated interest.

The Company leases land from a relative of a director, shareholder and executive officer of the Company (see Note 10). Lease expenses charged to operations under these arrangements totaled $9, $9 and $10 in 2007, 2006 and 2005, respectively.

NOTE 13 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the ordinary course of business, and to meet the financing needs of its customers, the Bank is party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and statndby letters of credit is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and

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conditional obligations as it does for on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2007 and 2006, unfunded commitments to extend credit were $76,874 and $71,053, respectively. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collatereal obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate. At December 31, 2007 and 2006, there were outstanding letters of credit totaling $897 and $1,318, respectively.

NOTE 14 - EMPLOYEE BENEFIT PLAN

The Bank sponsors the GrandSouth Bank Profit Sharing Section 401(k) Plan (the "Plan") for the benefit of all eligible employees. The Bank contributes seventy-five percent of the first four percent of the employee's compensation contributed to the Plan. Contributions made to the Plan in 2007, 2006 and 2005 were $118, $67 and $56, respectively.

In 2001, supplemental benefits were approved by the Board of Directors for certain executive officers of the Bank. These benefits are not qualified under the Internal Revenue Code and they are not funded. However, certain funding is provided informally and indirectly by life insurance policies owned by the Bank. The Company recorded net expense related to these benefits of $4, $61 and $61 in 2007, 2006 and 2005, respectively.

NOTE 15 - STOCK OPTION PLAN

During 1998, the Board of Directors approved a stock option plan for the benefit of the directors, officers and employees. The Board may grant up to 856,028 options (after the shareholders approved an amendment to increase the number of shares in the plan at the 2005 Annual Meeting) at an exercise price per share not less than the fair market value on the date of grant. All options granted to directors, officers and employees vest 20 percent each year for five years and expire 10 years from the grant date. The related compensation expense is recognized over the vesting period. The Company measures the fair value of each option award on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for awards granted in 2007, 2006 and 2005, as indicated in the following table:

	Years Ended December 31,		
	2007	2006	2005
Assumptions:			
Dividend yield	0.72%	0.64%	0.89%
Weighted average risk-free interest rate	4.55%	5.04%	4.24%
Weighted average expected volatility	60.30%	31.14%	20.09%
Weighted average expected life in years	6.00	8.00	8.00
Weighted average grant date fair value	$ 6.35	$ 5.42	$ 2.79

The Company determines the assumptions used in the Black-Scholes option-pricing model as follows: the dividend yield is based on the historical dividend yield of the Company's stock, adjusted to reflect the expected dividend yield over the expected life of the option, the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; volatility is based on historical volatility adjusted to reflect the ways in which current information indicates that the future is reasonably expected to differ from the past; and the simplified method of Staff Accounting Bulletin 107 was used to estimate the average life.

The following table summarizes the activity during 2007 related to stock options awarded by the Company:

<PAGE>

<TABLE>
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	Year Ended December 31, 2007			
	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contrctual Life (Years)	Intrinsic Value
		(Dollars in thousands, except per share)		
<S>	<C>	<C>	<C>	<C>
Outstanding at beginning of year	472,038	$ 5.53		
Granted	25,000	14.84		
Exercised	(7,642)	3.25		
Forfeited or expired	-	-		
Outstanding at end of year	489,396	$ 6.04	4.19	$ 2,221
Options outstanding and expected to vest	489,396	$ 6.04	4.19	$ 2,221
Options exercisable at year-end	361,115	$ 4.56	2.89	$ 2,065

</TABLE>

The weighted average grant date fair values of options granted in 2007 and 2006 were $6.35 and $5.42, respectively. The total intrinsic value of options exercised in 2007 and 2006 was $57 and $33, respectively.

As of December 31, 2007, total compensation costs of unvested options that have not yet been recognized were $471. Those compensation costs will be recognized over the remaining weighted average vesting period of 1.7 years.

Intrinsic value is calculated in the aggregate for shares granted, outstanding and exercisable by taking the closing price of the Company's common stock as of December 31, 2007, as reported by the OTCBB, and subtracting the weighted-average exercise price of the respective category of stock option. That result is then multiplied by the number of options outstanding.

Intrinsic value for shares exercised represents the closing price of the stock on the date of exercise as reported by the OTCBB less the actual exercise price of the options exercised multiplied by the number of options exercised. These intrinsic values are calculated for each exercise during the year and the resulting total is presented.

All share and per share values have been retroactively restated for all stock dividends since the date the options were granted. The Company issues authorized but unissued shares to satisfy option exercises. As of December 31, 2007, there were 358,990 shares available for grant under the Plan.

NOTE 16 - SHAREHOLDERS' EQUITY

Restrictions on Subsidiary Dividends, Loans or Advances - South Carolina banking regulations restrict the amount of dividends that banks can pay to shareholders. Any of the banking subsidiary's dividends to the parent company which exceed in amount the subsidiary's current year-to-date earnings ($3,226 at December 31, 2007) are subject to the prior approval of the South Carolina Commissioner of Banking. Therefore, $25,221 of the Company's equity in the net assets of the Bank was restricted as of December 31, 2007. In addition, dividends paid by the banking subsidiary to the parent company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. Under Federal Reserve Board regulations, the amounts of loans or advances from the banking subsidiary to the parent company are generally limited to 10% of the Bank's capital stock and surplus on a secured basis. Furthermore, in the event that interest payments on the junior subordinated debentures (see Note 9) are deferred by the Company, the Company would be restricted in its ability to pay dividends on its common stock.

Stock Dividends - The Company's Board of Directors declared a 10% stock dividend on July 19, 2006. All per share information has been retroactively adjusted to give effect to the stock dividend.

Accumulated Other Comprehensive Income (Loss) - As of December 31, 2007 and 2006, accumulated other comprehensive income (loss) included as a component of shareholders' equity in the consolidated balance sheets consisted of accumulated changes in the unrealized holding gains and (losses) on available-for-sale securities, net of income tax effects, amounting to $322 and $223 respectively.

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Earnings per Share - Net income per share and net income per share, assuming dilution, were computed as follows:

<TABLE>
<CAPTION>

	Years Ended December 31, 2007	2006	2005
	(Dollars in thousands, except per share amounts)		
Net income per share, basic			
<S>	<C>	<C>	<C>
Numerator - net income	$ 2,799	$ 3,260	$ 2,361
Denominator			
Weighted average common shares issued and outstanding	3,373,909	3,372,065	2,840,528
Net income per share, basic	$ .83	$ .97	$ .83
Net income per share, assuming dilution			
Numerator			
Net income, as reported	$ 2,799	$ 3,260	$ 2,361
Add: Interest savings, net of tax, on weighted average incremental shares assumed on conversion of subordinated debentures	-	-	73
Net income (2007 and 2006) and pro forma net income (2005)	$ 2,799	$ 3,260	$ 2,434
Denominator			
Weighted average common shares issued and outstanding	3,373,909	3,372,065	2,840,528
Effect of assumed conversion of subordinated debentures	-	-	532,356
Effect of dilutive stock options	251,042	281,784	168,001
Total shares	3,624,951	3,653,849	3,540,885
Net income per share, assuming dilution	$ .77	$ .89	$ .69

</TABLE>

Weighted average common shares outstanding have been retroactively restated to reflect a 10% stock dividend declared on July 19, 2006.

Regulatory Capital - All bank holding companies and banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, bank holding companies and banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking subsidiary to maintain minimum amounts and ratios set forth in the table below of Total and Tier 1 Capital, as defined in the regulations, to risk weighted assets, as defined, and of Tier 1 Capital, as defined, to average assets, as defined. Management believes, as of December 31, 2007 and 2006, that the Company and its subsidiary bank exceeded all capital adequacy minimum requirements.

As of December 31, 2007, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized as defined in the Federal Deposit Insurance Act, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. Bank holding companies with higher levels of risk, or that are experiencing or anticipating significant growth, are expected

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by the Federal Reserve to maintain capital well above the minimums. The Company's and Bank's actual capital amounts and ratios are also presented in the table.

<TABLE>
<CAPTION>

	Actual		Minimum for Capital Adequacy		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2007			(Dollars in thousands)			
Tier 1 Capital (to Average Assets)						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Company	$ 28,850	8.4%	$ 13,750	4.0%	NA	NA
GrandSouth Bank	27,526	8.6%	12,869	4.0%	$ 16,087	5.0%
Tier 1 Capital (to Risk Weighted Assets)						
Company	$ 28,850	10.1%	$ 11,414	4.0%	NA	NA
GrandSouth Bank	27,526	9.6%	11,432	4.0%	$ 17,148	6.0%
Total Capital (to Risk Weighted Assets)						
Company	$ 32,489	11.4%	$ 22,828	8.0%	NA	NA
GrandSouth Bank	30,469	10.7%	22,864	8.0%	$ 28,580	10.0%
December 31, 2006						
Tier 1 Capital (to Average Assets)						
Company	$ 26,079	9.3%	$ 11,199	4.0%	NA	NA
GrandSouth Bank	25,200	8.5%	11,812	4.0%	$ 14,765	5.0%
Tier 1 Capital (to Risk Weighted Assets)						
Company	$ 26,079	10.7%	$ 9,788	4.0%	NA	NA
GrandSouth Bank	25,200	10.3%	9,777	4.0%	$ 14,666	6.0%
Total Capital (to Risk Weighted Assets)						
Company	$ 30,031	12.3%	$ 19,576	8.0%	NA	NA
GrandSouth Bank	27,623	11.3%	19,555	8.0%	$ 24,443	10.0%

</TABLE>

NOTE 17 - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Values of Financial Instruments," as amended, requires disclosure of the estimated fair value of on-balance sheet and off-balance sheet financial instruments. A financial instrument is defined by SFAS No. 107 as cash, evidence of an ownership interest in an entity or a contract that creates a contractual obligation or right to deliver or receive cash or another financial instrument from a second entity on potentially favorable or unfavorable terms.

Fair value estimates are made at a specific point in time based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. No active trading market exists for a significant portion of the Company's financial instruments. Fair value estimates for these instruments are based on management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-and-off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are specifically excluded from the disclosure requirements include net deferred tax assets, interest receivable and payable, assets acquired in settlement of loans, bank owned life insurance, goodwill, other assets and liabilities, and premises and equipment. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

The following methods and assumptions were used by the Company in estimating the fair values of its financial instruments:

For cash and due from banks and federal funds sold, the carrying amount approximates fair value because these instruments generally mature in 90 days or less.

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The fair value of debt securities issued by government-sponsored enterprises is estimated based on published closing quotations. The fair value of state, county and municipal securities is generally not available from published quotations; consequently, their fair values estimates are based on matrix pricing or quoted market prices of similar instruments adjusted for credit quality differences between the quoted instruments and the securities being valued. Fair value for mortgage-backed securities is estimated primarily using dealers' quotes.

The fair value of other investments approximates the carrying amount.

Fair values are estimated for loans using discounted cash flow analyses, using interest rates currently offered for loans with similar terms and credit quality. The Company does not engage in originating, holding, guaranteeing, servicing or investing in loans where the terms of the loan product give rise to a concentration of credit risk.

The fair value of deposits with no stated maturity (noninterest bearing demand, interest bearing demand and money market accounts and savings) is estimated as the amount payable on demand, or carrying amount. The fair value of time deposits is estimated using a discounted cash flow calculation that applies rates currently offered to aggregate expected maturities.

The fair values of the Company's short-term borrowings approximate their carrying amounts.

The fair values of variable rate long-term debt instruments are estimated at the carrying amount.

The estimated fair values of off-balance-sheet financial instruments such as loan commitments and standby letters of credit are generally based upon fees charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' creditworthiness. The vast majority of the banking subsidiary's loan commitments do not involve the charging of a fee, and fees associated with outstanding standby letters of credit are not material. For loan commitments and standby letters of credit, the committed interest rates are either variable or approximate current interest rates offered for similar commitments. Therefore, the estimated fair values of these off-balance-sheet financial instruments are nominal.

The following is a summary of the carrying amounts and estimated fair values of the Company's financial assets and liabilities:

<TABLE>
<CAPTION>

	December 31,			
	2007		2006	
	Carrying Amount of Assets (Liabilities)	Estimated Fair Value of Assets (Liabilities)	Carrying Amount of Assets (Liabilities)	Estimated Fair Value of Assets (Liabilities)
	(Dollars in thousands)			
Financial Assets:				
<S>	<C>	<C>	<C>	<C>
Cash and due from banks	$ 4,585	$ 4,585	$ 6,145	$ 6,145
Federal funds sold	4,420	4,420	13,659	13,659
Securities available-for-sale	59,567	59,567	41,646	41,646
Other investments	765	765	504	504
Loans, net	259,786	259,911	224,338	224,206
Financial Liabilities:				
Deposits	305,639	306,514	268,923	268,737
Short-term borrowings	5,000	5,000	-	-
Long-term debt	8,247	8,247	8,247	8,247

</TABLE>

<TABLE>
<CAPTION>

	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-balance-sheet commitments				
<S>	<C>	<C>	<C>	<C>
Loan commitments	$76,874	$ -	$71,053	$ -
Standby letters of credit	897	-	1,318	-

</TABLE>

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RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Impact of Recent Accounting Changes

Fair Value Measurements - The provisions of Statement of Financial Accounting Standards No. 157 ("SFAS No. 157"), "Fair Value Measurements," are effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard eliminates inconsistencies found in various prior pronouncements but does not require any new fair value measurements. The adoption of SFAS No. 157 in 2008 will not impact the Company's accounting measurements but it is expected to result in additional disclosures.

Fair Value Option - The provisions of Statements of Financial Accounting Standards No. 159 ("SFAS No. 159") , "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement 115," are effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). This Statement provides an entity the option to measure many financial instruments and certain other items at fair value. Changes in the fair values of items for which the option is selected will be recorded in the entity's earnings. The objective is to improve financial reporting by allowing entities to mitigate the earnings volatility that has resulted from the previously required application of different measurement attributes without the need to apply complex hedge accounting provisions. The Company has not elected to apply the Statement's provisions to any items held as of January 1, 2008 and does not currently expect that it will apply the Statement's provisions to any items acquired subsequently. Therefore, the adoption of the Statement in 2008 has not had, and is not expected to have, any effect on the Company's consolidated financial statements.

Accounting for Uncertainty in Income Taxes - In June 2006, the FASB issued Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes," to clarify the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company implemented the provisions of FIN 48 as of January 1, 2007, and has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company believes that its income tax filing positions taken or expected to be taken in an its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

Accounting for Bank Owned Life Insurance - In September 2006, the FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4, "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). Entities purchase life insurance for various reasons including protection against loss of key employees and to fund postretirement benefits. The two most common types of life insurance arrangements are endorsement split dollar life and collateral assignment split dollar life. EITF 06-4 covers the former and EITF 06-10 (discussed below) covers the latter. EITF 06-4 states that entities with endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board ("APB") Opinion No. 12, "Omnibus Opinion--1967" (if the arrangement is, in substance, an individual deferred compensation contract). Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. EITF 06-4 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB ratified the consensus reached on EITF 06-5, "Accounting for Purchases of Life Insurance--Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance" ("EITF 06-5"). EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-5 will have a material impact on its financial position, results of operations or cash flows.

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In March 2007, the FASB ratified the consensus reached on EITF 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" ("EITF 06-10"). The postretirement aspect of this EITF is substantially similar to EITF 06-4 discussed above and requires that an employer recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either FASB Statement No. 106 or APB Opinion No. 12, as appropriate, if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive agreement with the employee. In addition, a consensus was reached that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. EITF 06-10 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-10 will have a material impact on its financial position, results of operations or cash flows.

Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards - In June 2007, the FASB ratified the consensus reached by the EITF with respect to EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" ("EITF 06-11"). Under EITF 06-11, a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified nonvested equity shares, nonvested equity share units and outstanding equity share options should be recognized as an increase in additional paid-in capital. This EITF is to be applied prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared beginning in 2008, and interim periods within those fiscal years. Early application is permitted. The Company does not believe the adoption of EITF 06-11 will have a material impact on its financial position, results of operations or cash flows.

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

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NOTE 19 - GRANDSOUTH BANCORPORATION (PARENT COMPANY ONLY)

	December 31, 2007	December 31, 2006
	(Dollars in thousands)	
Condensed Balance Sheets		
Assets		
Cash	$ 343	$ 350
Investment in banking subsidiary	28,447	25,799
Due from subsidiary	968	848
Investment in capital trust	247	247
Deferred tax asset	787	549
Total assets	$30,792	$27,793
Liabilities		
Other liabilities	$ 78	$ 76
Junior subordinated debt	8,247	8,247
Shareholders' equity	22,467	19,470
Total liabilities and shareholders' equity	$30,792	$27,793

<TABLE>
<CAPTION>

	Years Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
Condensed Statements of Income			
Income			
<S>	<C>	<C>	<C>
Dividends received from banking subsidiary	$ 900	$ -	$ -
Other income	18	12	-
Total income	918	12	-
Expenses			
Interest expense	599	495	320
Other expenses	84	76	67
Total expenses	683	571	387
Income before income taxes and equity in undistributed earnings of banking subsidiary	235	(559)	(387)
Income tax benefit	(238)	(188)	(142)
Equity in undistributed earnings of banking subsidiary	2,326	3,631	2,606
Net income	$ 2,799	$ 3,260	$ 2,361

</TABLE>

<PAGE>

<TABLE>
<CAPTION>

	2007	2006	2005
	Years Ended December 31, (Dollars in thousands)		
Condensed Statements of Cash Flows			
Operating activities			
<S>	<C>	<C>	<C>
Net income	$ 2,799	$ 3,260	$ 2,361
Adjustments to reconcile net income to net cash provided (used) by operating activities			
Deferred income taxes	(238)	(175)	(132)
Other liabilities	-	28	50
Share-based compensation	121	110	-
Increase in due from subsidiary	(120)	(111)	(841)
Equity in undistributed net income of banking subsidiary	(2,326)	(3,631)	(2,606)
Net cash provided provided by (used for) operating activities	236	(519)	(1,168)
Investing activities			
Investment in banking subsidiary	-	(3,050)	(200)
Investment in capital trust	-	(247)	-
Net cash used for investing activities	-	(3,297)	(200)
Financing activities			
Proceeds of issuance of junior subordinated debentures	-	8,247	-
Proceeds from other borrowings	-	100	1,400
Repayments of other borrowings	-	(4,000)	-
Exercise of stock options	25	12	-
Cash dividends paid	(268)	(252)	(192)
Cash paid in lieu of fractional shares	-	(5)	(2)
Net cash (used for) provided by financing activities	(243)	4,102	1,206
(Decrease) increase in cash and cash equivalents	(7)	286	(162)
Cash and cash equivalents, beginning	350	64	226
Cash and cash equivalents, ending	$ 343	$ 350	$ 64
Supplemental Schedule of Non-Cash Investing and Financing Activities			
Dividends declared but unpaid	$ 69	$ 67	$ 61
Subordinated debentures converted into common stock	$ -	$ -	$ 3,500
Stock dividend	$ -	$ 4,592	$ -

</TABLE>

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GRANDSOUTH BANCORPORATION
Consolidated Balance Sheets
<TABLE>
<CAPTION>

	(Unaudited) March 31, 2008	December 31, 2007
	(Dollars in thousands)	
Assets		
<S>	<C>	<C>
Cash and due from banks	$ 5,648	$ 4,585
Federal funds sold	8,861	4,420
Cash and cash equivalents	14,509	9,005
Securities available-for-sale	56,530	59,567
Other investments, at cost	1,071	765
Loans, net of allowance for loan losses $3,071 for 2008 and $2,943 for 2007	265,568	259,786
Premises and equipment, net	4,880	4,896
Bank owned life insurance	4,799	4,753
Assets acquired in settlement of loans	307	1,752
Interest receivable	2,235	2,313
Deferred income taxes	472	544
Goodwill	737	737
Other assets	598	1,006
Total assets	$351,706	$345,124
Liabilities		
Deposits		
Noninterest bearing	$ 16,327	$ 15,037
Interest bearing	290,318	290,602
Total deposits	306,645	305,639
Short-term borrowings	5,000	5,000
Long-term Federal Home Loan Bank advances	5,000	-
Junior subordinated debentures	8,247	8,247
Interest payable	651	754
Other liabilities	2,972	3,017
Total liabilities	328,515	322,657
Shareholders' equity		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 3,381,488 at March 31, 2008 and 3,381,488 at December 31, 2007	19,234	19,200
Retained earnings	3,627	3,083
Accumulated other comprehensive income	330	184
Total shareholders' equity	23,191	22,467
Total liabilities and shareholders' equity	$351,706	$345,124

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Income
<TABLE>
<CAPTION>

	(Unaudited) Three Months Ended March 31,	
	2008	2007
	(Dollars in thousands, except per share)	
Interest income		
<S>	<C>	<C>
Loans, including fees	$5,771	$5,640
Investment securities		
Taxable	617	497
Nontaxable	141	49
Dividends	14	7
Other, principally federal funds sold	48	149
Total interest income	6,591	6,342
Interest expense		
Deposits	3,138	3,063
Federal Home Loan Bank advances	80	-
Junior subordinated debt	137	154
Total interest expense	3,355	3,217
Net interest income	3,236	3,125
Provision for loan losses	255	255
Net interest income after provision for loan losses	2,981	2,870
Noninterest income		
Service charges on deposit accounts	110	94
Other income	76	59
Total noninterest income	186	153
Noninterest expenses		
Salaries and employee benefits	1,356	1,218
Occupancy and equipment	210	165
Data processing	144	130
Insurance expense	66	120
Professional services	143	87
Other expense	296	215
Total noninterest expenses	2,215	1,935
Income before income taxes	952	1,088
Income tax expense	340	390
Net income	$ 612	$ 698
Per share		
Net income	$ 0.18	$ 0.21
Net income, assuming dilution	0.17	0.19
Cash dividends declared	0.02	0.02

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

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GRANDSOUTH BANCORPORATION
Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income

<TABLE>
<CAPTION>

(Unaudited)

	Common Stock Number of Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Dollars in thousands, except per share)				
<S>	<C>	<C>	<C>	<C>	<C>
Balance, January 1, 2007	3,373,846	$ 19,054	$ 554	$ (138)	$ 19,470
Comprehensive income:					
Net income	-	-	698	-	698
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $24	-	-	-	47	47
Total other comprehensive income	-	-	-	-	47
Total comprehensive income	-	-	-	-	745
Share-based compensation	-	26	-	-	26
Cash dividend declared, $.02 per share	-	-	(67)	-	(67)
Balance, March 31, 2007	3,373,846	$ 19,080	$ 1,185	$ (91)	$ 20,174
Balance, January 1, 2008	3,381,488	$ 19,200	$ 3,083	$ 184	$ 22,467
Comprehensive income:					
Net income	-	-	612	-	612
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $76	-	-	-	146	146
Total other comprehensive income	-	-	-	-	146
Total comprehensive income	-	-	-	-	758
Share-based compensation	-	34	-	-	34
Cash dividend declared, $.02 per share	-	-	(68)	-	(68)
Balance, March 31, 2008	3,381,488	$ 19,234	$ 3,627	$ 330	$ 23,191

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows
<TABLE>
<CAPTION>

	(Unaudited) Three Months Ended March 31, 2008	2007
	(Dollars in thousands)	
Operating activities		
<S>	<C>	<C>
Net income	$ 612	$ 698
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	255	255
Depreciation	82	99
Securities accretion and premium amortization	(7)	(2)
Gain on sale of premises and equipment	(14)	-
Loss on sale of assets acquired in settlement of loans	53	-
Increase in cash surrender value of bank owned life insurance	(46)	(43)
Decrease in other assets	486	122
(Decrease) increase in other liabilities	(216)	328
Increase in deferred tax assets	(4)	-
Share-based compensation	34	26
Net cash provided by operating activities	1,235	1,483
Investing activities		
Purchases of securities available-for-sale	(959)	(8,128)
Principal paydowns of available-for-sale mortgage-backed investment securities	1,225	832
Maturities and calls of securities available-for-sale	3,000	3,015
Purchases of other investments	(306)	(36)
Net increase in loans made to customers	(6,037)	(16,774)
Purchases of premises and equipment	(71)	(94)
Proceeds from sales of premises and equipment	19	-
Proceeds from sale of assets acquired in settlement of loans	1,392	149
Net cash used by investing activities	(1,737)	(21,036)
Financing activities		
Net increase in deposits	1,006	14,800
Increase in long-term Federal Home Loan Bank advances	5,000	-
Cash dividends paid	-	(67)
Net cash provided by financing activities	6,006	14,733
Increase (decrease) in cash and cash equivalents	5,504	(4,820)
Cash and cash equivalents, beginning of period	9,005	19,804
Cash and cash equivalents, end of period	$ 14,509	$ 14,984
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for		
Interest	$ 3,458	$ 3,158
Income taxes	737	85
Noncash investing and financing activities:		
Other comprehensive income	146	47
Transfers of loans to assets acquired in settlement of loans	-	35
Cash dividends declared and unpaid	68	-

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

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GRANDSOUTH BANCORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts)

NOTE 1 - ORGANIZATION

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees and operates as one business segment. The Company is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The unaudited consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

NOTE 2 - BASIS OF PRESENTATION

A summary of significant accounting policies and the audited financial statements for 2007 are included in GrandSouth Bancorporation's Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission.

The accompanying interim financial statements in this report are unaudited. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present a fair statement of the results for the interim period have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the 2007 Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported shareholders' equity or net income.

NOTE 3 - NON-PERFORMING LOANS

As of March 31, 2008, there were $3,620 in nonaccrual loans, no loans 90 or more days past due and still accruing interest and no restructured loans.

NOTE 4 - LONG-TERM DEBT

Late in the first quarter of 2008, the Bank borrowed $5,000 from the Federal Home Loan Bank of Atlanta at a fixed rate of 3.42%. The debt matures on March 26, 2013.

NOTE 5 - NET INCOME PER SHARE

Net income per share is computed on the basis of the weighted average number of common shares outstanding in accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share." Diluted net income per share is computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding during each period plus the assumed exercise of dilutive stock options using the treasury stock method.

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Following is a reconciliation of basic net income per share to diluted net income per share for the three months ended March 31, 2008 and 2007.

<TABLE>
<CAPTION>

	(Unaudited) Three Months Ended March 31, 2008	(Unaudited) Three Months Ended March 31, 2007
	(Dollars in thousands, except per share amounts)	
Net income per share, basic		
<S>	<C>	<C>
Numerator - net income	$ 612	$ 698
Denominator		
Weighted average common shares issued and outstanding	3,381,488	3,373,846
Net income per share, basic	$ .18	$ .21
Net income per share, assuming dilution		
Numerator - net income	$ 612	$ 698
Denominator		
Weighted average common shares issued and outstanding	3,381,488	3,373,846
Effect of dilutive stock options	186,440	330,244
Total shares	3,567,928	3,704,090
Net income per share, assuming dilution	$ .17	$ .19

</TABLE>

NOTE 6 -FAIR VALUE MEASUREMENTS

The Company implemented Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") as required on January 1, 2008. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly fashion between market participants at the measurement date (an exit price), and establishes a framework for measuring fair value. It also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, eliminates the consideration of large position discounts for financial instruments quoted in active markets, requires consideration of the Company's creditworthiness when valuing its liabilities, and expands disclosures about instruments measured at fair value.

The following is a summary of the measurement attributes applicable to financial assets and liabilities that are measured at fair value on a recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
<S>		<C>	<C>	<C>
Securities available-for-sale		$ -	$ 56,530	$ -

</TABLE>

Pricing for the Company's securities available-for-sale is obtained from an independent third-party that uses a process that may incorporate current market

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prices, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, other reference data and industry and economic events that a market participant would be expected to use in valuing the securities. Not all of the inputs listed apply to each individual security at each measurement date. The independent third party assigns specific securities into an "asset class" for the purpose of assigning the applicable level of the fair value hierarchy used to value the securities. The techniques used after adoption of SFAS No. 157 are consistent with the methods used previously.

No cumulative effect adjustments were required upon initial application of SFAS No. 157. Available-for-sale securities continue to be measured at fair value with unrealized gains and losses recorded in other comprehensive income.

The following is a summary of the measurement attributes applicable to assets and liabilities that are measured at fair value on a non-recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
<S>		<C>	<C>	<C>
Collateral dependent impaired loans		$ -	$ -	$ 2,626

</TABLE>

Collateral dependent impaired loans consist of nonaccrual loans and potential problem loans for which the underlying collateral provides the sole repayment source. The Company measures the amount of the impairment for such loans by determining the difference between the fair value of the underlying collateral and the recorded amount of the loan. The fair value of the underlying collateral generally is based on appraisals performed in accordance with applicable appraisal standards by independent appraisers engaged by the Company. In many cases, management updates values reflected in older appraisals obtained at the time of loan origination and already in the Company's possession using its own knowledge, judgments and assumptions about current market and other conditions in lieu of obtaining a new independent appraisal. If the fair value of the collateral is less than the recorded amount of the loan, a valuation allowance is established for the difference; otherwise, no valuation allowance is established. The valuation allowance for impaired loans is a component of the allowance for loan losses. Periodically, management reevaluates the fair value of the collateral and makes adjustments to the valuation allowance as appropriate. However, if the fair value of the collateral subsequently recovers in value such that it exceeds the recorded loan amount, no adjustment is made in the loan's value for the excess. The amount of the valuation allowance for the Company's collateral dependent impaired loans was $1,179 as of March 31, 2008.

In February 2008, the Financial Accounting Standards Board Staff issued FASB Staff Position No. FAS 157-2 ("FSP 157-2") which delays for one year the effective date of the application of Statement of Financial Accounting Standards No. 157 "Fair Value Measurements" ("SFAS No. 157") to nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In accordance with FSP 157-2, the Company has only partially applied SFAS No. 157. The major categories of assets or liabilities disclosed at fair value in the financial statements for which the Company has not applied the provisions of SFAS No. 157 under the provisions of FSP 157-2 are goodwill and assets acquired in settlement of loans.

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159" or the "Statement") which was effective for the Company as of January 1, 2008. Under the provisions of SFAS No. 159, entities may choose, but are not required, to measure many financial instruments

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and certain other items at their fair values, with changes in the fair values of those instruments reported in earnings. The Company has not elected to measure at fair value any financial instruments under the provisions of SFAS No. 159. The adoption of the Statement had no effect on the Company's financial statements.

NOTE 7 - VARIABLE INTEREST ENTITY

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I (the "Trust"), and is the sole owner of the $247 in common securities issued by the Trust. On May 10, 2006, the Trust issued $8,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire $8,247 principal amount of the Company's floating rate junior subordinated debt securities due 2036 ("Debentures"), which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3 month LIBOR plus 185 basis points, and was 4.54% as of March 31, 2008. The Company may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under other obligations that are not senior to the Debentures.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Prior to that date, the Debentures are redeemable at par plus a premium of up to 4.40% of par upon the occurrence of certain events that would have a negative tax effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve Board. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with Financial Accounting Standards Board Interpretation 46(R), the Trust is not consolidated in the Company's financial statements.

NOTE 8 -NEW ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 is effective for years beginning after December 31, 2008, is to be applied prospectively with retrospective presentation and disclosure requirements for comparative financial statements. Early adoption is prohibited. SFAS No. 160 seeks to improve the relevance, comparability and transparency of financial information that a reporting entity provides in its consolidated financial statements by separately identifying and reporting several financial statement components into amounts that are attributable to the reporting entity or that are attributable to noncontrolling interests. SFAS No. 160 also specifies the conditions under which an entity is required to deconsolidate its interest in a subsidiary. The Company currently has no consolidated subsidiaries that are not wholly owned nor are any transactions contemplated that would result in such a condition. Therefore, it is expected that the adoption of SFAS No. 160 in January 2009 will have no effect on the Company's consolidated financial statements.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GRANDSOUTH BANCORPORATION
Consolidated Balance Sheets
<TABLE>
<CAPTION>

	(Unaudited) June 30, 2008	December 31, 2007
	(Dollars in thousands)	
Assets		
<S>	<C>	<C>
Cash and due from banks	$ 10,647	$ 4,585
Federal funds sold	500	4,420
Cash and cash equivalents	11,147	9,005
Securities available for sale	53,345	59,567
Other investments, at cost	1,926	765
Loans, net of allowance for loan losses of $3,246 for 2008 and $2,943 for 2007	284,632	259,786
Premises and equipment, net	4,897	4,896
Bank owned life insurance	4,846	4,753
Assets acquired in settlement of loans	347	1,752
Interest receivable	2,159	2,313
Deferred income taxes	704	544
Goodwill	737	737
Other assets	559	1,006
Total assets	$ 365,299	$ 345,124
Liabilities		
Deposits		
Noninterest bearing	$ 17,511	$ 15,037
Interest bearing	283,531	290,602
Total deposits	301,042	305,639
Short-term borrowings	39	5,000
Long-term Federal Home Loan Bank advances	29,000	-
Junior subordinated debentures	8,247	8,247
Interest payable	635	754
Other liabilities	3,018	3,017
Total liabilities	341,981	322,657
Shareholders' equity		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 3,381,488 at June 30, 2008 and 3,381,488 at December 31, 2007	19,253	19,200
Retained earnings	4,187	3,083
Accumulated other comprehensive income (loss)	(122)	184
Total shareholders' equity	23,318	22,467
Total liabilities and shareholders' equity	$ 365,299	$ 345,124

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Income
<TABLE>
<CAPTION>

	(Unaudited) Period Ended June 30,			
	Three Months		Six Months	
	2008	2007	2008	2007
	(Dollars in thousands, except per share)			
Interest income				
<S>	<C>	<C>	<C>	<C>
Loans, including fees	$ 5,437	$ 5,924	$11,208	$11,564
Investment securities				
Taxable	574	467	1,191	964
Nontaxable	143	68	284	117
Dividends	23	10	37	17
Other, principally federal funds sold	79	167	127	316
Total interest income	6,256	6,636	12,847	12,978
Interest expense				
Deposits	2,726	3,303	5,864	6,366
Federal Home Loan Bank advances	187	-	267	-
Junior subordinated debt	93	147	230	301
Total interest expense	3,006	3,450	6,361	6,667
Net interest income	3,250	3,186	6,486	6,311
Provision for loan losses	460	170	715	425
Net interest income after provision for loan losses	2,790	3,016	5,771	5,886
Noninterest income				
Service charges on deposit accounts	125	110	235	204
Gain on sale of securities available for sale	16	-	16	-
Other income	67	70	143	129
Total noninterest income	208	180	394	333
Noninterest expense				
Salaries and employee benefits	1,296	1,308	2,652	2,526
Occupancy and equipment	197	240	407	405
Data processing	127	132	271	262
Insurance expense	134	140	200	260
Postage and supplies	43	70	116	120
Professional services	114	178	257	265
Real estate and loan	31	38	133	73
Other	80	63	201	193
Total noninterest expenses	2,022	2,169	4,237	4,104
Income before income taxes	976	1,027	1,928	2,115
Income tax expense	349	372	689	762
Net income	$ 627	$ 655	$ 1,239	$ 1,353
Per share				
Net income	$ 0.19	$ 0.19	$ 0.37	$ 0.40
Net income, assuming dilution	0.18	0.18	0.35	0.37
Cash dividends declared	0.02	0.02	0.04	0.04

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income

<TABLE>
<CAPTION>

(Unaudited)

	Common Stock				
	Number of Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Dollars in thousands, except per share)				
<S>	<C>	<C>	<C>	<C>	<C>
Balance, January 1, 2007	3,373,846	$ 19,054	$ 554	$ (138)	$ 19,470
Comprehensive income:					
Net income	-	-	1,353	-	1,353
Unrealized holding gains and losses on available for sale securities arising during the period, net of income taxes of $138	-	-	-	(268)	(268)
Total comprehensive income	-	-	-	-	1,085
Share-based compensation	-	55	-	-	55
Cash dividends declared, $.04 per share	-	-	(134)	-	(134)
Balance, June 30, 2007	3,373,846	$ 19,109	$ 1,773	$ (406)	$ 20,476
Balance, January 1, 2008	3,381,488	$ 19,200	$ 3,083	$ 184	$ 22,467
Comprehensive income:					
Net income	-	-	1,239	-	1,239
Unrealized holding gains and losses on available for sale securities arising during the period, net of income taxes of $151	-	-	-	(295)	(295)
Less: Reclassification adjustment for gain on sale of securities available for sale, net of income taxes of $5	-	-	-	(11)	(11)
Other comprehensive income					(306)
Total comprehensive income	-	-	-	-	933
Share-based compensation	-	53	-	-	53
Cash dividends declared, $.04 per share	-	-	(135)	-	(135)
Balance, June 30, 2008	3,381,488	$ 19,253	$ 4,187	$ (122)	$ 23,318

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows
<TABLE>
<CAPTION>

	(Unaudited) Six Months Ended June 30, 2008	2007
	(Dollars in thousands)	
Operating activities		
<S>	<C>	<C>
Net income	$ 1,239	$ 1,353
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	715	425
Depreciation	166	199
Net securities accretion	(31)	(7)
Gain on sale of securities available for sale	(16)	-
Gain on sale of premises and equipment	(26)	-
Loss (gain) on sale of assets acquired in settlement of loans	53	(6)
Increase in cash surrender value of bank owned life insurance	(93)	(88)
Decrease (increase) in other assets	601	(64)
Decrease in other liabilities	(186)	(106)
Increase in deferred tax assets	(4)	-
Share-based compensation	53	55
Net cash provided by operating activities	2,471	1,761
Investing activities		
Purchases of securities available for sale	(3,199)	(14,800)
Principal paydowns of available for sale mortgage-backed investment securities	2,976	1,667
Maturities and calls of securities available for sale	5,000	8,015
Proceeds of sales of securities available for sale	1,030	-
Purchases of other investments	(1,161)	(36)
Net increase in loans made to customers	(25,601)	(26,898)
Purchases of premises and equipment	(182)	(108)
Proceeds from sales of premises and equipment	41	-
Proceeds from sale of assets acquired in settlement of loans	1,392	190
Net cash used by investing activities	(19,704)	(31,970)
Financing activities		
Net (decrease) increase in deposits	(4,597)	29,158
Decrease in short-term borrowings	(4,961)	-
Increase in long-term Federal Home Loan Bank advances	29,000	-
Cash dividends paid	(67)	(67)
Net cash provided by financing activities	19,375	29,091
Increase (decrease) in cash and cash equivalents	2,142	(1,118)
Cash and cash equivalents, beginning of period	9,005	19,804
Cash and cash equivalents, end of period	$ 11,147	$ 18,686

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows (continued)
<TABLE>
<CAPTION>

	(Unaudited) Six Months Ended June 30, 2008	2007
	(Dollars in thousands)	
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for		
<S>	<C>	<C>
Interest	$ 6,480	$ 6,584
Income taxes	1,077	655
Noncash investing and financing activities		
Other comprehensive income (loss)	(306)	(268)
Transfers of loans to assets acquired in settlement of loans	40	335
Dividends declared but unpaid	68	67

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

GRANDSOUTH BANCORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts)

NOTE 1 - ORGANIZATION

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees and operates as one business segment. The Company is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The unaudited consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

NOTE 2 - BASIS OF PRESENTATION

A summary of significant accounting policies and the audited financial statements for 2007 are included in GrandSouth Bancorporation's Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission.

The accompanying interim financial statements in this report are unaudited. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present a fair statement of the results for the interim period have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the 2007 Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported shareholders' equity or net income.

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NOTE 3 - NON-PERFORMING LOANS

As of June 30, 2008 and December 31, 2007, there were $1,425 and $1,127 in nonaccrual loans, respectively. There were no loans 90 or more days past due and still accruing interest and no restructured loans as of either date.

NOTE 4 - LONG-TERM DEBT

During the first six months of 2008, the Bank borrowed $29,000 from the Federal Home Loan Bank of Atlanta. These borrowings were fixed rate advances with a weighted average interest rate of 3.62% and a weighted average maturity of 3.33 years.

NOTE 5 - NET INCOME PER SHARE

Net income per share is computed on the basis of the weighted average number of common shares outstanding in accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share." Diluted net income per share is computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding during each period plus the assumed exercise of dilutive stock options using the treasury stock method.

Following is a reconciliation of basic net income per share to diluted net income per share for the three and six months periods ended June 30, 2008 and 2007.

<TABLE>
<CAPTION>

	(Unaudited) Period Ended June 30,			
	Three Months		Six Months	
	2008	2007	2008	2007
	(Dollars in thousands, except per share amounts)			
<S>	<C>	<C>	<C>	<C>
Net income per share, basic				
Numerator - net income	$ 627	$ 655	$ 1,239	$ 1,353
Denominator				
Weighted average common shares issued and outstanding	3,381,488	3,373,846	3,381,488	3,373,846
Net income per share, basic	$ .19	$ .19	$ .37	$ .40
Net income per share, assuming dilution				
Numerator - net income	$ 627	$ 655	$ 1,239	$ 1,353
Denominator				
Weighted average common shares issued and outstanding	3,381,488	3,373,846	3,381,488	3,373,846
Effect of dilutive stock options	184,971	282,318	186,949	310,754
Total shares	3,566,459	3,656,164	3,568,437	3,684,600
Net income per share, assuming dilution	$ .18	$ .18	$ .35	$ .37

</TABLE>

<PAGE>

NOTE 6 - FAIR VALUE MEASUREMENTS

The Company implemented Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") as required on January 1, 2008. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly fashion between market participants at the measurement date (an exit price), and establishes a framework for measuring fair value. It also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, eliminates the consideration of large position discounts for financial instruments quoted in active markets, requires consideration of the Company's creditworthiness when valuing its liabilities, and expands disclosures about instruments measured at fair value.

The following is a summary of the measurement attributes applicable to financial assets and liabilities that are measured at fair value on a recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
<S>		<C>	<C>	<C>
Securities available for sale		$ -	$ 53,345	$ -

</TABLE>

Pricing for the Company's securities available-for-sale is obtained from an independent third-party that uses a process that may incorporate current market prices, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, other reference data and industry and economic events that a market participant would be expected to use in valuing the securities. Not all of the inputs listed apply to each individual security at each measurement date. The independent third party assigns specific securities into an "asset class" for the purpose of assigning the applicable level of the fair value hierarchy used to value the securities. The techniques used after adoption of SFAS No. 157 are consistent with the methods used previously.

No cumulative effect adjustments were required upon initial application of SFAS No. 157. Available for sale securities continue to be measured at fair value with unrealized gains and losses recorded in other comprehensive income.

The following is a summary of the measurement attributes applicable to assets and liabilities that are measured at fair value on a non-recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
<S>		<C>	<C>	<C>
Collateral dependent impaired loans		$ -	$ 677	$ -

</TABLE>

Collateral dependent impaired loans consist of nonaccrual loans and potential problem loans for which the underlying collateral provides the sole repayment source. The Company measures the amount of the impairment for such loans by

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determining the difference between the fair value of the underlying collateral and the recorded amount of the loan. The fair value of the underlying collateral generally is based on appraisals performed in accordance with applicable appraisal standards by independent appraisers engaged by the Company. In many cases, management updates values reflected in older appraisals obtained at the time of loan origination and already in the Company's possession using its own knowledge, judgments and assumptions about current market and other conditions in lieu of obtaining a new independent appraisal. If the fair value of the collateral is less than the recorded amount of the loan, a valuation allowance is established for the difference; otherwise, no valuation allowance is established. The valuation allowance for impaired loans is a component of the allowance for loan losses. Periodically, management reevaluates the fair value of the collateral and makes adjustments to the valuation allowance as appropriate. However, if the fair value of the collateral subsequently recovers in value such that it exceeds the recorded loan amount, no adjustment is made in the loan's value for the excess. The amount of the valuation allowance for the Company's collateral dependent impaired loans was $285 as of June 30, 2008.

In February 2008, the Financial Accounting Standards Board Staff issued FASB Staff Position No. FAS 157-2 ("FSP 157-2") which delays for one year the effective date of the application of Statement of Financial Accounting Standards No. 157 "Fair Value Measurements" ("SFAS No. 157") to nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In accordance with FSP 157-2, the Company has only partially applied SFAS No. 157. The major categories of assets or liabilities disclosed at fair value in the financial statements for which the Company has not applied the provisions of SFAS No. 157 under the provisions of FSP 157-2 are goodwill and assets acquired in settlement of loans.

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159" or the "Statement") which was effective for the Company as of January 1, 2008. Under the provisions of SFAS No. 159, entities may choose, but are not required, to measure many financial instruments and certain other items at their fair values, with changes in the fair values of those instruments reported in earnings. The Company has not elected to measure at fair value any financial instruments under the provisions of SFAS No. 159. The adoption of the Statement had no effect on the Company's financial statements.

NOTE 7 - VARIABLE INTEREST ENTITY

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I (the "Trust"), and is the sole owner of the $247 in common securities issued by the Trust. On May 10, 2006, the Trust issued $8,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire $8,247 principal amount of the Company's floating rate junior subordinated debt securities due 2036 ("Debentures"), which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3 month LIBOR plus 185 basis points, and was 4.65% as of June 30, 2008. The Company may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under other obligations that are not senior to the Debentures.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Prior to that date, the Debentures are redeemable at par plus a premium of up to 4.40% of par upon the occurrence of certain events that would have a negative tax effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause

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trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve Board. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with Financial Accounting Standards Board Interpretation 46(R), the Trust is not consolidated in the Company's financial statements.

NOTE 8 -NEW ACCOUNTING PRONOUNCEMENTS

In May, 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 162, "The Hierarchy of Generally Accepted Accounting Principles," ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS No. 162 will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The application of the Statement will have no effect on the Company's financial position, results of operations or cash flows.

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

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

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

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

<PAGE>

FSP is effective for the Company on January 1, 2009. The Company is currently evaluating the impact, if any, that the adoption of FSP 140-3 will have on its financial position, results of operations and cash flows.

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

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

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

GRANDSOUTH BANCORPORATION
Consolidated Balance Sheets
<TABLE>
<CAPTION>

	(Unaudited) September 30, 2008	(Audited) December 31, 2007
	(Dollars in thousands)	
Assets		
<S>	<C>	<C>
Cash and non-interest bearing due from banks	$ 4,587	$ 4,287
Interest bearing transaction deposits with other banks	5,101	298
Federal funds sold	8,322	4,420
Cash and cash equivalents	18,010	9,005
Certificates of deposit with other banks	2,000	-
Securities available for sale	50,571	59,567
Other investments, at cost	1,926	765
Loans, net of allowance for loan losses - $3,553 for 2008 and $2,943 for 2007	290,236	259,786
Premises and equipment, net	4,813	4,896
Bank owned life insurance	4,892	4,753
Assets acquired in settlement of loans	605	1,752
Interest receivable	2,184	2,313
Deferred income taxes	586	544
Goodwill	737	737
Other assets	881	1,006
Total assets	$377,441	$345,124
Liabilities		
Deposits		
Noninterest bearing	$ 18,030	$ 15,037
Interest bearing	294,443	290,602
Total deposits	312,473	305,639
Short-term borrowings	-	5,000
Long-term Federal Home Loan Bank advances	29,000	-
Junior subordinated debentures	8,247	8,247
Interest payable	560	754
Other liabilities	2,580	3,017
Total liabilities	352,860	322,657
Shareholders' equity		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 3,565,964 at September 30, 2008 and 3,381,488 at December 31, 2007	19,884	19,200
Retained earnings	4,588	3,083
Accumulated other comprehensive income (loss)	109	184
Total shareholders' equity	24,581	22,467
Total liabilities and shareholders' equity	$377,441	$345,124

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Income
<TABLE>
<CAPTION>

	(Unaudited) Period Ended September 30,			
	Three Months		Nine Months	
	2008	2007	2008	2007
	(Dollars in thousands, except per share)			
Interest income				
<S>	<C>	<C>	<C>	<C>
Interest and fees on loans	$ 5,394	$ 5,946	$ 16,602	$ 17,510
Investment securities				
Taxable	510	527	1,701	1,491
Nontaxable	143	97	427	214
Dividends	14	7	51	24
Other, principally federal funds sold	74	190	201	506
Total interest income	6,135	6,767	18,982	19,745
Interest expense				
Deposits	2,695	3,508	8,559	9,874
Federal Home Loan Bank advances	264	-	531	-
Junior subordinated debentures	99	155	329	456
Total interest expense	3,058	3,663	9,419	10,330
Net interest income	3,077	3,104	9,563	9,415
Provision for loan losses	670	255	1,385	680
Net interest income after provision for loan losses	2,407	2,849	8,178	8,735
Noninterest income				
Service charges on deposit accounts	139	114	374	318
Gain (loss) on sale of securities available for sale	-	(24)	16	(24)
Gain (loss) on sale of assets acquired in settlement of loans	29	-	(24)	6
Gain on sale of premises and equipment	16	-	43	-
Other income	77	76	193	199
Total noninterest income	261	166	602	499
Noninterest expense				
Salaries and employee benefits	1,189	1,066	3,841	3,592
Premises and equipment	90	168	497	507
Data processing	120	103	391	365
Insurance	96	140	296	400
Postage and supplies	73	72	189	214
Professional fees	113	138	370	374
Real estate and loan	44	81	124	154
Other	206	143	407	409
Total noninterest expenses	1,931	1,911	6,115	6,015
Income before income taxes	737	1,104	2,665	3,219
Income tax expense	265	398	954	1,160
Net income	$ 472	$ 706	$ 1,711	$ 2,059
Per share				
Net income	$ 0.14	$ 0.21	$ 0.50	$ 0.61
Net income, assuming dilution	0.13	0.20	0.48	0.57
Dividends declared	0.02	0.02	0.06	0.06

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income
<TABLE>
<CAPTION>

(Unaudited)

	Common Stock Number of Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
		(Dollars in thousands, except per share)			
<S>	<C>	<C>	<C>	<C>	<C>
Balance, January 1, 2007	3,373,846	$ 19,054	$ 554	$ (138)	$ 19,470
Comprehensive income:					
Net income	-	-	2,059	-	2,059
Net unrealized holding gains and losses on available for sale securities arising during the period, net of income taxes of $68	-	-	-	132	132
Reclassification adjustment, net of income taxes of $8	-	-	-	16	16
Total other comprehensive income	-	-	-	-	148
Total comprehensive income	-	-	-	-	2,207
Share-based compensation	-	85	-	-	85
Cash dividends declared, $.06 per share	-	-	(201)	-	(201)
Balance, September 30, 2007	3,373,846	$ 19,139	$ 2,412	$ 10	$ 21,561
Balance, January 1, 2008	3,381,488	$ 19,200	$ 3,083	$ 184	$ 22,467
Comprehensive income:					
Net income	-	-	1,711	-	1,711
Net unrealized holding gains and losses on available for sale securities arising during the period, net of income taxes of $33	-	-	-	(64)	(64)
Reclassification adjustment, net of income taxes of $5	-	-	-	(11)	(11)
Total other comprehensive income (loss)	-	-	-	-	(75)
Total comprehensive income	-	-	-	-	1,636
Exercise of stock options	184,476	599	-	-	599
Share-based compensation	-	85	-	-	85
Cash dividends declared, $.06 per share	-	-	(206)	-	(206)
Balance, September 30, 2008	3,565,964	$ 19,884	$ 4,588	$ 109	$ 24,581

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

<PAGE>

GRANDSOUTH BANCORPORATION
Consolidated Statements of Cash Flows
<TABLE>
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	(Unaudited) Nine Months Ended September 30, 2008	2007
	(Dollars in thousands)	
Operating activities		
<S>	<C>	<C>
Net income	$ 1,711	$ 2,059
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	1,385	680
Depreciation	252	295
Net securities (discount accretion) and premium amortization	(35)	9
(Gain) or loss on sale of securities available for sale	(16)	24
Gain on sale of premises and equipment	(43)	-
Loss (gain) on sale of assets acquired in settlement of loans	24	(6)
Increase in cash surrender value of bank owned life insurance	(139)	(132)
Decrease (increase) in other assets	250	(258)
(Decrease) increase in other liabilities	(633)	347
Share-based compensation	85	85
Net cash provided by operating activities	2,841	3,103
Investing activities		
Purchases of certificates of deposit in other banks	(2,000)	-
Purchases of securities available for sale	(3,199)	(29,207)
Principal paydowns of available for sale mortgage-backed investment securities	4,104	2,613
Maturities, calls and paydowns of securities available for sale	7,000	10,015
Proceeds of sale of securities available for sale	1,029	2,448
Purchases of other investments	(1,161)	(36)
Net increase in loans made to customers	(32,445)	(34,005)
Purchases of premises and equipment	(183)	(147)
Proceeds from sale of premises and equipment	57	-
Proceeds from sale of assets acquired in settlement of loans	1,733	490
Net cash used by investing activities	(25,065)	(47,829)
Financing activities		
Net increase in deposits	6,834	36,891
Decrease in short-term borrowings	(5,000)	-
Increase in long-term Federal Home Loan Bank advances	29,000	-
Cash dividends paid	(204)	(134)
Exercise of stock options	599	-
Net cash provided by financing activities	31,229	36,757
Increase (decrease) in cash and cash equivalents	9,005	(7,969)
Cash and cash equivalents, beginning of period	9,005	19,804
Cash and cash equivalents, end of period	$ 18,010	$ 11,835

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

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Supplemental Disclosure of Cash Flow Information
<TABLE>
<CAPTION>

	(Unaudited) Nine Months Ended September 30, 2008	2007
	(Dollars in thousands)	
Cash paid during the period for		
<S>	<C>	<C>
Interest	$ 9,614	$10,333
Income taxes	1,444	1,082
Noncash investing and financing activities:		
Other comprehensive income (loss)	(75)	148
Transfers of loans to assets acquired in settlement of loans	610	335
Dividends declared but unpaid	71	67

</TABLE>

GRANDSOUTH BANCORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts)

NOTE 1 - ORGANIZATION

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of $2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees and operates as one business segment. The Company is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The unaudited consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

NOTE 2 - BASIS OF PRESENTATION

Accounting Principles - A summary of significant accounting policies and the audited financial statements for 2007 are included in GrandSouth Bancorporation's Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission. The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and the instructions to Form 10-Q.

The accompanying interim financial statements in this report are unaudited. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present a fair statement of the results for the interim period have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the 2007 Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to conform to the current presentation. These reclassifications have no effect on previously reported shareholders' equity or net income. All dollar amounts are in thousands, except per share data.

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NOTE 3 - NON-PERFORMING LOANS

As of September 30, 2008, there were $6,081 in nonaccrual loans, $348 in loans 90 or more days past due and still accruing interest and no restructured loans. As of December 31, 2007, there were $1,127 in nonaccrual loans, no loans 90 or more days past due and still accruing interest and no restructured loans.

NOTE 4 - LONG-TERM DEBT

During the first nine months of 2008, the Bank borrowed $29,000 from the Federal Home Loan Bank of Atlanta. These borrowings were fixed rate advances with a weighted average interest rate of 3.62% and a weighted average maturity of 3.33 years.

NOTE 5 - NET INCOME PER SHARE

Net income per share is computed on the basis of the weighted average number of common shares outstanding in accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share." Diluted net income per share is computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding during each period plus the assumed exercise of dilutive stock options using the treasury stock method.

Following is a reconciliation of basic net income per share to diluted net income per share for the three and nine month periods ended September 30, 2008 and 2007.

<TABLE>
<CAPTION>

	(Unaudited) Period Ended September 30,			
	Three Months		Nine Months	
	2008	2007	2008	2007
	(Dollars in thousands, except per share amounts)			
Net income per share, basic				
<S>	<C>	<C>	<C>	<C>
Numerator - net income	$ 472	$ 706	$ 1,711	$ 2,059
Denominator				
Weighted average common shares issued and outstanding	3,481,747	3,373,846	3,415,152	3,373,846
Net income per share, basic	$ .14	$ .21	$ .50	$ .61
Net income per share, assuming dilution				
Numerator - net income	$ 472	$ 706	$ 1,711	$ 2,059
Denominator				
Weighted average common shares issued and outstanding	3,481,747	3,373,846	3,415,152	3,373,846
Effect of dilutive stock options	63,267	210,207	141,913	264,730
Total shares	3,545,014	3,584,053	3,557,065	3,638,576
Net income per share, assuming dilution	$ .13	$ .20	$ .48	$ .57

</TABLE>

NOTE 6 -FAIR VALUE MEASUREMENTS

The Company implemented Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS No. 157") as required on January 1, 2008. SFAS

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No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly fashion between market participants at the measurement date (an exit price), and establishes a framework for measuring fair value. It also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, eliminates the consideration of large position discounts for financial instruments quoted in active markets, requires consideration of the Company's creditworthiness when valuing its liabilities, and expands disclosures about instruments measured at fair value.

The following is a summary of the measurement attributes applicable to financial assets and liabilities that are measured at fair value on a recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(Dollars in thousands)	
<S>		<C>	<C>	<C>
Securities available for sale		$ -	$50,571	$ -

</TABLE>

Pricing for the Company's securities available-for-sale is obtained from an independent third-party that uses a process that may incorporate current market prices, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, other reference data and industry and economic events that a market participant would be expected to use in valuing the securities. Not all of the inputs listed apply to each individual security at each measurement date. The independent third party assigns specific securities into an "asset class" for the purpose of assigning the applicable level of the fair value hierarchy used to value the securities. The techniques used after adoption of SFAS No. 157 are consistent with the methods used previously.

No cumulative effect adjustments were required upon initial application of SFAS No. 157. Available for sale securities continue to be measured at fair value with unrealized gains and losses recorded in other comprehensive income.

The following is a summary of the measurement attributes applicable to financial assets and liabilities that are measured at fair value on a non-recurring basis:

<TABLE>
<CAPTION>

		Fair Value Measurement at Reporting Date Using		
Description	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(Dollars in thousands)	
<S>		<C>	<C>	<C>
Collateral dependent impaired loans		$ -	$ 4,784	$ -

</TABLE>

Collateral dependent impaired loans consist of nonaccrual loans and potential problem loans for which the underlying collateral provides the sole repayment source. The Company measures the amount of the impairment for such loans by determining the difference between the fair value of the underlying collateral and the recorded amount of the loan. The fair value of the underlying collateral generally is based on appraisals performed in accordance with applicable appraisal standards by independent appraisers engaged by the Company. In many

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cases, management updates values reflected in older appraisals obtained at the time of loan origination and already in the Company's possession using its own knowledge, judgments and assumptions about current market and other conditions in lieu of obtaining a new independent appraisal. If the fair value of the collateral is less than the recorded amount of the loan, a valuation allowance is established for the difference; otherwise, no valuation allowance is established. The valuation allowance for impaired loans is a component of the allowance for loan losses. Periodically, management reevaluates the fair value of the collateral and makes adjustments to the valuation allowance as appropriate. However, if the fair value of the collateral subsequently recovers in value such that it exceeds the recorded loan amount, no adjustment is made in the loan's value for the excess. The amount of the valuation allowance for the Company's collateral dependent impaired loans was $1,503 as of September 30, 2008.

In February 2008, the Financial Accounting Standards Board Staff issued FASB Staff Position No. FAS 157-2 ("FSP 157-2") which delays for one year the effective date of the application of Statement of Financial Accounting Standards No. 157 "Fair Value Measurements" ("SFAS No. 157") to nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In accordance with FSP 157-2, the Company has only partially applied SFAS No. 157. The major categories of assets or liabilities disclosed at fair value in the financial statements for which the Company has not applied the provisions of SFAS No. 157 under the provisions of FSP 157-2 are goodwill and assets acquired in settlement of loans.

The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159" or the "Statement") which was effective for the Company as of January 1, 2008. Under the provisions of SFAS No. 159, entities may choose, but are not required, to measure many financial instruments and certain other items at their fair values, with changes in the fair values of those instruments reported in earnings. The Company has not elected to measure at fair value any financial instruments under the provisions of SFAS No. 159. The adoption of the Statement had no effect on the Company's financial statements.

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

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

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

NOTE 7 - VARIABLE INTEREST ENTITY

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I (the "Trust"), and is the sole owner of the $247 in common securities issued by the Trust. On May 10, 2006, the Trust issued $8,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire $8,247 principal amount of the Company's floating rate junior subordinated debt securities due 2036 ("Debentures"), which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest

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rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3 month LIBOR plus 185 basis points, and was 5.06% as of September 30, 2008. The Company may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under other obligations that are not senior to the Debentures.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Prior to that date, the Debentures are redeemable at par plus a premium of up to 4.40% of par upon the occurrence of certain events that would have a negative tax effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve Board. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with Financial Accounting Standards Board Interpretation 46(R), the Trust is not consolidated in the Company's financial statements.

NOTE 8 -NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

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

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

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

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

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