



STAYING THE COURSE



THE VICTORY BANK STATEMENT OF PURPOSE

We exist to optimize the financial lives of our clients.

The Victory Bank Client Experience

is defined by fairness and good advice, by convenience, speed and responsiveness, and by integrity and respect.

VALUES

The Victory Bank Team achieves success through high personal and corporate character, by sharing valuable experience and knowledge, and by exhibiting consistent, daily behavior that benefits our clients.

We value:

- **Extraordinary Personal Service** – Every client contact is an opportunity to better our clients' lives, leaving them feeling valued, important and satisfied. Perfection of **The Victory Bank Client Experience** is our inspiration.
- **Ethical Behavior** – We always strive to do what is right and best for the long-term interests of our clients, team members and shareholders.
- **Personal and Corporate Integrity** – Our values stand the challenges of business, and the tests of time. We do not compromise our values for personal or corporate gain.
- **Candor** – Open, honest and direct communication is expected throughout the organization regardless of title or position. Pollution of our work environment with gossip and negativity is not acceptable.
- **Respect for All** – We conduct business so that all constituencies are served, regardless of age, gender, race, sexual preference, disability, religious or political views, and in a way that benefits our team members, our local communities and our shareholders.
- **Credibility** – We do what we promise.
- **Consistency and Excellence** – We love doing things right the first time, and are relentlessly committed to excellence.
- **Planning, Efficiency and Systematic Thinking** – We establish clear plans and goals, designed to ensure the success of the bank. We carefully consider the long-term implications of our decisions, and operate efficiently and without waste.
- **A Learning Organization** – We are committed to the never-ending improvement of our systems and technology, and to constantly bettering our individual knowledge and skills.
- **Creativity and Innovation** – We recognize and reward those team members who find better ways to do things. Change and experimentation are encouraged, and mistakes are viewed as opportunities to learn and improve. When things go wrong, we focus on solutions and learning rather than blame.
- **A Great Working Environment** – The safety and satisfaction of our team members is fundamental to meeting our goals. Our long-term goal is to make The Victory Bank the employer of choice.
- **Teamwork** – We recognize and celebrate the importance and power of teamwork, of working in a collaborative way where individual recognition is secondary to accomplishing the common good.

Ultimately, we measure our success through the outlook of our clients, whose total satisfaction assures corporate growth and financial success. Perfection is our inspiration.





TABLE OF CONTENTS

Letter from the Chairman and CEO	2
Independent Auditors' Report	5
Consolidated Balance Sheet	6
Consolidated Statement of Operations.	7
Consolidated Statement of Stockholders' Equity	8
Consolidated Statement of Cash Flows	9
Notes to Consolidated Financial Statements	10
Board of Directors	28
The Victory Bank Team	29



Introduction

Thousands of years ago, merchants using pack animals and the strength of their own backs set out on long expeditions, carrying spices, exotic foods, silks and oils, navigating along river valleys and over mountain ranges, through ever-changing weather and treacherous conditions, in the hopes of selling these goods for a small profit. While they sometimes used the sun, moon, and stars to guide their travels, they more commonly followed the simple dirt paths that lay before them, trodden into recognition over time by their predecessors, knowing that these proven paths led to their chosen destinations.

In our modern world, trucks, railroads, airplanes and gigantic ships laden with raw materials, clothing, produce, automobiles and every kind of consumer goods are in constant motion, guided by satellites and computers, able to avoid the worst kinds of weather and travel at high speeds across many thousands of miles from continent to continent and deliver billions of dollars of goods each day.

Despite these many technological changes, I would argue that in the most important way, *nothing about the merchant business has changed!* The value created to others by these modern merchants is not at all about available tonnage, modern navigation systems or the cost of fuel. The value of the business is still about **delivering the goods!** In other words, nobody on the receiving end thinks much about the logistics required in getting fresh blueberries to the market all the way from Chile – they just want to go in the market and buy berries of good quality at a fair price.

And so it is in banking.

Our customers are not looking for a fancy marketing slogan, technology so slick they don't know how to use it, or some kind of clever "brand," filled with promises we don't intend to keep. What they need is good advice, convenience, consistency, accuracy, and most importantly, the peace of mind they achieve banking with experienced local bankers they know and trust.

That is why The Victory Bank is here.

Great advice, consistent personal service and impeccable credibility are the goods we strive to deliver.



Joseph W. Major
Chairman and CEO

Like the time-worn trails followed by those ancient traders, the path we chose when we founded this bank was clear and straightforward – to build a local banking company focused on the needs of local businesses and professionals, and to do everything within our power to create a banking relationship molded around their needs and preferences, instead of what was convenient or easy for us as bankers. The path we chose obligates us to always consider the long term best interests of every client, in everything that we do.

We believe that if we do this in a most consistent way, if we **stay the course** we have chosen, our business will grow and prosper, and our shareholders will benefit from such growth and prosperity.

Key Success Factors

The Victory Bank focuses its efforts on these Key Success Factors:

- Clear Strategic Focus
- Management by Values
- Hiring, Training and Keeping Better Bankers
- “Golden Rule” Service
- State of the Art Technology
- Efficiency
- Our **Clear Strategic Focus** directs us to efficiently deliver loans, deposit products, cash management services and merchant services to small and medium sized businesses and professional practices, and to avoid the distraction of trying to be all things to all people.
- **Management by Values** means that we hire team members for whom the values listed in our Statement of Purpose resonate in a profound way, and that we use these values to govern our behavior and to lead us to making good decisions.
- **Hiring, Training and Keeping Better Bankers** is the foundation of our strategic approach to banking, and our most important differentiator.
- **“Golden Rule” Service** creates a strategic advantage for our bank as compared with many other financial services companies. Our focus is to always do what is right for our customers and treat them the way we wish to be treated.

- Our application of **State of the Art Technology** allows the bank to provide our clients with unmatched convenience and service, and to control costs.
- Our commitment to **Efficiency** drives us to operate in a careful, frugal manner, and to consider the revenue gain to be derived from any proposed expenditure.

Financial Results and Key Milestones

It is self-evident that the operating environment experienced by the bank has been far different than what we had expected during the planning phases for the bank in 2006/2007, with overall loan and deposit rates much lower than our forecasts, overall credit demand and credit quality extraordinarily lower than in the past, and yields on alternative investments also at historic lows. Given the reality of the fixed overhead required to run any bank (think buildings, computer systems, qualified people, legal fees, etc.), we had no choice but to grow the balance sheet in a manner designed to reach sustained profitability, all without taking dangerous risks in making loans, a challenging undertaking indeed given the treacherous external operating environment. The core of our success thus far is the creation of valuable relationships with local businesses and professionals, based upon knowing the marketplace and holding ourselves to traditional underwriting standards.

We are pleased to report that the bank enjoyed its first profitable month in October of 2010, and generated an overall profit of over \$200,000 during the fourth quarter consisting of core profits and tax benefits generated through the recapture of losses as offset against projected 2011 earnings. This was the 11th full quarter of operations, a point in time almost exactly in line with the original projections for reaching profitability. For the year 2010, we had budgeted a loss of \$613,562, but the actual loss was smaller at \$499,067.

We believe the bank has reached a size where it can be sustainably profitable, in essence to have “grown into” the fixed overhead burden, while maintaining overall quality in its credit and interest rate risk profiles. Please note the following financial highlights:

- Total Assets grew from \$55.6 million at December 31, 2009 to \$84.9 million at year-end 2010.
- Total Loans, net of the allowance for loan losses, increased \$27.0 million during 2010 to \$73.4 million.
- Deposit Growth of \$27.3 million to \$75.4 million during 2010.
- Growth in Net Interest Margin from 2.82% in 2009 to 3.74% during 2010.
- Net Interest Income more than doubled from \$1.1 million in 2009 to \$2.6 million in 2010.
- Non-Interest Income increased from \$134 thousand in 2009 to \$310 thousand in 2010.
- Asset Quality – The Bank’s allowance for loan losses to total loans increased slightly from 1.23% at December 31, 2009 to 1.26% a year later.
- The Bank’s Capital Ratios remain well in excess of regulatory requirements for Capital Adequacy Purposes and also to be considered Well Capitalized under Prompt Corrective Action Provisions.

Capital Raise

Banking is a highly regulated industry, perhaps more today than ever before. A common misconception is that banks can use their deposits and borrowings to fund all of their lending and investment activities; however, like all banks, The Victory Bank is required to keep a certain amount of capital on the balance sheet, usually derived from investors and from earnings retained over time. These various capital ratios are absolute limitations on the overall asset size of the company, and on how much risk it can take.

The Victory Bancorp conducted a small, private-placement stock offering in the fourth quarter of 2010, issuing a new class of convertible/preferred stock that is expected to pay a 7%, non-cumulative dividend, subject to quarterly regulatory approval and approval of the board. Prior to year-end, the company received additional capital of \$1.2 million from this offering. The Victory Bancorp retained approximately \$138 thousand of this raise at the holding company level, down-streaming the rest of the capital to the bank, to allow the bank to continue to follow its business plan and grow its overall asset size.

Because of market conditions and valuations on all bank stocks, it was necessary to establish a conversion price and dividend payout that would attract new capital into the bank, a valuation that was ultimately somewhat dilutive to the original investors. However, with this new capital on the balance sheet, we believe that the bank is well-positioned to continue its growth path well into the future.

Plans for 2011 and Beyond – Staying the Course

Fundamentally, the company plans to grow the balance sheet at a steady pace, remaining committed to its core strategy and values. Our budgets call for adding experienced commercial bankers and support staff so that we can provide our existing client base with excellent service and good advice, while adding new clients in a consistent pattern of

growth. Boiled down to its essence, we intend to “stay the course,” and use the recent infusion of capital to do “more of the same.”

We also believe there is great value in expanding our use of technology; many of our clients make almost all of their deposits using one of the Remote Capture Services available from our bank, sometimes supplemented with our courier service. They take advantage of our on-line banking products to pay bills, and our highly competitive merchant services program so that they can accept credit card payments from their customers.

Our plans also call for greater efficiency than ever. In part because of new legislation passed by Congress during 2010 in response to the financial crisis of the past few years, and in part because of the overall banking regulatory climate, the burden on our company to comply with laws and regulations is greater than ever, and is expected to become even more difficult in the future. Crying about it won’t help - part of our solution is to systematize our practices in this regard, making sure that this company is both compliant and efficient. We also plan to drive our growth using our existing banking facility in Limerick, and have no plans for additional bank branches in the immediate future.

Conclusion

Certainly 2010 was a crucial year in the history of The Victory Bank, a year that will always be remembered as the time when we achieved sufficient growth to start generating a profit, and were able to attract a significant amount of new capital to facilitate growth and stability. In closing, I would offer our most sincere thanks and appreciation to all of you who have invested into the bank, to those who have joined our team and helped us build our business, and to those who have chosen to bank with us. Thanks to all of you for your support and referrals, as we look forward to a successful 2011 and beyond.

Sincerely Yours,



Joseph W. Major
Chairman and CEO

The Victory Bank
The Victory Bancorp




Independent Auditors' Report

Board of Directors
The Victory Bancorp, Inc.

We have audited the accompanying consolidated balance sheet of The Victory Bancorp, Inc. and subsidiary (the "Bank") as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 The Victory Bancorp, Inc. and subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



ParenteBeard LLC

Philadelphia, Pennsylvania
April 6, 2011

THE VICTORY BANCORP INC

Consolidated Balance Sheet
December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets		
Cash and due from banks	\$ 1,642,452	\$ 780,655
Federal funds sold	1,013,000	3,905,000
	<u>2,655,452</u>	<u>4,685,655</u>
Cash and cash equivalents	2,655,452	4,685,655
Securities available-for-sale	6,676,813	2,391,338
Loans receivable, net of allowance for loan losses of \$932,831 and \$579,849	73,391,444	46,360,661
Premises and equipment, net	1,037,740	1,193,065
Restricted investment in bank stocks	461,600	482,800
Accrued interest receivable	218,026	147,223
Federal Deposit Insurance Corporation prepaid assessment	159,462	263,899
Other assets	341,839	130,149
	<u>84,942,376</u>	<u>55,654,790</u>
Total assets	<u>\$ 84,942,376</u>	<u>\$ 55,654,790</u>
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Non-interest bearing	\$ 8,931,322	\$ 4,130,170
Interest-bearing	66,467,718	43,974,374
	<u>75,399,040</u>	<u>48,104,544</u>
Total deposits	75,399,040	48,104,544
Secured borrowings	1,151,034	-
Accrued interest payable	26,488	23,266
Other liabilities	343,220	213,359
	<u>76,919,782</u>	<u>48,341,169</u>
Total liabilities	76,919,782	48,341,169
Stockholders' Equity		
Preferred stock, \$1 par value; authorized 2,000,000:		
Series A - Series D cumulative, non-convertible, \$1,000 liquidation value, 2,107 shares issued and outstanding	2,107,000	2,107,000
Series E non-cumulative, convertible, \$100 liquidation value 13,208 shares issued and outstanding	1,247,785	-
Common stock, \$1 par value; authorized 10,000,000 shares; issued and outstanding 1,025,464 shares	1,025,464	1,025,464
Surplus	9,293,580	9,231,324
Accumulated deficit	(5,661,231)	(5,060,030)
Accumulated other comprehensive income	9,996	9,863
	<u>8,022,594</u>	<u>7,313,621</u>
Total stockholders' equity	8,022,594	7,313,621
	<u>\$ 84,942,376</u>	<u>\$ 55,654,790</u>
Total liabilities and stockholders' equity	<u>\$ 84,942,376</u>	<u>\$ 55,654,790</u>

See notes to consolidated financial statements

THE VICTORY BANCORP INC

Consolidated Statement of Operations
Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Interest Income		
Interest and fees on loans	\$ 3,514,132	\$ 1,858,145
Interest on investment securities	49,265	94,956
Interest on federal funds sold	7,436	7,183
Interest on deposits in other banks	526	1,629
	<u>3,571,359</u>	<u>1,961,913</u>
Interest Expense		
Deposits	964,548	846,992
Short-term borrowings	3,475	1,704
	<u>968,023</u>	<u>848,696</u>
Total interest expense	968,023	848,696
Net interest income	2,603,336	1,113,217
Provision for Loan Losses	<u>352,982</u>	<u>380,717</u>
Net interest income after provision for loan losses	<u>2,250,354</u>	<u>732,500</u>
Non-Interest Income		
Service charges and activity fees	76,828	19,633
Net gains on sales of loans	201,206	97,673
Other income	32,423	16,725
	<u>310,457</u>	<u>134,031</u>
Total non-interest income	310,457	134,031
Non-Interest Expenses		
Salaries and employee benefits	1,553,126	1,589,559
Occupancy and equipment	555,721	541,745
Legal and professional fees	191,091	253,255
Advertising and promotion	66,038	173,614
Loan expenses	35,147	25,544
Data processing costs	400,031	304,864
Supplies, printing and postage	56,482	57,516
Telephone	18,717	15,147
Entertainment	44,392	33,702
Mileage and tolls	19,692	13,582
Insurance	34,149	28,409
Federal Deposit Insurance Corporation premiums	114,746	86,432
Dues and subscriptions	25,912	21,442
Shares tax	72,371	74,120
Other	12,263	6,888
	<u>3,199,878</u>	<u>3,225,819</u>
Total non-interest expenses	3,199,878	3,225,819
Loss before income tax benefit	(639,067)	(2,359,288)
Income Tax Benefit	<u>140,000</u>	<u>-</u>
Net loss	(499,067)	(2,359,288)
Preferred Stock Dividends	<u>102,134</u>	<u>21,128</u>
Net loss available to common stockholders	<u>\$ (601,201)</u>	<u>\$ (2,380,416)</u>

See notes to consolidated financial statements

THE VICTORY BANCORP INC

Consolidated Statement of Stockholders' Equity Years Ended December 31, 2010 and 2009

	Preferred Stock	Common Stock	Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2009	\$ -	\$ 1,025,464	\$ 9,168,812	\$ (2,679,614)	\$ (8,701)	\$ 7,505,961
Comprehensive loss:						
Net loss	-	-	-	(2,359,288)	-	(2,359,288)
Unrealized losses on securities available- for-sale	-	-	-	-	18,564	18,564
Total comprehensive loss						(2,340,724)
Issuance of preferred stock,	2,046,000	-	-	-	-	2,046,000
Exercise of warrants	61,000	-	(61,000)	-	-	-
Cash dividends on preferred stock	-	-	-	(21,128)	-	(21,128)
Share-based compensation expense	-	-	123,512	-	-	123,512
Balance, December 31, 2009	2,107,000	1,025,464	9,231,324	(5,060,030)	9,863	7,313,621
Comprehensive loss:						
Net loss	-	-	-	(499,067)	-	(499,067)
Unrealized losses on securities available- for-sale	-	-	-	-	133	133
Total comprehensive loss						(498,934)
Issuance of preferred stock, net of offering cost of \$73,015	1,247,785	-	-	-	-	1,247,785
Cash dividends on preferred stock	-	-	-	(102,134)	-	(102,134)
Share-based compensation expense	-	-	62,256	-	-	62,256
Balance, December 31, 2010	\$ 3,354,785	\$ 1,025,464	\$ 9,293,580	\$ (5,661,231)	\$ 9,996	\$ 8,022,594

See notes to consolidated financial statements

THE VICTORY BANCORP INC

Consolidated Statement of Cash Flows
Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash Flows from Operating Activities		
Net loss	\$ (499,067)	\$ (2,359,288)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for loan losses	352,982	380,717
Depreciation	212,723	229,490
Share-based compensation	62,256	123,512
Deferred income taxes (benefit)	(140,000)	-
Net accretion of investment securities	3,318	5,256
Net realized gain on sale of loans held for sale	(201,206)	(97,673)
Origination of loans held for sale	(3,285,975)	(830,689)
Proceeds from sale of loans held for sale	3,620,115	913,758
Increase in accrued interest receivable	(70,803)	(98,109)
(Increase) decrease in Federal Deposit Insurance Corporation prepaid assessment	104,437	(263,899)
Increase in other assets	(71,690)	(55,025)
Increase in accrued interest payable	3,222	17,779
Increase in other liabilities	129,861	87,156
	<u>220,173</u>	<u>(1,947,015)</u>
Cash Flows from Investing Activities		
Activity in available-for-sale securities:		
Purchases	(36,999,391)	(33,500,664)
Proceeds from maturities, calls and principal paydowns	32,710,731	33,613,933
Net increase in loans	(27,516,699)	(28,863,040)
Redemption of restricted investment in bank stocks	21,200	-
Purchase of restricted investment in bank stocks	-	(399,100)
Purchases of premises and equipment	(77,079)	(566,986)
Disposition of premises and equipment	19,681	-
	<u>(31,841,557)</u>	<u>(29,715,857)</u>
Cash Flows from Financing Activities		
Net increase in deposits	27,294,496	32,584,039
Net proceeds from issuance of preferred stock	1,247,785	2,046,000
Cash dividends on preferred stock	(102,134)	(21,128)
Proceeds from secured borrowing	1,151,034	-
	<u>29,591,181</u>	<u>34,608,911</u>
Net cash provided by financing activities	<u>29,591,181</u>	<u>34,608,911</u>
Net increase (decrease) in cash and cash equivalents	(2,030,203)	2,946,039
Cash and Cash Equivalents, Beginning	<u>4,685,655</u>	<u>1,739,616</u>
Cash and Cash Equivalents, Ending	<u>\$ 2,655,452</u>	<u>\$ 4,685,655</u>
Supplementary Cash Flows Information		
Exercise of warrants	<u>\$ -</u>	<u>\$ 61,000</u>
Interest paid	<u>\$ 964,801</u>	<u>\$ 830,917</u>

See notes to consolidated financial statements

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements of The Victory Bancorp, Inc. (the "Corporation") are prepared on the accrual basis and included in the accounts of The Victory Bancorp, Inc. and its wholly-owned subsidiary, The Victory Bank (the "Bank"). All significant accounts and transactions have been eliminated from the accompanying consolidated financial statements.

Organization and Nature of Operations

The Victory Bancorp, Inc. is a registered bank holding company, which owns 100% of the outstanding capital stock of The Victory Bank. The Corporation was incorporated under the laws of the State of Pennsylvania in 2009 for the purpose of serving as The Victory Bank's holding company. The holding company structure provides flexibility for growth through expansion of our businesses and access to varied capital raising operations. The Corporation's primary business activity consists of ownership of all of the outstanding stock of The Victory Bank. As of December 31, 2010, we had 308 stockholders of record.

The Bank is a Pennsylvania chartered commercial bank which was chartered in January 2008. The Bank operates a full-service commercial and consumer banking business in Montgomery County, Pennsylvania. Our focus is on small- and middle-market commercial and retail customers. The Bank originates secured and unsecured commercial loans, commercial mortgage loans, consumer loans and construction loans. We do not make subprime loans. We also offer revolving credit loans, small business loans and automobile loans. The Bank offers a variety of deposit products, including demand and savings deposits, regular savings accounts, investment certificates and fixed-rate certificates of deposit. As a state-chartered bank, the Bank is subject to regulation of the Pennsylvania Department of Banking and Federal Deposit Insurance Corporation. The area served by the Bank is primarily Montgomery County, Pennsylvania.

Basis of Financial Statement Presentation

Accounting Standards Codification (ASC) 855 establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. ASC 855 sets forth the period after the balance sheet date during which management of an entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that should be made about events or transactions that occur after the balance sheet date. In preparing these consolidated financial statements, the Bank evaluated the events and transactions that occurred between December 31, 2010 and April 6, 2011, the date these financial statements were issued.

Estimates

The preparation of 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other than temporary impairment of securities, and the valuation of deferred tax assets.

1. Summary of Significant Accounting Policies (Continued)**Significant Group Concentrations of Credit Risk**

Most of the Bank's activities are with customers located within Montgomery County, Pennsylvania. Note 4 discusses the types of lending that the Bank engages in. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold, all of which mature within ninety days. Generally, federal funds are sold for one day periods.

Securities

Management determines the appropriate classification of debt investment securities at the time of purchase and reevaluates such designation as of each balance sheet date. Securities that management has the positive intent and ability to hold until maturity are classified as held-to-maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums, or unaccreted discounts. At December 31, 2010 and 2009, the Bank had no investment securities classified as held-to-maturity.

Securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as available-for-sale. These securities are carried at fair value, which is determined by obtaining quoted market prices or matrix pricing. Unrealized gains and losses are excluded from earnings and are reported in other comprehensive income. Realized gains and losses are recorded on the trade date and are determined using the specific identification method. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

Management evaluates securities for other-than-temporary impairment on at least an annual basis, and more frequently when economic or market concerns warrant such evaluation. Declines in fair value of securities below their cost that are deemed to be other-than-temporary are separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income (loss). In estimating 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) whether or not management intends to sell or expects that it is more likely than not that it will be required to sell the debt security prior to any anticipated recovery in fair value.

U.S. Small Business Association (SBA) Lending Activities

The Bank originates loans to customers in its primary market area under an SBA program that generally provides for SBA guarantees of up to 90 percent of each loan. The Bank generally sells the guaranteed portion of its SBA loans to a third party and retains the servicing, holding the nonguaranteed portion in its portfolio. When the guaranteed portion of a SBA loan is sold, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income. However, new authoritative accounting guidance effective January 1, 2010, under Financial Accounting Standards Board ASC 860, *Transfers and Servicing*, requires that the gains on sales of SBA 7(a) loans be deferred for a 90-day period after the sale, which coincides with the buyback or warranty period required by the SBA for all secondary market sales.

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

1. Summary of Significant Accounting Policies (Continued)

At December 1, 2010, the Bank had committed to sell three loans totaling approximately \$1.2 million, which are presented as secured borrowings on the balance sheet.

On January 28, 2011, the SBA released notice of a change in the Secondary Participation and Guaranty Agreements removing the warranty period of 90 days for all loan sales made under the new agreement after February 15, 2011.

SBA servicing assets are recognized separately when rights are acquired through the sale of the SBA guaranteed portion. These servicing rights are initially measured at fair value at the date of sale and included in the gain on sale. To determine the fair value of Mortgage Servicing Rights (MSRs), the Bank uses market prices for comparable mortgage servicing contracts, when available, or alternatively, uses a valuation model that calculates the present value of estimated future net servicing income. In using this valuation method, the Bank incorporates assumptions that market participants would use in estimating future net servicing income, which includes estimates of the cost to service, the discount rate, custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates, late fees and losses.

These MSRs are amortized in proportion to and over the period of estimated net servicing income or net servicing loss and measured for impairment or increased obligation based on fair value at each reporting date. The amortization of the MSRs is analyzed periodically and is adjusted to reflect changes in prepayment rates and other estimates.

Serviced loans sold to others are not included in the accompanying consolidated balance sheet. Income (losses) and fees collected for loan servicing are included in non-interest income.

Loans Receivable

Loans receivable that management has the intent and the ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

1. Summary of Significant Accounting Policies (Continued)

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revisions as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired 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.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and home equity loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Transfers of Financial Assets

Transfers of financial assets, including loan and loan participation sales, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets.

1. Summary of Significant Accounting Policies (Continued)

Restricted Investment in Bank Stocks

Restricted investment in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost, and consists of common stock of the Atlantic Central Bankers Bank and Federal Home Loan Bank (FHLB) stocks totaling 461,600 and 482,800 at December 31, 2010 and 2009, respectively. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of capital stock and as of December 31, 2010 has not changed its position regarding dividend payments. During 2010, the FHLB of Pittsburgh did perform a limited excess capital stock repurchase based upon positive third quarter net income. Any future capital stock repurchases will be made on a quarterly basis if conditions warrant such repurchases.

Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Advertising Costs

The Bank follows the policy of charging the costs of advertising to expense as incurred. Advertising expense incurred for the years ended December 31, 2010 and 2009 totaled approximately \$16,309 and \$8,133, respectively.

Income Taxes

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for current period by applying the provisions of the enacted tax law to the taxable income to excess of deductions over revenues. The Bank determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Bank accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

1. Summary of Significant Accounting Policies (Continued)

The Bank recognizes interest and penalties on income taxes, if any, as a component of the provision for income taxes. There were no interest and penalties recognized in 2010 or 2009.

Federal and state tax returns for the years 2008 through 2010 are open for examination as of December 31, 2010.

Comprehensive Income (Loss)

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains on securities available-for-sale which is recognized as a separate component of equity.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated balance sheet when they are funded.

Employee Benefit Plan

During 2008, the Bank established a 401(k) plan ("the Plan"). Under the Plan, all employees are eligible to contribute the maximum allowed by the Internal Revenue Code of 1986, as amended. The Bank may make discretionary matching contributions. For the years ended December 31, 2010 and 2009, expense attributable to the Plan amounted to \$30,299 and \$29,779, respectively.

Share-Based Compensation

The Bank adopted the provisions of ASC 718-10, *Share-Based Payment*. This standard requires the Bank to recognize the cost of employee and organizer services received in share-based payment transactions and measure the cost based on the grant-date fair value of the award. The cost will be recognized over the period during which the employee or organizer is required to provide service in exchange for the award.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employee's service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Sholes model is used to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards.

2. Restrictions on Cash and Due from Banks

In return for services obtained through correspondent banks, the Bank is required to maintain non-interest bearing cash balances in those correspondent banks. At December 31, 2010 and 2009, compensating balances approximated \$150,000.

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

3. Securities Available-for-Sale

The amortized cost and approximate fair value of securities as of December 31, 2010 and 2009 is summarized as follows:

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government agency debt securities	\$ 5,999,633	\$ -	\$ -	\$ 5,999,633
Residential mortgage-backed securities	667,184	9,996	-	677,180
	<u>\$ 6,666,817</u>	<u>\$ 9,996</u>	<u>\$ -</u>	<u>\$ 6,676,813</u>
2009				
U.S. Government agency debt securities	\$ 1,495,200	\$ -	\$ -	\$ 1,495,200
Residential mortgage-backed securities	886,275	9,863	-	896,138
	<u>\$ 2,381,475</u>	<u>\$ 9,863</u>	<u>\$ -</u>	<u>\$ 2,391,338</u>

The amortized cost and fair value of securities as of December 31, 2010 and 2009, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because the securities may be called without any penalties.

	2010		2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or under	\$ 5,999,633	\$ 5,999,633	\$ -	\$ -
Due after one year through five years	-	-	1,495,200	1,495,200
Due after five years through ten years	-	-	-	-
Due after ten years	667,184	677,180	886,275	896,138
	<u>\$ 6,666,817</u>	<u>\$ 6,676,813</u>	<u>\$ 2,381,475</u>	<u>\$ 2,391,338</u>

All U.S. Government agency and mortgage backed securities at December 31, 2010 and 2009 have been pledged to collateralize municipal deposits. There were no individual securities in an unrealized loss position as of December 31, 2010 and 2009.

4. Loans Receivable

The composition of loans receivable at December 31, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Commercial term	\$ 19,996,943	\$ 10,704,445
Commercial mortgage	26,952,341	11,711,151
Commercial line	11,687,329	10,395,675
Construction	1,326,006	1,040,440
Home equity	9,639,770	11,126,941
Consumer	4,738,609	2,016,507
Total loans	74,340,998	46,995,159
Deferred fees, net	(16,723)	(54,649)
Allowance for loan losses	(932,831)	(579,849)
Net loans	\$ 73,391,444	\$ 46,360,661

The Bank originates and sells loans secured by the SBA. The Bank retains the unguaranteed portion of the loan and the servicing on the loans sold and receives a fee based upon the principal balance outstanding. During the years ended December 31, 2010 and 2009, the Bank sold loans held for sale for total proceeds of \$3,620,115 and \$913,758 respectively. The loan sales resulted in realized gains of \$201,206 and \$97,673 for the years ended December 31, 2010 and 2009, respectively. Loans held for sale at December 31, 2010 and 2009 amounted to \$1,151,034 and \$-0-, respectively.

Loans serviced for others are not included in the accompanying consolidated balance sheet. The risks inherent in the servicing assets relate primarily to changes in prepayments that result from shifts in interest rates. The unpaid principal balances of loans serviced for others were \$4,054,599 and \$830,689 at December 31, 2010 and 2009, respectively. The following summarizes the activity pertaining to servicing rights using the amortization method for the years ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Balance, beginning	\$ 17,484	\$ -
Additions	63,543	17,484
Disposals	-	-
Amortization	(2,157)	-
Balance, ending	\$ 78,870	\$ 17,484

The changes in the allowance for loan losses for the year ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Balance, beginning of year	\$ 579,849	\$ 199,132
Provision for loan losses	352,962	380,717
Balance, end of year	\$ 932,831	\$ 579,849

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

4. Loans Receivable (Continued)

The following table presents the Bank's impaired loans at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Impaired loans without a valuation allowance	\$ -	\$ -
Impaired loans with a valuation allowance	210,499	249,965
Total impaired loans	\$ 210,499	\$ 249,965
Valuation allowance related to impaired loans	\$ 76,915	\$ 62,915
Total loans past-due ninety days or more and still accruing	-	-
Average investment in impaired loans	241,340	49,993
Interest income recognized on impaired loans	-	-
Interest income recognized on a cash basis on impaired loans	-	-

At December 31, 2010 and 2009, the Bank had non-accrual loans of \$210,499 and \$249,965, respectively.

5. Bank Premises and Equipment

The components of premises and equipment at December 31, 2010 and 2009 are as follows:

	<u>Estimated Useful Lives</u>	<u>2010</u>	<u>2009</u>
Leasehold improvements	10 - 20 years	\$ 707,791	\$ 696,661
Computer equipment and software	3 - 5 years	389,598	373,879
Automobiles	3 years	85,596	85,572
Bank unique equipment	5 years	155,291	145,446
Furniture, fixtures and equipment	3 - 10 years	161,553	158,454
		1,499,829	1,460,012
Accumulated depreciation		(462,089)	(266,947)
		\$ 1,037,740	\$ 1,193,065

Depreciation expense charged to operations amounted to \$212,723 and \$229,490 for the years ended December 31, 2010 and 2009, respectively.

6. Deposits

The components of deposits at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Demand, non-interest bearing	\$ 8,931,322	\$ 4,130,170
Demand interest bearing	2,261,349	1,594,907
Money market accounts	10,114,285	11,801,503
Savings accounts	27,394,506	18,021,145
Time, \$100,000 and over	14,494,601	5,142,219
Time, other	12,202,977	7,414,600
	<u>\$ 75,399,040</u>	<u>\$ 48,104,544</u>

At December 31, 2010, the scheduled maturities of time deposits are as follows:

2011	\$ 14,735,419
2012	6,473,510
2013	4,375,084
2014	992,590
2015	120,975
	<u>\$ 26,697,578</u>

Included in time deposits are brokered deposits of \$1,548,667 and \$808,690 for the years ended December 31, 2010 and 2009, respectively.

7. Lines of Credit

The Bank has a \$1,500,000 unsecured federal funds overnight line of credit with a correspondent bank. There were no borrowings on the line of credit at December 31, 2010 and 2009.

8. Lease Commitments and Total Rental Expense

The Bank has an operating lease agreement for its main banking office. Future minimum lease payments by year under the non-cancellable lease agreements for the Bank's facilities are as follows:

2011	\$ 226,000
2012	226,000
2013	227,437
2014	243,250
2015	243,250
Thereafter	<u>3,454,417</u>
	<u>\$ 4,620,354</u>

Rent expense for the lease for the years ended December 31, 2010 and 2009 was \$274,060 and \$278,147, respectively.

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

9. Stockholders' Equity

During 2009, the Bank was incorporated as a one-bank holding company under the laws of the state of Pennsylvania. Pursuant to the creation of the holding company, all outstanding shares of the Bank's class of common stock were exchanged one-to-one for shares of The Victory Bancorp, Inc. common stock.

On February 27, 2009, pursuant to the U.S. Department of Treasury's Troubled Asset Relief Program ("TARP") Capital Purchase Program, the Bank issued the following securities to the initial selling security holder for an aggregate consideration of \$541,000: (i) 541 shares of fixed-rate non-cumulative perpetual preferred stock, Series A, having par value of \$1 per share; and (ii) 27 shares of fixed-rate non-cumulative perpetual preferred stock, Series B, having a par value of \$1 per share, pursuant to the exercise of a preferred stock warrant. All warrants were exercised immediately in exchange for 1,000 shares of preferred stock each. The proceeds from this transaction count as Tier 1 capital and the warrant qualifies as tangible equity.

On December 8, 2009, pursuant to the U.S. Department of Treasury's TARP Capital Purchase Program, the Corporation issued the following securities to the initial selling security holder for an aggregate consideration of \$1,505,000: (i) 1,505 shares of fixed-rate non-cumulative perpetual preferred stock, Series C, having par value of \$1 per share; and (ii) 34 shares of fixed-rate non-cumulative perpetual preferred stock, Series D, having a par value of \$1 per share, pursuant to the exercise of a preferred stock warrant. All warrants were exercised immediately in exchange for 1,000 shares of preferred stock each. The proceeds from this transaction count as Tier 1 capital and the warrant qualifies as tangible equity.

Series A Preferred Stock and Series C Preferred Stock pay cumulative dividends at a rate of 5% per year for the first five years and, thereafter, at a rate of 9% per year.

Series B Preferred Stock and Series D Preferred Stock pay cumulative dividends at a rate of 9% per year.

The Bank is authorized to issue 50,000 shares of Preferred Series E stock, par value of \$1 per share. During 2010, the Corporation issued 13,208 shares of Preferred Series E stock at \$100 per share, which resulted in gross proceeds of \$1,320,800, net of offerings costs of \$73,015. Holders of the shares are entitled to receive a quarterly non-cumulative dividend at an annual rate of 7.0% if and when declared by the Company's board of directors.

The Pennsylvania Department of Banking, in issuing its charter to the Bank, required an allocation of its initial capital to an Expense Fund in the amount of \$1,000,000 to defray anticipated initial losses. Accordingly, \$1,000,000 of the Bank's surplus is reserved for this purpose until the Bank becomes profitable.

10. Federal Income Taxes

The components of income tax expense for the years ended December 31, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Current	\$ -	\$ -
Deferred	140,000	-
	<u>\$ 140,000</u>	<u>\$ -</u>

10. Federal Income Taxes (Continued)

The components of the net deferred tax asset (liability) at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Deferred tax assets:		
Allowance for loan losses	\$ 269,343	\$ 149,329
Organization and start-up costs	212,354	229,929
Nonqualified stock options	21,042	15,782
Net operating loss carryforwards	1,317,521	1,258,765
Premises and equipment	247,754	-
Deferred loan costs	15,243	-
	<u>2,083,257</u>	<u>1,653,805</u>
Valuation allowance	<u>(1,884,884)</u>	<u>(1,500,467)</u>
Total deferred tax assets, net of valuation allowance	<u>198,373</u>	<u>153,338</u>
Deferred tax liabilities:		
Premises and equipment	-	(105,385)
Cash basis conversion	(58,373)	(19,301)
Deferred loan costs	-	(28,652)
	<u>(58,373)</u>	<u>(153,338)</u>
Net deferred tax asset	<u>\$ 140,000</u>	<u>\$ -</u>

The income tax provision for financial reporting purposes differs from the amount computed by applying the statutory income tax rate of 34% to income before income taxes. The difference relates primarily to the impact of non-taxable income offset by the increase in deferred tax asset valuation allowance.

The Bank has net operating loss carryforwards available for federal income tax purposes of approximately \$3,875,062 which expire through 2030.

11. Transactions with Executive Officers, Directors and Principal Stockholders

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. There were loans receivable from related parties totaling \$1,440,464 and \$1,523,511 at December 31, 2010 and 2009, respectively. Loans originated for related parties totaled \$224,317 and \$241,300 and payments received were \$307,364 and \$117,968 for the years ended December 31, 2010 and 2009, respectively. Deposits of related parties totaled \$1,500,740 and \$1,826,748 as of December 31, 2010 and 2009, respectively.

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

12. Share-Based Compensation

Organizers of the Bank were issued a total of 100,000 "organizer warrants" for their efforts during the organization and start-up of the Bank. These warrants are immediately exercisable, expire in 10 years and will enable the warrant holder to purchase one share of common stock at \$10.00 per share for each warrant exercised.

In 2008, the Board of Directors adopted the 2008 Stock Option Plan ("2008 Plan"), which was approved by the Board of Directors on March 18, 2008, and was approved by the shareholders on May 28, 2008.

The 2008 Plan enables the Board of Directors to grant stock options to employees, directors, consultants, and other individuals who provide services to the Bank. The shares subject to or related to options under the Plan are authorized and unissued shares of the Corporation. The maximum number of shares that may be subject to options under the Plan is 205,092, all of which may be issued as Incentive Stock Options and as Non-Qualified Stock Options. Incentive Stock Options are subject to limitations under Section 422 of the Internal Revenue Code. The Bank has reserved, for the purposes of the Plan, out of its authorized and unissued shares, such number of shares. The 2008 Plan will terminate ten years from stockholder approval. Options may not be granted with an exercise price that is less than 100% of the fair market value of the Corporation's common stock on the date of grant. Options may not be granted with a term longer than 10 years. However, any Incentive Stock Option granted to any employee who, at the time such Option is granted, owns more than 10% of the voting power of all classes of shares of the Corporation, its parent or of a subsidiary may not have a term of more than five years. Options will vest and be exercisable at such time or times and subject to such terms and conditions as determined by the Board of Directors. Generally, options will vest over a vesting period of approximately equal percentages each year over an initial term no shorter than three (3) years. In 2009, 4,000 Incentive Stock Options were issued under the Plan and -0- Non-Qualified Stock Options were issued under the Plan. No options were granted in 2010. At December 31, 2010 and 2009, there are 30,679 shares available for grant under the 2008 Plan.

The following is a summary of the Corporation's share-based compensation activity and related information for the year ended December 31, 2010:

	Warrants and Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2009	274,513	\$ 10.00		
Stock options granted in 2009	4,000	10.00		
Stock options forfeited in 2009	(4,100)	10.00		
Outstanding at December 31, 2009	274,413	10.00	9 years	\$ -
Stock options granted in 2010	-	-		
Stock options forfeited in 2010	(105,455)	10.00		
Outstanding at December 31, 2010	168,958	\$ 10.00	8 years	\$ -
Exercisable at December 31, 2010	168,958	\$ 10.00	8 years	\$ -

There were no organizer warrants granted in 2010 or 2009. The fair value of the warrants granted in 2008 was \$2.96.

12. Share-Based Compensation (Continued)

No options were granted during 2010.

The fair value of each option granted during 2009 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	<u>2009</u>
Dividend yield	-
Expected life	7 years
Expected volatility	32.50 %
Risk-free interest rate	2.46 %

The volatility percentage was based on the average expected volatility of similar public financial institutions in the Bank's market area. The fair value of the options granted in 2009 was \$3.91.

During 2010, the directors, senior management and employees of the Corporation forfeited all non-vested options as of July 1, 2010.

Total share-based compensation cost for the year ended December 31, 2010 was \$62,256 related to stock options. There were no tax benefits recognized related to the share-based compensation expense due to the net operating loss incurred.

Total share-based compensation cost for the year ended December 31, 2009 was \$123,512 related to stock options. There were no tax benefits recognized related to the share-based compensation expense due to the net operating loss incurred.

13. Financial Instruments with Off-Balance Sheet Risk

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

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 is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Bank had the following off-balance sheet financial instruments whose contract amounts represent credit risk at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Commitments to grant loans	\$ -	\$ -
Unfunded commitments under lines of credit	12,035,905	8,599,000
	<u>\$ 12,035,905</u>	<u>\$ 8,599,000</u>

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

13. Financial Instruments with Off-Balance Sheet Risk (Continued)

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment. The liability associated with these commitments is not material at December 31, 2010.

14. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the 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 Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

The Federal Deposit Insurance Corporation requires that the Bank maintain a ratio of Tier 1 leverage capital to total assets of at least 8% during the first seven years of operation. Under these guidelines, the Bank is considered well capitalized as of December 31, 2010.

The Bank's actual capital amounts and ratios at December 31, 2010 and 2009 are presented below:

	2010					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollar Amounts in Thousands)					
Total capital (to risk-weighted assets)	\$ 8,799	11.90 %	\$ ≥5,916	≥8.00 %	\$ ≥7,394	≥10.00 %
Tier 1 capital (to risk-weighted assets)	7,875	10.65	≥2,958	≥4.00	≥4,437	≥ 6.00
Tier 1 capital (to average assets)	7,875	9.68	≥3,255	≥4.00	≥4,068	≥ 5.00
	2009					
Total capital (to risk-weighted assets)	\$ 7,884	16.76 %	\$ ≥3,762	≥8.00 %	\$ ≥4,703	≥10.00 %
Tier 1 capital (to risk-weighted assets)	7,304	15.53	≥1,881	≥4.00	≥2,822	≥ 6.00
Tier 1 capital (to average assets)	7,304	13.15	≥2,222	≥4.00	≥2,778	≥ 5.00

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations.

15. Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Bank's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year end.

Determination of Fair Value

The Corporation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Topic 820 *Fair Value Measurements and Disclosures* fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instruments.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Corporation groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

THE VICTORY BANCORP INC

Notes to Consolidated Financial Statements
December 31, 2010 and 2009

15. Fair Value Measurements (Continued)

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2010 and 2009 are as follows:

	2010			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government agency debt securities	\$ 5,999,633	\$ -	\$ 5,999,633	\$ -
Residential mortgage-backed securities	677,180	-	677,180	-
	<u>\$ 6,676,813</u>	<u>\$ -</u>	<u>\$ 6,676,813</u>	<u>\$ -</u>
	2009			
U.S. Government agency debt securities	\$ 1,495,200	\$ -	\$ 1,495,200	\$ -
Residential mortgage-backed securities	896,138	-	896,138	-
	<u>\$ 2,391,338</u>	<u>\$ -</u>	<u>\$ 2,391,338</u>	<u>\$ -</u>

The Victory Bancorp, Inc.'s available-for-sale investment securities, which generally include U.S. government agencies and mortgage-backed securities, are reported at fair value. These securities are valued by an independent third party ("preparer"). The preparer's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

Impaired loans are those that the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

15. Fair Value Measurements (Continued)

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	2010			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ 133,584	\$ -	\$ -	\$ 133,584
	2009			
Impaired loans	\$ 187,050	\$ -	\$ -	\$ 187,050

Non-accrual loans are evaluated for impairment on an individual basis under FASB ASC Topic 310, *Receivables*. The impairment analysis includes current collateral values, known relevant factors that may affect loan collectibility, and risks inherent in different kinds of lending. When the collateral value or discounted cash flows less costs to sell is less than the carrying value of the loan a specific reserve (valuation allowance) is established.

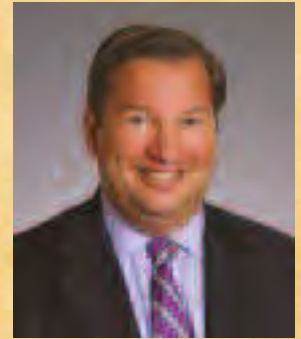
BOARD OF DIRECTORS



Alan S. Apt
President and CEO
Aptcor Commercial Realtors



Matthew "Bo" Bates
Chief Executive Officer
West Motor Freight



Robert L. Brant, Esquire
Principal
Robert L. Brant & Associates
LLC



Beryl B. Byles
Executive Coach
Beryl B. Byles Consulting



Michael A. Eddinger
Principal and Co-Owner
Suburban Water Technology



Karl Glocker
President
Glocker and Co.



Kevin L. Johnson
President
Traffic Planning and Design,
Inc.



Joseph W. Major
Chairman and CEO
The Victory Bank



Dennis R. Urffer, CPA
*Vice President and
Shareholder*
Resnick Amsterdam Leshner,
PC

THE VICTORY BANK TEAM



L-R: **Noel Billingsley**, Vice President, Commercial Relationship Manager; **Noreen Cobourn**, Assistant Vice President, Loan Operations Manager; **Trisha Metz**, Assistant Vice President, Credit Department Manager; **Roxanne Raymond**, Banking Center Assistant Manager; **Donna Colella**, Assistant Vice President, Operations Manager; **Dennis Zielinski**, Bank Secrecy Act and Security Officer; **Pam Havrilla**, Loan Process Manager; **James Phillips**, Business Development Officer; **Joseph Major**, Chairman and Chief Executive Officer; **Matthew Melcher**, Credit Analyst; **Richard Graver**, President and Chief Lending Officer; **Shelly Stockmal**, Banking Officer, Executive Assistant; **Joseph Bergquist**, Vice President, Commercial Relationship Manager; **Eric Offner**, Executive Vice President, Chief Credit Officer; **Leslie Unger**, Administrative Assistant; **Saul Rivkin**, Vice President, Chief Retail Officer; **Diana Stephens**, Banking Center Representative; and **Robert Schultz**, Chief Financial Officer and Chief Operating Officer.

Missing from photo: **Mary Locricchio**, Banking Center Representative and **Vincent Raffeo**, Business Development.





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