FSB Community Bankshares Inc
Form 10-Q
November 14, 2008

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

[X] Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2008

OR

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______________ to ______________________

Commission File No. 001-52751

FSB Community Bankshares, Inc.
(Exact name of registrant as specified in its charter)

| United States | 4-3164710 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 45 South Main Street, Fairport, New York | 14450 |
| (Address of Principal Executive Offices) | Zip Code |

(585) 223-9080
(Registrant's telephone number)

N/A
(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days. YES X NO ____.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

| | | | |
|---|---|---|---|
| Large accelerated filer | [ ] | Accelerated filer | [ ] |
| Non-accelerated filer (Do not check if smaller reporting company) | [ ] | Smaller reporting company | [ ] |

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

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As of November 14, 2008 there were 1,785,000 shares of the Registrant's common stock, par value $0.10 per share, outstanding, 946,050 of which were held by FSB Community Bankshares, MHC, the Registrant's mutual holding company.

FSB Community Bankshares, Inc.
FORM 10-Q

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Part I. Financial Information

Item 1. Consolidated Financial Statements

FSB COMMUNITY BANKSHARES, INC.

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

| Assets | September 30, 2008 |
|---|---|
| Cash and due from banks | $ 2,801 |
| Interest-earning demand deposits | 3,796 |
| Cash and Cash Equivalents | 6,597 |
| Securities available for sale | 41,386 |
| Securities held to maturity (fair value 2008 - $8,603, 2007- $28,597) | 8,566 |
| Investment in FHLB stock | 2,184 |
| Loans receivable, net of allowance for loan losses of: 2008 - $335, 2007 - $319 | 136,963 |
| Accrued interest receivable | 948 |
| Premises and equipment, net | 2,363 |
| Other assets | 513 |
| Total Assets | $ 199,520 |
| **Liabilities & Stockholders' Equity** | |
| Deposits: | |
| Non-interest-bearing | $ 3,147 |
| Interest-bearing | 129,217 |
| Total Deposits | 132,364 |
| Borrowings | 42,622 |
| Advances from borrowers for taxes and insurance | 985 |
| Official bank checks | 3,340 |
| Other liabilities | 353 |
| Total Liabilities | 179,664 |
| **Stockholders' Equity** | |
| Preferred Stock- no par- 1,000,000 shares authorized; | -- |

| | |
|---|---|
| no shares issued and outstanding | |
| Common Stock- $0.10 par value - 10,000,000 shares authorized; 1,785,000 shares issued and outstanding | 179 |
| Additional paid-in-capital | 7,288 |
| Retained earnings | 13,129 |
| Accumulated other comprehensive income (loss) | (102) |
| Unearned ESOP shares - at cost | (638) |
| Total Stockholders' Equity | 19,856 |
| Total Liabilities and Stockholders' Equity | $ 199,520 |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Operations
Three Months Ended September 30, 2008 and 2007 (unaudited)
(Dollars in thousands, except per share data)

| | 2008 |
|---|---|
| Interest and Dividend Income | |
| Loans | $ 1,962 |
| Securities - taxable | 350 |
| Mortgage-backed securities | 288 |
| Other | 14 |
| Total Interest and Dividend Income | 2,614 |
| Interest Expense | |
| Deposits | 998 |
| Long Term Borrowings | 465 |
| Total Interest Expense | 1,463 |
| Net Interest Income | 1,151 |
| Provision for Loan Losses | 8 |
| Net Interest Income After Provision for Loan Losses | 1,143 |
| Other Income | |
| Service fees | 57 |
| Fee income | 53 |
| Realized gain on sale of securities available for sale | -- |
| Impairment loss on securities available for sale | (57) |
| Other | 36 |
| Total Other Income | 89 |

| | |
|---|---|
| Other Expenses | |
| Salaries and employee benefits | 655 |
| Occupancy expense | 118 |
| Data processing costs | 22 |
| Advertising | 54 |
| Equipment expense | 84 |
| Electronic banking | 15 |
| Directors' fees | 28 |
| Mortgage fees and taxes | 86 |
| Other expense | 135 |
| Total Other Expenses | 1,197 |
| Income (Loss) Before Income Taxes | 35 |
| Provision for Income Taxes | 34 |
| Net Income (Loss) | $ 1 |
| Earnings (Loss) per common share | $ 0.00 |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Operations
Nine Months Ended September 30, 2008 and 2007 (unaudited)
(Dollars in thousands, except per share data)

| | 2008 |
|---|---|
| Interest and Dividend Income | |
| Loans | $ 5,626 |
| Securities - taxable | 1,033 |
| Mortgage-backed securities | 792 |
| Other | 104 |
| Total Interest and Dividend Income | 7,555 |
| Interest Expense | |
| Deposits | 3,205 |
| Short Term Borrowings | -- |
| Long Term Borrowings | 1,274 |
| Total Interest Expense | 4,479 |
| Net Interest Income | 3,076 |
| Provision for Loan Losses | 14 |

| | |
|---|---|
| Net Interest Income After Provision for Loan Losses | 3,062 |
| **Other Income** | |
| Service fees | 146 |
| Fee income | 107 |
| Realized gain on sale of securities available for sale | -- |
| Impairment loss on securities available for sale | (57) |
| Other | 118 |
| Total Other Income | 314 |
| **Other Expenses** | |
| Salaries and employee benefits | 1,839 |
| Occupancy expense | 346 |
| Data processing costs | 63 |
| Advertising | 203 |
| Equipment expense | 249 |
| Electronic banking | 50 |
| Directors' fees | 85 |
| Mortgage fees and taxes | 182 |
| Other expense | 474 |
| Total Other Expenses | 3,491 |
| Loss Before Income Taxes | (115) |
| Benefit for Income Taxes | (20) |
| Net Loss | $ (95) |
| Loss per common share | $ (0.06) |

See accompanying notes to consolidated financial statements



FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Stockholders' Equity
Nine Months Ended September 30, 2008 and 2007
(unaudited) (Dollars in thousands)

| | Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensiv Income (Loss |
|---|---|---|---|---|
| Balance - January 1, 2007 | $ -- | $ 10 | $ 13,505 | $ 355 |
| Comprehensive loss: | | | | |

| | | | | |
|---|---|---|---|---|
| Net loss | -- | -- | (248) | -- |
| Change in net unrealized gain on securities available for sale, net of taxes | -- | -- | -- | (103) |
| Total Comprehensive Loss | | | | |
| Shares issued in public offering | 179 | 7,281 | -- | -- |
| Shares Purchased by ESOP | -- | -- | -- | -- |
| ESOP shares committed to be released | -- | -- | -- | -- |
| Balance - September 30, 2007 | $ 179 | $ 7,291 | $ 13,257 | $ 252 |
| Balance - January 1, 2008 | $ 179 | $ 7,293 | $ 13,224 | $ 118 |
| Comprehensive loss: | | | | |
| Net loss | -- | -- | (95) | -- |
| Change in net unrealized gain (loss) on securities available for sale, net of taxes | -- | -- | -- | (220 |
| Total Comprehensive Loss | | | | |
| ESOP shares committed to be released | -- | (5) | -- | -- |
| Balance - September 30, 2008 | $ 179 | $ 7,288 | $ 13,129 | $ (102 |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2008 and 2007 (unaudited)
(Dollars in thousands)

| | 2008 |
|---|---|
| Cash Flows From Operating Activities | |
| Net Loss | $ (95 |
| Adjustments to reconcile net loss to net cash provided (used) by operating activities: | |
| Gain on sale of securities available for sale | -- |
| Impairment loss on securities available-for-sale | 57 |
| Net amortization of premiums and discounts on investments | 233 |
| Gain on sale of loans | (9 |
| Amortization of net deferred loan origination fees | (17 |
| Depreciation and amortization | 201 |
| Provision for loan losses | 14 |
| Expense related to stock-based compensation plans | 22 |
| Deferred income tax benefit | (36 |
| Decrease (increase) in accrued interest receivable | (76 |

| | |
|---|---|
| Increase in other assets | (258 |
| Increase in other liabilities | 153 |
| Net Cash Provided (Used) By Operating Activities | 189 |
| Cash Flows From Investing Activities | |
| Purchase of securities held to maturity | (3,001 |
| Proceeds from maturities and calls of securities held to maturity | 20,999 |
| Proceeds from principal paydowns of securities held to maturity | 1,970 |
| Purchase of securities available for sale | (51,439 |
| Proceeds from maturities and calls of securities available for sale | 7,500 |
| Proceeds from principal paydowns of securities available for sale | 2,206 |
| Proceeds from sales of securities available for sale | -- |
| Net increase in loans | (14,543 |
| Proceeds from sales of loans | 1,918 |
| Purchase (redemption) of Federal Home Loan Bank stock | (779 |
| Purchase of premises and equipment | (28 |
| Net Cash Used By Investing Activities | (35,197 |
| Cash Flows From Financing Activities | |
| Net increase in deposits | 13,206 |
| Net decrease in short term borrowings | -- |
| Proceeds from borrowings | 21,500 |
| Repayments on borrowings | (4,459 |
| Net increase (decrease) in advances from borrowers for taxes and insurance | (913 |
| Net increase in official bank checks | 2,827 |
| Net proceeds from common stock offering | -- |
| Purchase of shares for employee stock ownership program | -- |
| Net Cash Provided By Financing Activities | 32,161 |
| Net Increase (Decrease) in Cash and Cash Equivalents | (2,847 |
| Cash and Cash Equivalents- Beginning | 9,444 |
| Cash Equivalents- End | $ 6,597 |

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Cash Flows, Continued

| | 2008 |
|---|---|
| Supplementary Cash Flows Information | |
| Interest paid | $ 4,536 |
| Income taxes paid | $ 1 |
| Non-Cash Operating, Investing and Financing Activities | |

| | |
|---|---|
| Transfer of loans to foreclosed assets | $ - |

See accompanying notes to consolidated financial statements

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Notes to Consolidated Financial Statements

Note 1-Basis of Presentation

The accompanying unaudited consolidated financial statements of FSB Community Bankshares, Inc., and its wholly owned subsidiary (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes necessary for a complete presentation of consolidated financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

The unaudited consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with the Company's audited financial statements for the years ended December 31, 2007 and 2006, included in the Annual Report filed on Form 10-KSB with the Securities and Exchange Commission ("SEC") on March 31, 2008.

Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The consolidated financial statements at September 30, 2008 and December 31, 2007 and for the three and nine months ended September 30, 2008 and 2007 include the accounts of the Company, Fairport Savings Bank (the "Bank") and the Bank's wholly-owned subsidiary, Oakleaf Services Corporation ("Oakleaf"). All inter-company balances and transactions have been eliminated in consolidation. Certain amounts from prior periods have been reclassified, when necessary, to conform to current period presentation.

Note 2-Fair Value Accounting

In September 2006, the FASB issued FASB Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The Company adopted SFAS 157 on January 1, 2008.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or

liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows at September 30, 2008:

| (Dollars in Thousands) | Total | Level 1 | Level 2 |
|---|---|---|---|
| Securities available for sale | $41,386 | $ -- | $41,386 |

The fair values for available-for-sale securities in the table above were based upon a market approach. Securities that are fixed income instruments that are not quoted on an exchange, but are traded in active markets, are obtained through third party data service providers or dealer market participants which the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include market quotations.

Securities are evaluated periodically to determine whether a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable. Once a decline in fair value is determined to be other than temporary the cost basis of the security is reduced through a charge to earnings in the consolidated statement of income.

At September 30, 2008, the Company recorded a $57,000 other-than-temporary impairment charge related to its investment in Federal Home Loan Mortgage Corporation (Freddie Mac) common stock. The impairment charge in the Company's holdings of Freddie Mac common stock resulted from the decline in market value of these shares in connection with the federal government's conservatorship of Freddie Mac in September 2008. The carrying value of the Company's remaining Freddie Mac common stock at September 30, 2008 after the other-than-temporary impairment charge was $8,757. The Company does not have any preferred stock issued by Freddie Mac or Fannie Mae.

Note 3-Recent Accounting Pronouncements

In October 2008, the FASB issued FSP SFAS No. 157-3, "Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active" (FSP 157-3), to clarify the application of the provisions of SFAS 157 in an inactive market

and how an entity would determine fair value in an inactive market. FSP 157-3 is effective immediately and applies to the Company's September 30, 2008 consolidated financial statements. The application of the provisions of FSP 157-3 did not materially affect the Company's results of operations or financial condition as of and for the period ended September 30, 2008.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

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Note 4-Comprehensive Income (Loss)

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the stockholders' equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income (loss).

The components of other comprehensive loss and related tax effects for the three and nine months ended September 30, 2008 and 2007 are as follows:

| | For the Three Months Ended September 30, | | For the Ni Sept |
|---|---|---|---|
| | 2008 | 2007 | 2008 |
| Unrealized holding loss on securities available for sale | $ (72) | $ (9) | $ (395) |
| Reclassification adjustment for realized gains included in net loss | -- | (81) | -- |
| Reclassification adjustment for impairment loss on securities available-for-sale included in net loss | 57 | -- | 57 |
| Net unrealized loss | (15) | (90) | (338) |
| Tax effect | 7 | 31 | 118 |
| Net of tax amount | $ (8) | $ (59) | $ (220) |

Note 5- Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is calculated by dividing the net income (loss) by the weighted-average number of common shares outstanding during the period. The common shares issued to FSB Community Bankshares, MHC of 946,050 are assumed to be outstanding for all periods presented, consistent with the provisions of SFAS No. 128, Earnings per Share, pertaining to changes in capital

structure. The 838,950 shares issued to the public are included in the weighted average common shares outstanding calculation only from the date such shares were issued. The Company has not granted any restricted stock awards or stock options and, during the nine months ended September 30, 2008 and 2007, had no potentially dilutive common stock equivalents. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating basic earnings (loss) per common share until they are released. The basic average common shares outstanding were 1,718,526 for the three months and nine months ended September 30, 2008 and 1,380,690 for the three months ended September 30, 2007 and 1,092,522 for the nine months ended September 30, 2007.



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

### General

Throughout the Management's Discussion and Analysis ("MD&A"), the term "the Company" refers to the consolidated entity of FSB Community Bankshares, Inc., Fairport Savings Bank, and Oakleaf Services Corporation, a wholly owned subsidiary of Fairport Savings Bank. At September 30, 2008, FSB Community Bankshares, MHC the Company's mutual holding company parent, held 946,050 shares, or 53.0%, of the Company's common stock, engaged in no significant activities and was not included in the MD&A.

### Forward Looking Statements

This Quarterly Report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in economic conditions including real estate values in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market areas and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

### Critical Accounting Policies

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements ("the Consolidated Financial Statements") included in the Company's Annual Report filed on Form 10-KSB with the Securities and Exchange Commission on March 31, 2008. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying

those amounts, management has identified the determination of the allowance for loan losses and the evaluation of investment securities for other that temporary impairment to be the accounting areas that require the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available.

Allowance for Loan Losses. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. The amount of the allowance is based on significant estimates, and the ultimate losses may vary from such estimates as more information becomes available or conditions change. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions used and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial percentage of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are



critical in determining the amount of the allowance required for specific loans. Assumptions are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. Management carefully reviews the assumptions supporting such appraisals to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

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

Actual loan losses may be significantly more than the allowance we have established which could have a material negative effect on our financial results.

The Company carries most of its investments at fair value with any unrealized gains or losses on those securities reported net of tax as an adjustment to stockholders' equity, except for other-than-temporary impairment losses, which are charged to earnings. All securities purchased in 2008, other than $3.0 million of United States Government agency securities purchased in January 2008, have been classified as securities available for sale. The Company's ability to

fully realize the value of its investments in various securities is dependent on the underlying creditworthiness of the issuing organizations. In evaluating the security portfolio for other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2008, the Company recorded a $57,000 other-than-temporary impairment charge related to it's investment in Federal Home Loan Mortgage Corporation (Freddie Mac) common stock. The impairment charge in the Company's holdings of Freddie Mac common stock resulted from the decline in market value of these shares in connection with the federal government's conservatorship of Freddie Mac in September 2008. The carrying value of the Company's remaining Freddie Mac common stock at September 30, 2008 after the other-than-temporary impairment charge was $8,757. The Company does not have any preferred stock issued by Freddie Mac or Fannie Mae.

Comparison of Financial Condition at September 30, 2008 and December 31, 2007

Total Assets. Total assets increased by $31.9 million, or 19.0%, to $199.5 million at September 30, 2008 from $167.6 million at December 31, 2007. The primary increase in total assets reflected increases in securities and loans receivable, partially offset with decreases in cash and cash equivalents.

Cash and cash equivalents decreased by $2.8 million, or 29.8% to $6.6 million on September 30, 2008 from $9.4 million on December 31, 2007. With the Federal Reserve decreasing short term interest rates 325 basis points from 5.25% to 2.00% since September 2007, management decided to invest excess interest earning demand deposits in higher yielding securities and loans.

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Securities increased by $21.2 million, or 73.6%, to $50.0 million at September 30, 2008 from $28.8 million at December 31, 2007. The increase was attributable to the purchase of $33.9 million of United States Government agency securities, purchases of $20.5 million of mortgage-backed securities, partially offset with maturities of $28.5 million of United States Government agency securities, $4.2 million of principal payments received from mortgage-backed securities, and a $395,000 decrease in the fair value of securities available for sale. In February 2008, the Company executed a $14.6 million mortgage-backed securities balance sheet leverage strategy in an effort to increase earnings that is performing as projected at the time of the transaction. All securities purchased in 2008, other than $3.0 million of United States Government agency securities purchased in January 2008, have been classified as securities available for sale. Management made the decision to increase the securities classified as available for sale providing a portfolio of marketable securities for liquidity as an alternative to borrowings.

Investment in FHLB of New York stock increased by $779,000 or 55.5% to $2.2 million at September 30, 2008, from $1.4 million at December 31, 2007. The FHLB of New York requires members to purchase stock based on the level of borrowings.

Loans receivable increased by $12.6 million, or 10.2%, to $136.9 million at September 30, 2008 from $124.3 million at December 31, 2007. The increase in loans receivable was primarily the result of increases in net residential mortgage loans totaling $13.2 million, home equity loan and line increases totaling $1.1 partially offset by sales of fixed rate 30 year residential mortgages totaling $1.7 million. The Bank has never been involved with, and has no direct exposure to, sub-prime lending activities. The Bank continues to

execute on its business plan of making high quality loans to existing customers and new customers in our market area with $5.1 million, or 15.3% annualized loan growth in the third quarter of 2008. Our loan strategy continues to be in residential mortgage, home equity loan and home equity line of credit originations which provide a higher yield than alternative investment yields. Credit quality, proven by our lack of non-accruals continues to be the highest priority when underwriting a loan. Subjective judgments about a borrower's ability to repay and the value of any underlying collateral are made prior to approving a loan.

Deposits and Borrowings. Total deposits increased by $13.2 million, or 11.1%, to $132.4 million at September 30, 2008 from $119.2 million at December 31, 2007. Certificates of deposit, including IRAs, increased by $7.0 million. Transaction accounts, including checking, NOW, money market and savings accounts, increased by $6.2 million. The net deposit growth was attributable to the Irondequoit branch growth of $6.0 million, Fairport branch growth of $3.6 million and Penfield branch growth of $3.6 million.

Borrowings increased by $17.0 million, or 66.4%, to $42.6 million at September 30, 2008 from $25.6 million on December 31, 2007. The increase in borrowings included $14.6 million as part of the balance sheet leverage strategy executed in February 2008.

Official Bank Checks. Official bank checks increased by $2.8 million, or 551.1%, to $3.3 million at September 30, 2008 from $513,000 at December 31, 2007. This increase was caused by the payment of property taxes due at September 30, 2008 from customer mortgage escrow accounts.

Stockholders' Equity. Total stockholders' equity decreased by $293,000 or 1.5%, to $19.9 million at September 30, 2008 from $20.1 million at December 31, 2007. The decrease resulted principally from a net loss of $95,000 for the nine months ended September 30, 2008, and a $220,000 decrease in accumulated other comprehensive income (loss).

Non-Performing Assets. At September 30, 2008, the Company had no non-performing assets compared to $63,000 in one-to-four-family residential mortgage loans classified as non-performing assets at December 31, 2007.

At September 30, 2008, there were no loans or other assets that are not



disclosed or disclosed as classified or special mention, where known information about possible credit problems of borrowers caused us to have serious doubts as to the ability of the borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans in the future.

Average balances and yields. The following tables set forth average balance sheets, average yields and costs, and certain other information at and for the periods indicated. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, where applicable, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income. Yields have been annualized.

| | For the Three Months Ended September 30, | |
|---|---|---|
| | 2008 | 2007 |

| | Average Balance | Interest Income Expense | Yield/ Cost | Average Balance | Interest Income Expense |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| Interest-earning assets: | | | | | |
| Loans......................... | $ 134,873 | $ 1,962 | 5.82% | $ 121,315 | $ 1,819 |
| Securities.................... | 29,211 | 350 | 4.79 | 22,011 | 293 |
| Mortgage-backed securities.... | 24,997 | 288 | 4.61 | 7,221 | 76 |
| Other......................... | 3,063 | 14 | 1.83 | 9,229 | 120 |
| Total interest-earning assets | 192,144 | 2,614 | 5.44% | 159,776 | 2,308 |
| Non-interest-earning assets... | 5,554 | | | 7,242 | |
| Total assets.............. | $ 197,698 | | | $ 167,018 | |
| Interest-bearing liabilities: | | | | | |
| NOW accounts.................. | $ 7,776 | $ 24 | 1.23% | 6,336 | 10 |
| Passbook savings.............. | 14,248 | 32 | .90 | 17,913 | 56 |
| Money market savings......... | 11,860 | 57 | 1.92 | 10,681 | 79 |
| Individual retirement accounts | 16,339 | 177 | 4.33 | 16,021 | 181 |
| Certificates of deposit....... | 75,916 | 708 | 3.73 | 70,975 | 820 |
| Borrowings.................... | 44,838 | 465 | 4.15% | 19,838 | 241 |
| Total interest-bearing liabilities............. | 170,977 | 1,463 | 3.42% | 141,764 | 1,387 |
| Non-interest-bearing liabilities: | | | | | |
| Demand deposits............... | 3,220 | | | 3,222 | |
| Other......................... | 3,671 | | | 2,079 | |
| Total liabilities........ | 177,868 | | | 147,065 | |
| Stockholders' equity.......... | 19,830 | | | 19,953 | |
| Total liabilities and stockholders' equity..... | $ 197,698 | | | $ 167,018 | |
| Net interest income........... | | $ 1,151 | | | $ 921 |
| Interest rate spread (1)...... | | | 2.02% | | |
| Net interest-earning assets (2) | $ 21,167 | | | $ 18,012 | |
| Net interest margin (3)....... | | 2.40% | | | 2.31 |
| Average interest-earning assets to average interest-bearing liabilities................ | 112% | | | 113% | |

(1) Interest rate spread represents the difference between the yield on average interest-earning interest-bearing liabilities.
(2) Net interest-earning assets represent total interest-earning assets less total interest-bear
(3) Net interest margin represents net interest income divided by total interest-earning assets.

| | For the Three Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2008 | | | 2007 | |
| | Average Balance | Interest Income Expense | Yield/ Cost | Average Balance | Interest Income Expense |
| | (Dollars in thousands) | | | | |
| Interest-earning assets: | | | | | |
| Loans......................... | $ 128,300 | $ 5,626 | 5.85% | $ 120,622 | $ 5,394 |
| Securities.................... | 29,018 | 1,033 | 4.75 | 20,067 | 770 |
| Mortgage-backed securities.... | 23,138 | 792 | 4.56 | 6,339 | 199 |
| Other......................... | 5,055 | 104 | 2.74 | 4,322 | 167 |
| Total interest-earning assets | 185,511 | 7,555 | 5.43% | 151,350 | 6,530 |
| Non-interest-earning assets... | 5,122 | | | 5,636 | |
| Total assets............... | $ 190,633 | | | $ 156,986 | |
| Interest-bearing liabilities: | | | | | |
| NOW accounts.................. | $ 6,733 | $ 51 | 1.01% | $ 5,537 | $ 26 |
| Passbook savings.............. | 13,984 | 103 | .98 | 14,542 | 132 |
| Money market savings......... | 11,307 | 176 | 2.08 | 10,498 | 225 |
| Individual retirement accounts | 16,246 | 538 | 4.42 | 15,578 | 225 |
| Certificates of deposit....... | 75,456 | 2,337 | 4.13 | 68,234 | 2,279 |
| Borrowings.................... | 40,774 | 1,274 | 4.17 | 21,519 | 786 |
| Total interest-bearing liabilities............. | 164,500 | 4,479 | 3.63% | 135,908 | 3,959 |
| Non-interest-bearing liabilities: | | | | | |
| Demand deposits......... | 3,202 | | | 3,197 | |
| Other......................... | 2,904 | | | 2,294 | |
| Total liabilities........ | 170,606 | | | 141,399 | |
| Stockholders' equity.......... | 20,027 | | | 15,587 | |
| Total liabilities and stockholders' equity..... | $ 190,633 | | | $ 156,986 | |
| Net interest income........... | | $ 3,076 | | | $ 2,571 |
| Interest rate spread (1)...... | | | 1.80% | | |
| Net interest-earning assets (2) | $ 21,011 | | | $ 15,442 | |
| Net interest margin (3)....... | | 2.21 | | | 2.26 |
| Average interest-earning assets to average interest-bearing liabilities................ | 113% | | | 111% | |

Comparison of Operating Results for the Three Months Ended September 30, 2008 and September 30, 2007

General. We had net income of $1,000 for the three months ended September 30, 2008 compared to a net loss of $1,000 for the three months ended September 30, 2007. The increase of $2,000 in net income for the third quarter of 2008 compared to the third quarter of 2007 resulted primarily from an increase in net interest income of $230,000, partially offset by an increase in provision for loan losses of $8,000, decrease in other income of $80,000, increase of other expenses of $106,000, and increase in income tax expense of $34,000. The increase in net interest income was the result of a steepened yield curve that positively impacted the net interest margin increasing to 2.40% in the third quarter of 2008 compared to a 2.31% net interest margin in the third quarter of 2007. The improved net interest margin resulted primarily from an improved yield from mortgage backed securities, the benefit of a higher percentage of earning assets deployed in higher yielding loan assets, and lower funding costs. Securities are evaluated periodically to determine whether a decline in their fair value is other than temporary. At September 30, 2008, the Company recorded a $57,000 other-than-temporary impairment loss related to its investment in Freddie Mac common stock.

Interest and Dividend Income. Interest and dividend income increased by $306,000 or 13.3%, to $2.6 million for the three months ended September 30, 2008 from $2.3 million for the three months ended September 30, 2007. The increase in interest and dividend income resulted from a $143,000 or 7.9%, increase in interest income from loans, a $57,000 or 19.5%, increase in interest income from securities, a $212,000 or 278.9% increase in interest income from mortgage-backed securities, offset by a $106,000 or 88.3% decrease in other interest income, primarily interest earning demand accounts. Average interest-earning assets increased by $32.3 million, or 20.2%, to $192.1 million for the three months ended September 30, 2008 from $159.8 million for the three months ended September 30, 2007. The yield on interest-earning assets decreased by 34 basis points to 5.44% for the three months ended September 30, 2008 compared to 5.78% for the three months ended September 30, 2007, reflecting the effect of the 325 basis point drop in interest rates by the Federal Reserve since September 2007.

Interest Expense. Interest expense increased $76,000 or 5.5%, to $1.5 million for the three months ended September 30, 2008 from $1.4 million for the three months ended September 30, 2007. The increase in interest expense resulted from an increase in the average balances in interest-bearing liabilities which was mitigated by the lower rates paid on these liabilities. The average balance of interest-bearing liabilities increased $29.2 million, or 20.6%, to $171.0 million for the three months ended September 30, 2008 compared to $141.8 million for the three months ended September 30, 2007. The average cost of interest-bearing liabilities decreased by 49 basis points to 3.42% for the three months ended September 30, 2008 from 3.91% for the three months ended September 30, 2007. The average cost of deposit accounts decreased by 60 basis points to 3.16% for the three months ended September 30, 2008 compared to 3.76% for the three months ended September 30, 2007. The average cost of borrowings decreased by 71 basis points to 4.15% for the three months ended September 30, 2008 compared to 4.86% for the three months ended September 30, 2007. The increase in interest expense reflects a higher volume of deposits and borrowings.

At September 30, 2008, we had $33.3 million of certificates of deposit, including individual retirement accounts that will mature during the fourth quarter of 2008 with a weighted average cost of 3.85%. Based on current market rates, if these funds remain with Fairport Savings Bank, the rates we pay on these deposits will remain similar, depending on the maturity term.

Net Interest Income. Net interest income increased $230,000 or 25.0%, to

$1.2 million for the three months ended September 30, 2008 from $921,000 for the three months ended September 30, 2007. The increase in net interest income was due primarily to an increase in average interest-earning assets of $3.2 million



more than interest-bearing liabilities, due to the investment of the proceeds of the initial stock offering that closed in August 2007. The improved net interest margin resulted primarily from an improved yield from mortgage backed securities, the benefit of a higher percentage of earning assets deployed in higher yielding loan assets, and lower funding costs. The Company's net interest margin increased 9 basis points to 2.40% for the three months ended September 30, 2008 from 2.31% for the three months ended September 30, 2007. The increase in net interest margin was also attributable to the effect of a normal yield curve in 2008 compared to the effect of the flat or inverted yield curve that existed for much of 2007. If the current interest rate environment remains relatively stable through the remainder of 2008, we anticipate modest improvement in our net interest margin with certificates of deposits maturing and renewing at similar interest rates, and new loan volume added at higher interest rates.

Provision for Loan Losses. Based on management's evaluation of the factors that determine the level of the allowance for loan losses, we recorded $8,000 in provision for loan losses for the three month period ended September 30, 2008 compared to no provision for loan losses for the three months ended September 30, 2007. The allowance for loan losses as of September 30, 2008 was $335,000 or ..24% of total loans, compared to $319,000 or .26% of total loans as of September 30, 2007. We ended the quarter with no non-accrual loans as of September 30, 2008 compared to $100,000 or .08% of loans in non-accrual loan status as of September 30, 2007. We had $41,000 in foreclosed real estate as of September 30, 2007 and no foreclosed real estate as of September 30, 2008.

Other Income. Total other income decreased $80,000 or 47.3%, to $89,000 for the three months ended September 30, 2008 compared to $169,000 for the three months ended September 30, 2007. In the three months ended September 2007, there was an $81,000 gain on sale of available for sale securities compared to no gain on sale of available for sale securities in 2008. In the three months ended September 30, 2008, the Company recorded a $57,000 other-than-temporary impairment loss related to its investment in Freddie Mac common stock. The decrease was partially offset by a $30,000 increase in checking account service charge fees associated with the courtesy overdraft protection at point of sale and ATM's, and an increase of $28,000 in commissions from Oakleaf Services insurance/annuity and security sales.

Other Expenses. Other expenses increased $106,000, or 9.7%, to $1.2 million for the three months ended September 30, 2008 compared to $1.1 million for the three months ended September 30, 2007. The increase was the primary result of an increase of $61,000 in salaries and benefits expense primarily due to annual cost of living raises effective January 1 of each year, and $41,000 in mortgage fees and taxes with additional mortgage volume.

The Federal Deposit Insurance Corporation ("FDIC") imposes an assessment against institutions for deposit insurance. This assessment is based on the risk category of the institution and ranges from 5 to 43 basis points of the institution's deposits. Federal law requires that the designated reserve ratio for the deposit insurance fund be established by the FDIC at 1.15% to 1.50% of estimated insured deposits. If this reserve ratio drops below 1.15% or the FDIC expects it to do so within six months, the FDIC must, within 90 days, establish and implement a plan to restore the designated reserve ratio to 1.15% of estimated insured deposits within five years (absent extraordinary circumstances).

Recent bank failures coupled with deteriorating economic conditions have significantly reduced the deposit insurance fund's reserve ratio. As of June 30, 2008, the designated reserve ratio was 1.01% of estimated insured deposits at March 31, 2008. As a result of this reduced reserve ratio, on October 16, 2008, the FDIC published a proposed rule that would restore the reserve ratios to its required level. The proposed rule would raise the current deposit insurance assessment rates uniformly for all institutions by 7 basis points (to a range from 12 to 50 basis points) for the first quarter of 2009. The proposed rule would also alter the way the FDIC calculates federal deposit insurance assessment rates beginning in the second quarter of 2009 and thereafter.

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Under the proposed rule, the FDIC would first establish an institution's initial base assessment rate. This initial base assessment rate would range, depending on the risk category of the institution, from 10 to 45 basis points. The FDIC would then adjust the initial base assessment (higher or lower) to obtain the total base assessment rate. The adjustments to the initial base assessment rate would be based upon an institution's levels of unsecured debt, secured liabilities, and brokered deposits. The total base assessment rate would range from 8 to 77.5 basis points of the institution's deposits. There can be no assurance that the proposed rule will be implemented by the FDIC or implemented in its proposed form.

In addition, the Emergency Economic Stabilization Act of 2008 (EESA) temporarily increased the limit on FDIC insurance coverage for deposits to $250,000 through December 31, 2009, and the FDIC took action to provide coverage for newly issued senior unsecured debt and non-interest bearing transaction accounts in excess of the $250,000 limit, for which institutions will be assessed additional premiums.

These actions will increase the Company's non-interest expense in 2009 and in future years as long as the increased premiums are in place.

Income Tax Expense/Benefit. We had pre-tax income of $35,000 for the three months ended September 30, 2008 versus a pre-tax loss of $1,000 for the three months ended September 30, 2007, which resulted in a $34,000 tax expense for the three months ended September 30, 2008, versus no taxes recorded for the three months ended September 30, 2007, a change of $34,000. The effective tax rate was 97.1% for the three months ended September 30, 2008 compared to no taxes for the three months ended September 30, 2007. There was no tax benefit recognized as a result of the $57,000 other-than-temporary impairment loss recorded on September 30, 2008. For tax purposes, this loss is considered to be a capital loss. Given the Company's lack of current and expected capital income, the Company has concluded that it is unlikely the tax benefit of the loss will be utilized.

Comparison of Operating Results for the Nine Months Ended September 30, 2008 and September 30, 2007

General. We had a net loss of $95,000 for the nine months ended September 30, 2008 compared to a net loss of $248,000 for the nine months ended September 30, 2007. The improvement was attributable to an increase in net interest income of $505,000, partially offset by an increase in other expenses of $206,000, a decrease in other income of $14,000, a provision for loan losses of $14,000, and a decrease in income tax benefit of $118,000. The net interest income improvement for the nine months ended September 30, 2008 was generated by an increase in interest-earning assets due to the investment of the proceeds of our initial stock offering that closed in August 2007, the $14.6 million balance sheet leverage transaction in February 2008, the benefit of a higher percentage of earning assets deployed in higher yielding loan assets, and lower funding costs due to a steepened yield curve.

Interest and Dividend Income. Interest and dividend income increased by

$1.1 million, or 16.9% to $7.6 million for the nine months ended September 30, 2008 from $6.5 million for the nine months ended September 30, 2007. The increase in interest and dividend income resulted primarily from a $232,000 or 4.3%, increase in interest income from loans, a $263,000 or 34.2%, increase in interest income from securities, a $593,000 or 298.0% increase in interest income from mortgage-backed securities, offset by a $63,000 or 37.7% decrease in interest income from other sources. Average interest-earning assets increased by $34.2 million, or 22.6%, to $185.5 million for the nine months ended September 30, 2008 from $151.3 million for the nine months ended September 30, 2007. The yield on interest earning assets decreased by 32 basis points to 5.43% for the nine months ended September 30, 2008 compared to 5.75% for the nine months ended September 30, 2007, reflecting the effect of the 325 basis point drop in interest rates by the Federal Reserve since September 2007.

Interest Expense. Interest expense increased $520,000 or 13.1%, to $4.5 million for the nine months ended September 30, 2008 from $4.0 million for the nine months ended September 30, 2007. The increase in interest expense resulted from an increase in average balances in interest-bearing liabilities of $28.6

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million, or 21.0%, to $164.5 million for the nine months ended September 30, 2008 compared to $135.9 million for the nine months ended September 30, 2007. The average cost of interest-bearing liabilities decreased by 25 basis points to 3.63% for the nine months ended September 30, 2008 from 3.88% for the nine months ended September 30, 2007. The average cost of deposit accounts decreased by 25 basis points to 3.45% for the nine months ended September 30, 2008 compared to 3.70% for the nine months ended September 30, 2007. In addition, the average cost of borrowings decreased by 70 basis points to 4.17% for the nine months ended September 30, 2008 compared to 4.87% for the nine months ended September 30, 2007. The interest expense increase was the result of increased volume in both deposits and borrowings.

Net Interest Income. Net interest income increased $505,000 or 19.6%, to $3.1 million for the nine months ended September 30, 2008 from $2.6 million for the nine months ended September 30, 2007. The increase in net interest income was due primarily to an increase of interest bearing assets of $5.6 million more than interest bearing liabilities. The average cost of our interest-bearing liabilities decreased by 25 basis points, while the average yield on our interest-earning assets decreased by 32 basis points, as the deposit growth of the Bank has primarily been in time deposits, which carry higher costs than other deposit alternatives. Our net interest margin decreased by 5 basis points to 2.21% for the nine months ended September 30, 2008 from 2.26% for the nine months ended September 30, 2007.

Provision for Loan Losses. Based on management's evaluation of the factors that determine the level of the allowance for loan losses, we recorded a $14,000 provision for loan losses for the nine month period ended September 30, 2008 compared to no provision for loan losses for the nine month period ended September 30, 2007. We continue to maintain exceptional credit quality within our loan portfolio with no charge-offs recorded within the reporting period. The allowance for loan losses as of September 30, 2008 was $335,000 or .24% of total loans, compared to $319,000 or .26% of total loans as of September 30, 2007. We had no non-accrual loans as of September 30, 2008 compared to $100,000 or .08% of loans in non-accrual status as of September 30, 2007.

Other Income. Other income decreased $14,000 or 4.3%, to $314,000 for the nine months ended September 30, 2008 compared to $328,000 for the nine months ended September 30, 2007. The decrease in other income was primarily the result of the impairment loss on securities available for sale recorded in the third quarter of 2008 of $57,000 and an $81,000 gain on sale of available for sale securities in the third quarter of 2007 compared to no gain on sale of

securities available for sale in 2008. The decrease is offset by a $40,000 increase in our Oakleaf subsidiary revenue and a $55,000 increase in Service fees from an increase in checking account service charge fees associated with the courtesy overdraft protection at point of sale and ATM's.

Other Expenses. Other expenses increased $206,000 or 6.3%, to $3.5 million for the nine months ended September 30, 2008 compared to $3.3 million for the nine months ended September 30, 2007. The increase was mainly the result of an additional $72,000 in salaries and benefits expense primarily due to annual cost of living raises effective January 1 of each year, a $66,000 increase in mortgage fees and taxes due to increased loan volume, a $21,000 increase in occupancy expense due to property taxes, an increase of $67,000 in other expenses, including legal fees, primarily due to increased costs associated with being a newly registered public company.

Income Tax Benefit. We had a pre-tax loss of $115,000 for the nine months ended September 30, 2008 versus a pre-tax loss of $386,000 for the nine months ended September 30, 2007, which resulted in a $20,000 tax benefit for the nine months ended September 30, 2008, versus a $138,000 tax benefit for the nine months ended September 30, 2007, a change of $118,000. The effective tax rate was (17.4%) for the nine months ended September 30, 2008 compared to (35.8%) for the nine months ended September 30, 2007. There was no tax benefit recognized as a result of the $57,000 other-than-temporary impairment loss recorded on September 30, 2008. For tax purposes, this loss is considered to be a capital loss. Given the Company's lack of current and expected capital income, the Company has concluded that it is unlikely the tax benefit of the loss will be utilized.



Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, advances from the Federal Home Loan Bank of New York, maturities and principal repayments of securities, and recently, but to a lesser extent, loan sales. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our asset/liability management committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We seek to maintain a liquidity ratio of 10.0% or greater. For the quarter ended September 30, 2008, our liquidity ratio averaged 19.6%. We believe that we have enough sources of liquidity to satisfy our short and long-term liquidity needs as of September 30, 2008.

We regularly adjust our investments in liquid assets based upon our assessment of:

(i) expected loan demand;

(ii) expected deposit flows;

(iii) yields available on interest-earning deposits and securities; and

(iv) the objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits,

short-term and intermediate-term securities and federal funds sold.

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At September 30, 2008, cash and cash equivalents totaled $6.6 million.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our Consolidated Financial Statements.

At September 30, 2008, we had $3.6 million in loan commitments outstanding. In addition to commitments to originate loans, we had $7.7 million in unused lines of credit to borrowers. Certificates of deposit, including individual retirement accounts comprised solely of certificates of deposits, due within one year of September 30, 2008 totaled $58.3 million, or 62.6% of our certificates of deposit and 44.1% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds including loan sales, other deposit products, including certificates of deposit, and Federal Home Loan Bank advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2009. We believe, however, based on past experience that a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activity is and will continue to be originating loans. During the nine months ended September 30, 2008, we originated $26.6 million of loans.



Financing activities consist primarily of activity in deposit accounts and Federal Home Loan Bank borrowings. We experienced a net increase in total deposits of $3.2 million for the quarter ended September 30, 2008. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of New York, which provides an additional source of funds. Federal Home Loan Bank borrowings increased by $17.0 million to $42.6 million for the nine months ended September 30, 2008, compared to a net decrease of $8.2 million to $19.8 million for the nine months ended September 30, 2007. Federal Home Loan Bank borrowings have primarily been used to fund loan demand; however $14.6 million of advances were used to fund the balance sheet leverage transaction. At September 30, 2008, we had the ability to borrow approximately $103.3 million from the Federal Home Loan Bank of New York, of which $42.6 million had been advanced.

Fairport Savings Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At September 30, 2008, Fairport Savings Bank exceeded all regulatory capital requirements, and was considered "well capitalized" under regulatory guidelines.

The net proceeds from our 2007 minority stock offering significantly increased our liquidity and capital resources. Over time, the initial level of liquidity will be reduced as net proceeds from the stock offering are used for general corporate purposes, including the funding of loans. Our financial condition and

results of operations will be enhanced by the net proceeds from the stock offering, resulting in increased net interest-earning assets and net interest income. However, due to the increase in equity resulting from the net proceeds raised in the stock offering, our return on equity was adversely affected following the stock offering.

Off-Balance Sheet Arrangements

In the ordinary course of business, the Bank is a party to credit-related financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit. We follow the same credit policies in making commitments as we do 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 condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by us, is based on our credit evaluation of the customer.

At September 30, 2008 and 2007, we had $3.6 million and $2.9 million, respectively, of commitments to grant loans, and $7.7 million and $7.7 million, respectively, of unfunded commitments under lines of credit.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable since the Company is a smaller reporting company.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the



effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no significant changes made in the Company's internal control over financial reporting or in other factors that could significantly affect the Company's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II - Other Information

Item 1. Legal Proceedings

The Company and its subsidiaries are subject to various legal actions

arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's financial condition or results of operations.

Item 1A. Risk Factors

Not applicable since the Company is a smaller reporting company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) There were no sales of unregistered securities during the period covered by this Report.

(b) Not applicable.

(c) There were no issuer repurchases of securities during the period covered by this Report.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

The following exhibits are either filed as part of this report or are incorporated herein by reference:

3.1 Charter of FSB Community Bankshares, Inc.*
3.2 Bylaws of FSB Community Bankshares, Inc.*



4 Form of Common Stock Certificate of FSB Community Bankshares, Inc.*
10.1 Amended and Restated Employment Agreement between FSB Community Bankshares, Inc. and Dana C. Gavenda**
10.2 Supplemental Executive Retirement Plan*
10.3 Form of Employee Stock Ownership Plan*
31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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* Filed as exhibits to the Company's Registration Statement on Form SB-2, and any amendments thereto, with the Securities and Exchange Commission (Registration No. 333-141380).

** Filed as an exhibit to the Company's Current Report on form 8-K filed

with the Securities and Exchange Commission on September 25, 2008.



SIGNATURES

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

FSB COMMUNITY BANKSHARES, INC.

Date: November 13, 2008

/s/ Dana C. Gavenda
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Dana C. Gavenda
President and Chief Executive Officer

Date: November 13, 2008

/s/ Kevin D. Maroney
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Kevin D. Maroney
Executive Vice President and Chief Financial Officer