Village Bank & Trust Financial Corp.
Form 10-Q
May 14, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

xQUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2009

oTRANSITION REPORT UNDER SECTION 13 OR 15(d)

OF THE EXCHANGE ACT

For the transition period from ______ to ______

____

Commission file number: 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	**16-1694602** (I.R.S. Employer Identification No.)

15521 Midlothian Turnpike, Midlothian, Virginia	**23113**
Address of principal executive offices)	(Zip code)

804-897-3900
(Registrant s telephone number, including area code)

Indicate by check whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **x** No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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.

Large Accelerated Filer o	Accelerated Filer o
Non-Accelerated Filer o (Do not check if smaller reporting company)	Smaller Reporting Company **x**

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

Indicate the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date.

4,230,590 shares of common stock, $4.00 par value, outstanding as of May 8, 2009

Village Bank and Trust Financial Corp.

Form 10-Q

TABLE OF CONTENTS

Part I Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets March 31, 2009 (unaudited) and December 31, 2008	2
Consolidated Statements of Income For the Three Months Ended March 31, 2009 and 2008 (unaudited)	3
Consolidated Statements of Stockholders Equity For the Three Months Ended March 31, 2009 and 2008 (unaudited)	4
Consolidated Statements of Cash Flows For the Three Months Ended March 31, 2009 and 2008 (unaudited)	5
Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of operations	14
Item 3. Quantitative and Qualitative Disclosures About Market Risk	30
Item 4T. Controls and Procedures	30

Part II Other Information

Item 1. Legal Proceedings	31
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	31
Item 3. Defaults Upon Senior Securities	31
Item 4. Submission of Matters to a Vote of Security Holders	31
Item 5. Other Information	31
Item 6. Exhibits	31
Signatures	32

PART I - FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
March 31, 2009 (Unaudited) and December 31, 2008

		March 31, 2009 (Unaudited)		December 31, 2008
Assets				
Cash and due from banks	$	13,414,337	$	13,107,245
Federal funds sold		11,382,190		13,493,584
Investment securities available for sale		25,806,650		24,300,962
Loans held for sale		9,531,878		4,325,746
Loans				
Outstanding		472,981,216		470,918,182
Allowance for loan losses		(6,848,682)		(6,059,272)
Deferred fees		(206,422)		(195,896)
		465,926,112		464,663,014
Premises and equipment, net		27,975,269		28,173,518
Accrued interest receivable		3,266,111		3,499,793
Goodwill		7,422,141		7,422,141
Real estate owned		3,967,225		2,932,100
Bank owned life insurance		5,158,567		5,099,022
Other assets		5,791,987		5,390,868
	$	579,642,467	$	572,407,993
Liabilities and Stockholders' Equity				
Liabilities				
Deposits		482,439,183		466,232,043
Trust preferred securities		8,764,000		8,764,000
Federal home loan bank advances		25,000,000		25,000,000
Other borrowings		15,090,100		23,962,898
Accrued interest payable		925,330		1,014,534
Other liabilities		1,447,898		1,271,944
Total liabilities		533,666,511		526,245,419
Stockholders' equity				
Preferred stock, $1 par value - 1,000,000 shares authorized; no shares issued and outstanding		-		-
Common stock, $4 par value - 10,000,000 shares authorized; 4,230,590 shares issued and outstanding at March 31, 2009 4,229,372 shares issued and outstanding at December 31, 2008		16,922,360		16,917,488
Additional paid-in capital		25,777,637		25,737,048
Accumulated other comprehensive income (loss)		(102,691)		54,250
Retained earnings		3,378,650		3,453,788
Total stockholders' equity		45,975,956		46,162,574
	$	579,642,467	$	572,407,993

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Income Statements

Three Months Ended March 31, 2009
(Unaudited)

	Three Months Ended March 31, 2009	2008
Interest income		
Loans	$ 8,009,697	$ 6,508,558
Investment securities	336,458	143,318
Federal funds sold	7,273	106,835
Total interest income	8,353,428	6,758,711
Interest expense		
Deposits	4,003,456	3,695,243
Borrowed funds	443,306	277,929
Total interest expense	4,446,762	3,973,172
Net interest income	3,906,666	2,785,539
Provision for loan losses	1,100,000	249,324
Net interest income after provision for loan losses	2,806,666	2,536,215
Noninterest income		
Service charges and fees	373,119	207,125
Gain on sale of loans	943,116	426,517
Rental Income	41,671	-
Other	98,480	124,749
Total noninterest income	1,456,386	758,391
Noninterest expense		
Salaries and benefits	2,464,614	1,846,522
Occupancy	444,044	252,603
Equipment	255,618	173,275
Supplies	125,825	96,427
Professional and outside services	435,641	341,088
Advertising and marketing	71,495	48,861
Other operating expense	579,662	394,423
Total noninterest expense	4,376,899	3,153,199
Net income (loss) before income taxes	(113,847)	141,407
Income tax expense (benefit)	(38,709)	48,078
Net income (loss)	$ (75,138)	$ 93,329
Earnings per share, basic	$ (0.02)	$ 0.04
Earnings per share, diluted	$ (0.02)	$ 0.04

See accompanying notes to consolidated financial statements

Village Bank and Trust Financial Corp. and Subsidiary

Consolidated Statements of Stockholders' Equity
Three Months Ended March 31, 2009 and 2008
Unaudited)

	Common Stock Number of Shares		Amount		Additional Paid-in Capital		Retained Earnings (Deficit)		Accumulated Other Comprehensive Income (loss)		Total
Balance, December 31, 2008	4,229,372	$	16,917,488	$	25,737,048	$	3,453,788	$	$ 54,250	$	46,162,574
Issuance of common stock	1,218		4,872		(4,872)		-		-		-
Stock based compensation					45,461						45,461
Minimum pension adjustment (net of income taxes of $729)									2,145		,145
Net loss	-		-		-		(75,138)		-		(75,138)
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $54,089)	-		-		-		-		(159,086)		(159,086)
Total comprehensive income (loss)	-		-		-		-		-		(232,079)
Balance, March 31, 2009	4,230,590	$	16,922,360	$	25,777,637	$	3,378,650	$	(102,691)	$	45,975,956
Balance, December 31, 2007	2,575,985	$	10,303,940	$	13,726,269	$	2,985,697	$	(122,607)	$	26,893,299
Issuance of common stock	3,740		14,960		10,040		-		-		25,000
Stock based compensation					19,412						19,412
Minimum pension adjustment (net of income taxes of $729)									2,145		2,145
Net income	-		-		-		93,329		-		93,329
Change in unrealized gain (loss) on securities available for sale (net of income taxes of $5,571)	-		-		-		-		16,385		16,385
Total comprehensive income (loss)	-		-		-		-		-		111,859
Balance, March 31, 2008	2,579,725	$	10,318,900	$	13,755,721	$	3,079,026	$	(104,077)	$	27,049,570

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Three Months Ended March 31, 2009 and 2008
(Unaudited)

	2009	2008
Cash Flows from Operating Activities		
Net income (loss)	$ (75,138)	$ 93,329
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	310,004	166,385
Provision for loan losses	1,100,000	249,324
Gain on securities	(8,061)	(23,194)
Gain on loans sold	(943,116)	(426,517)
Gain on sale of premises and equipment	(645)	-
Stock compensation expense	45,461	19,412
Proceeds from sale of mortgage loans	45,065,904	18,431,482
Origination of mortgage loans for sale	(49,328,920)	(19,287,465)
Amortization of premiums and accretion of discounts on securities, net	7,692	(22,374)
Increase in interest receivable	233,682	50,301
Increase in other assets	(1,401,382)	(496,177)
Decrease in interest payable	(89,204)	(4,316)
Increase (decrease) in other liabilities	175,954	(461,139)
Net cash used in operating activities	(4,907,769)	(1,710,949)
Cash Flows from Investing Activities		
Purchases of available for sale securities	(6,230,297)	(994,374)
Maturities and calls of available for sale securities	4,473,630	6,795,999
Net increase in loans	(2,363,098)	(20,257,182)
Purchases of premises and equipment	(120,736)	(3,086,833)
Proceeds from sale of premises and equipment	9,626	-
Net cash used in investing activities	(4,230,875)	(17,542,390)
Cash Flows from Financing Activities		
Issuance of common stock	-	25,000
Net increase in deposits	16,207,140	5,614,507
Federal Home Loan Bank borrowings	-	(2,000,000)
Net increase (decrease) in other borrowings	(8,872,798)	3,634,330
Net cash provided by financing activities	7,334,342	7,273,837
Net decrease in cash and cash equivalents	(1,804,302)	(11,979,502)
Cash and cash equivalents, beginning of period	26,600,829	22,115,004
Cash and cash equivalents, end of period	$ 24,796,527	$ 10,135,502

See accompanying notes to consolidated financial statements.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 - Principles of presentation

Village Bank and Trust Financial Corp. (the Company) is the holding company of Village Bank (the Bank). The consolidated financial statements include the accounts of the Company, the Bank and the Bank s three wholly-owned subsidiaries, Village Bank Mortgage Company, Village Insurance Agency, Inc., and Village Financial Services Company. All material intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying condensed consolidated financial statements of the Company have been prepared on the accrual basis in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, all adjustments that are, in the opinion of management, necessary for a fair presentation have been included. The results of operations for the three month period ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year ending December 31, 2009. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission.

Note 2 - Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheets and statements of income for the period. Actual results could differ significantly from those estimates.

Note 3 - Earnings per common share

Basic earnings per common share is computed by dividing the net income by the weighted-average number of common shares outstanding during the period. For the three month periods ended March 31, 2009 and 2008, the weighted-average number of common shares totaled 4,229,981 and 2,576,548, respectively. Diluted earnings per share reflect the potential dilution of securities that could share in the net income of the Company. Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. For the three month periods ended March 31, 2009 and 2008, the weighted-average number of common shares on a fully diluted basis totaled 4,229,981 and 2,607,777, respectively. Options to acquire 333,955 shares of common stock were anti-dilutive for the three month period ended March 31, 2009 and thus excluded from the computation of fully diluted earnings per share, and 98,350 were anti-dilutive for the three month period ended March 31, 2008.

Note 4 Stock warrant and incentive plans

The company has a stock incentive plan which authorizes the issuance of up to 455,000 shares of common stock to assist the Company in recruiting and retaining key personnel.

The following table summarizes stock options outstanding under the stock incentive plan at the indicated dates:

	Three Months Ended March 31, 2009							2008						
	Options		Weighted Average Exercise Price		Fair Value Per Share		Intrinsic Value	Options		Weighted Average Exercise Price		Fair Value Per Share		Intrinsic Value
Options outstanding, beginning of period	333,955	$	10.66	$	5.34			247,410	$	10.26	$	4.70		
Granted	-		-		-			-		-		-		
Forfeited	-		-		-			-		-		-		
Exercised	-		-		-			-		-		-		
Options outstanding, end of period	333,955	$	10.66		5.34	$	-	247,410	$	10.26	$	4.70	$	180,609
Options exercisable, end of period	298,600							229,910						

During the first quarter or 2009, we granted to certain officers 26,592 restricted shares of common stock with a weighted average fair market value of $4.60 at the date of grant. These restricted stock awards have three-year graded vesting and the performance shares cliff vest at the end of the three years. The number of performance shares that ultimately vest is dependent upon achieving specific performance targets. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock and performance share awards was 34,710 and 9,860 at March 31, 2009 and 2008, respectively.

Stock-based compensation expense was $45,461 and $19,412 for the three months ended March 31, 2009 and 2008, respectively. Unamortized stock-based compensation related to nonvested share based compensation arrangements granted under the Incentive Plan as of March 31, 2009 and 2008 was $441,312 and $204,974, respectively. Of the $441,312 of unamortized compensation at March 31, 2009, $91,055 relates to performance based restricted stock awards. The time based unamortized compensation of $350,257 is expected to be recognized over a weighted average period of 2.00 years.

Note 5 Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate at March 31, 2009 was 3.42%. The securities may be redeemed at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. The principal asset of the Trust is $5.2 million of the Company s junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a five year fixed income rate of 6.29% payable quarterly, converting after five years to a LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.40%) which adjusts, and is also payable, quarterly. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. The principal asset of the Trust is $3.6 million of the Company s junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust s obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends.

Note 6 Deposits

Deposits as of March 31, 2009 and December 31, 2008 were as follows:

		March 31, 2009			December 31, 2008	
		Amount	%		Amount	%
Noninterest bearing demand	$	38,074,200	7.89%	$	34,483,360	7.40%
Now		21,440,629	4.44%		17,427,061	3.74%
Money market		31,546,366	6.54%		30,002,756	6.43%
Savings		7,032,895	1.46%		5,387,829	1.15%
Time deposits of $100,000 and over		125,814,121	26.08%		120,750,254	25.90%
Other time deposits		258,530,972	53.59%		258,180,783	55.38%
Total	$	482,439,183	100.00%	$	466,232,043	100.00%

Note 7 Business Combination

On September 30, 2008 the Company acquired River City Bank for approximately $20,720,000. The total consideration included approximately $16,269,000 of common stock, representing approximately 1,441,000 shares, and cash of $3,962,244 paid to stockholders of River City Bank. The transaction requires no future contingent consideration payments. The merger of the Company and River City Bank resulted in a combined company with approximately $572 million in assets and increases the Company s presence in Henrico County and establishes a presence in Hanover County continuing our goal of expanding our franchise into other counties in the Richmond metropolitan area.

Goodwill of $6.7 million has been recorded in this transaction which will not be amortizable and is not deductible for tax purposes. The Company also recorded $809,318 in core deposits intangibles which will be amortized over eight years using the straight line method.

The acquisition of River City Bank constituted a business combination under SFAS No. 141 Business Combinations, and was accounted for using the purchase method of accounting. Accordingly the purchase price was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values on the date of acquisition. The excess of purchase price over the fair value of net assets was recorded as goodwill. The purchase price allocation as of December 31, 2008, is subject to revision in future periods, including adjustments that may be necessary upon the filing of the final tax returns of River City Bank.

Note 8 Fair value

Effective January 1, 2008, the Company adopted SFAS 157. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Significant other observable inputs other than Level 1 prices such as 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.

Level 3 Significant unobservable inputs that reflect a company s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Investment securities: The fair values for investment securities are determined by quoted prices for similar assets or liabilities (Level 2).

Residential loans held for sale: The fair value of loans held for sale is determined using quoted prices for a similar asset, adjusted for specific attributes of that loan (Level 2).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The use of discounted cash flow models and management s best judgment are significant inputs in arriving at the fair value measure of the underlying collateral and are therefore classified within (Level 3).

Assets and liabilities measured at fair value under SFAS No. 157 on a recurring and non-recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurement at March 31, 2009 Using (In Thousands)			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets-Recurring				
Available for sale investment securities (1)	$ 25,807		$ 25,807	
Residential loans held for sale	9,532		9,532	
Financial Assets-Non-Recurring				
Impaired loans (2)	13,369			$ 13,369
Real estate owned				3,967

(1) Excludes restricted stock.
(2) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

The following tables present the changes in the Level 3 fair value category for the three months ended March 31, 2009.

	Impaired Loans	**Total Assets**
Balance at December 31, 2008	$ 8,528	$ 8,528
Total realized and unrealized gains (losses)		
Included in earnings	-	-
Included in other comprehensive income	-	-
settlements, net	-	-
Transfers in and/or out of Level 3	4,841	4,841
Balance at March 31, 2009	$ 13,369	$ 13,369

	Fair Value Measurement at December 31, 2008 Using (In Thousands)			
	Carrying Value	Quoted Prices in Active Markets for Indentical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets-Recurring				
Available for sale investment securities (1)	$ 24,301	-	$ 24,301	-
Residential loans held for sale	$ 4,326	-	$ 4,326	-
Financial Assets-Non-Recurring				
Impaired loans (2)	$ 8,528	-	-	$ 8,528
Real estate owned				2,932

(1) Excludes restricted stock.
(2) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

Note 9 Subsequent events

On May 1, 2009, as part of the Capital Purchase Program established by the U.S. Department of the Treasury (the Treasury) under the Emergency Economic Stabilization Act of 2008 (EESA), the Company entered into a Letter Agreement and Securities Purchase Agreement Standard Terms (collectively, the Purchase Agreement) with the Treasury, pursuant to which the Company sold (i) 14,738 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $4.00 per share, having a liquidation preference of $1,000 per share (the Preferred Stock) and (ii) a warrant (the Warrant) to purchase 499,029 shares of the Company s common stock at an initial exercise price of $4.43 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of $14,738,000 in cash.

The Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum. The Preferred Stock is generally non-voting, other than on certain matters that could adversely affect the Preferred Stock.

The Warrant is immediately exercisable. The Warrant provides for the adjustment of the exercise price and the number of shares of common stock issuable upon exercise pursuant to customary anti-dilution provisions, such as upon stock splits or distributions of securities or other assets to holders of common stock, and upon certain issuances of common stock at or below a specified price relative to the then-current market price of common stock. The Warrant expires ten years from the issuance date. If, on or prior to December 31, 2009, the Company receives aggregate gross cash proceeds of not less than the purchase price of the Preferred Stock from one or more Qualified Equity Offerings announced after October 13, 2008, the number of shares of common stock issuable pursuant to the Treasury s exercise of the Warrant will be reduced by one-half of the original number of shares, taking into account all adjustments, underlying the Warrant. Pursuant to the Purchase Agreement, the Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

Note 10 Recent accounting pronouncements

On October 10, 2008, the FASB issued FSP No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). FSP 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The issuance of FSP 157-3 did not have any impact on the Company s determination of fair value for its financial assets.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, (SFAS 141(R)) which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. The Company does not expect the adoption of this statement to have a material effect on our results of operations or financial position at this time.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements-an amendment of ARB No. 51 (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting non-controlling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financials statements and separate from the parent s equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The adoption of this standard did not have a material impact on the Company s consolidated financial position or results of operations.

In April 2009, the FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. Earlier adoption is permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. FSP FAS 115-2 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its consolidated financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities. SAB 111 maintains the SEC Staff s previous views related to equity securities and amends Topic 5.M.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Forward-Looking Statements

Certain information contained in this discussion may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by phrases such as we expect, we believe or words of similar import. Such forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- interest rate fluctuations;
- risk inherent in making loans such as repayment risks and fluctuating collateral values;
- economic conditions in the Richmond metropolitan area;
- the ability to continue to attract low cost core deposits to fund asset growth;
- changes in general economic and business conditions;
- changes in laws and regulations applicable to us;
- competition within and from outside the banking industry;
- the ability to successfully manage the Company s growth or implement its growth strategies if it is unable to identify attractive markets, locations or opportunities to expand in the future;
- maintaining capital levels adequate to support the Company s growth;
- reliance on the Company s management team, including its ability to attract and retain key personnel;
- new products and services in the banking industry;
- problems with our technology;
- changing trends in customer profiles and behavior;
- negative developments in the financial services industry and U.S. and global credit markets may adversely impact our results of operations and our stock price; and
- soundness of other financial institutions could adversely affect us.

Although we believe that our expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

General

The Company was organized under the laws of the Commonwealth of Virginia as a bank holding company whose activities consist of investment in its wholly-owned subsidiary, the Bank. The Bank is engaged in commercial and retail banking. We opened to the public on December 13, 1999. We place special emphasis on serving the financial needs of individuals, small and medium sized businesses, entrepreneurs, and professional concerns.

The Bank has three subsidiaries: Village Bank Mortgage Company, Village Insurance Agency, Inc., and Village Financial Services Company. Through our combined companies, we offer a wide range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans. We are a community-oriented and locally owned and managed financial institution focusing on providing a high level of responsive and personalized services to our customers, delivered in the context of a strong direct relationship with the customer. We conduct our operations from our main office/corporate headquarters location and fourteen branch offices.

Net interest income is our primary source of earnings and represents the difference between interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. The level of net interest income is affected primarily by variations in the volume and mix of those assets and liabilities, as well as changes in interest rates when compared to previous periods of operation. In addition, revenues are generated from fees charged on deposit accounts and gains from sale of mortgage loans to third-party investors.

Our total assets increased to $579,642,000 at March 31, 2009 from $572,408,000 at December 31, 2008, an increase of $7,234,000, or 1.3%. During the first quarter of 2009 liquid assets (cash and due from banks, federal funds sold and investment securities available for sale) decreased by $299,000, loans held for sale increased by $5,206,000, net portfolio loans increased by $1,263,000, premises and equipment decreased by $198,000 and other assets increased by $1,262,000. The net increase in these assets of $7,234,000 was funded by a $16,207,000 increase in deposit accounts offset by a decrease in borrowings of $8,873,000.

The following presents management s discussion and analysis of the financial condition of the Company at March 31, 2009 and December 31, 2008, and results of operations for the Company for the three month periods ended March 31, 2009 and 2008. This discussion should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission as well as the first quarter 2009 financial statements and notes thereto appearing elsewhere in this report.

Results of operations

The Company had a loss totaling $(75,000), or $(0.02) per share on a fully diluted basis, in the first quarter of 2009 compared to net income of $93,000, or $0.04 per share on a fully diluted basis, in the first quarter of 2008. This represents a decrease in profitability of $168,000, or 181%.

The decline in net earnings during the quarter ended March 31, 2009 resulted primarily from an increase in the provision for loan losses of $851,000 offset by an increase in gain on sale of loans of $517,000. The increase in the provision for loan losses is discussed following under *Asset Quality and Provision for Loan Losses*. The increase in gain on sale of loans is attributable to increased loan production by the mortgage banking subsidiary of the Bank. The mortgage subsidiary closed $49,329,000 in mortgage loans in the first quarter of 2009 compared to $19,287,000 in the first quarter of 2008. Lower interest rates in 2009 have resulted in increased refinancing activity.

On October 1, 2008, River City Bank was merged into Village Bank adding approximately $157.7 million in assets at the time of merger. The financial statements of the Company for the first quarter of 2009 reflect the combined operations of the Company and River City Bank whereas the financial statements for the first quarter of 2008 do not. This merger has a significant affect on the Company s results of operations. A significant, and in certain instances dominant, component of the changes in the Company s results of operations between the first quarter of 2008 and the first quarter of 2009 is attributable to the merger.

Net interest income

Net interest income is our primary source of earnings and represents the difference between interest and fees earned on interest-earning assets and the interest paid on interest-bearing liabilities. The level of net interest income is affected primarily by variations in the volume and mix of those assets and liabilities, as well as changes in interest rates when compared to previous periods of operation.

Net interest income for the three months ended March 31, 2009 and 2008 was $3,907,000 and $2,786,000, respectively. This increase of $1,121,000 is primarily attributable to the merger with River City Bank.

Our net interest margin (net interest margin is calculated by dividing net interest income by average earning assets) for the first quarter of 2009 was 3.04% compared to 3.09% for the first quarter of 2008. The net interest margin for the first quarters of 2009 and 2008 were negatively affected by a reduction in interest income on loans resulting from the reversal of accrued interest on loans classified as nonaccrual of $171,000 and $107,000, respectively. Adjusting the net interest margins for the affect of such interest reversals would result in a net interest margins of 3.17% and 3.21%, respectively (see discussion of nonaccrual loans under *Asset Quality and Provision for Loan Losses*). Margin compression from declining interest rates over the last two years has been a significant factor in our decline in profitability over that period. As interest rates were reduced by the Federal Reserve during 2007 and 2008 in reaction to the declining economy, our margin was compressed as our deposits generally do not reprice as quickly as our loans. In addition, the net interest margin starting with the fourth quarter of 2008 was negatively affected by the merger with River City Bank primarily due to lower yields on loans acquired through the merger.

Average interest-earning assets for the first quarter of 2009 increased by $159,357,000, or 44%, compared to the first quarter of 2008. The increase in interest-earning assets was due primarily to the merger with River City Bank. The average yield on interest-earning assets decreased to 6.49% for the first quarter of 2009 compared to 7.50% for the first quarter of 2008. Many of our loans are indexed to short-term rates affected by the Federal Reserve s decisions about short-term interest rates, and, accordingly, as the Federal Reserve increases or decreases short-term rates, the yield on interest-earning assets is affected. As the Federal Reserve decreased interest rates starting in 2007 and into 2008, decreasing short-term interest rates by 5% over twelve months, the average yield on our interest-earning assets decreased. In addition, the yield on loans was negatively affected by the merger with River City Bank.

Our average interest-bearing liabilities increased by $153,696,000, or 45%, for the first quarter of 2009 compared to the first quarter of 2008. The growth in interest-bearing liabilities was primarily due to the merger with River City Bank. The average cost of interest-bearing liabilities decreased to 3.63% for the first three months of 2009 from 4.67% for the first quarter of 2008. The principal reason for the decrease in liability costs was the reduction in short-term interest rates by the Federal Reserve. See our discussion of interest rate sensitivity below for more information.

The following table illustrates average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted-average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances. We had no tax exempt assets for the periods presented.

Average Balance Sheets
(In thousands)

	Three Months Ended March 31, 2009			Three Months Ended March 31, 2008		
	Average Balance	Interest Income/ Expense	Annualized Yield Rate	Average Balance	Interest Income/ Expense	Annualized Yield Rate
Loans net of deferred fees	$ 474,419	$ 7,928	6.78%	$ 335,988	$ 6,466	7.74%
Investment securities	25,740	337	5.30%	10,861	143	5.31%
Loans held for sale	6,461	81	5.10%	2,780	42	6.10%
Federal funds and other	15,188	7	0.19%	12,822	107	3.35%
Total interest earning assets	521,808	8,353	6.49%	362,451	6,758	7.50%
Allowance for loan losses	(6,221)			(3,444)		
Cash and due from banks	12,300			6,124		
Premises and equipment, net	28,121			18,950		
Other assets	24,953			10,905		
Total assets	$ 580,961			$ 394,986		
Interest bearing deposits						
Interest checking	$ 19,122	$ 67	1.42%	$ 10,918	$ 27	0.99%
Money market	30,420	132	1.76%	25,548	169	2.66%
Savings	6,107	18	1.19%	3,361	10	1.20%
Certificates	388,877	3,786	3.95%	277,996	3,489	5.05%
Total deposits	444,526	4,003	3.65%	317,823	3,695	4.68%
Borrowings	51,609	443	3.48%	24,616	278	4.54%
Total interest bearing liabilities	496,135	4,446	3.62%	342,439	3,973	4.67%
Noninterest bearing deposits	36,013			23,329		
Other liabilities	2,746			1,991		
Total liabilities	534,894			367,759		
Equity capital	46,067			27,227		
Total liabilities and capital	$ 580,961			$ 394,986		
Net interest income before provision for loan losses		$ 3,907			$ 2,785	
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities			2.86%			2.83%
Annualized net interest margin (net interest income expressed as percentage of average earning assets)			3.04%			3.09%

Asset Quality and Provision for Loan Losses

Provisions for loan losses amounted to $1,100,000 for the three months ended March 31, 2009 compared to $249,000 for the first quarter of 2008. The increase in the provision for loan losses in 2009 when compared to 2008 reflects a higher level of problem loans, management s concern about the uncertainty in the economy, and the current nationwide credit crisis.

Nonperforming assets consisting of nonaccrual loans and other real estate owned for the indicated periods is as follows (dollars in thousands):

		March 31, 2009		December 31, 2008	% Increase
Nonaccrual loans					
Number		49		36	
Amount	$	13,369	$	8,528	56.77%
Other real estate owned		3,967		2,932	35.30%
	$	17,336	$	11,460	51.27%
Percentage of total assets		2.99%		2.00%	

The increase in nonperforming assets in the first quarter of 2009 reflects the continued decline in the economy and related stress on our lending relationships. Our approach to troubled lending relationships is to work with the borrower to the extent possible and still adhere to strong credit management guidelines. If the economy continues to be depressed at the levels we have experienced in the latter part of 2008 and into 2009, nonperforming assets could continue to increase. See our discussion of the allowance for loan losses under *Allowance for loan losses* and *Critical accounting policies* below.

In addition to the nonperforming assets at March 31, 2009, there were nineteen loans past due 90 days or more and still accruing interest totaling $1,435,000, down significantly from forty-three loans totaling $6,197,000 at December 31, 2008. We believe that these assets are adequately collateralized and are currently recorded at realistically recoverable values. However, economic circumstances related to specific credit relationships are changing, which may impact our assessments of collectability.

The following table reflects details related to asset quality and allowance for loan losses of Village Bank (dollars in thousands):

	March 31, 2009	Dec. 31, 2008	March 31, 2008
Loans 90+ days past due	$ 1,435	$ 6,197	$ 1,623
Nonaccrual loans	$ 13,369	$ 8,528	$ 6,835
Other real estate owned	$ 3,967	$ 2,932	$ 385
Allowance for loan losses			
Beginning balance	$ 6,059	$ 3,853	$ 3,469
Provision for loan losses	1,100	744	249
River City Bank acquisition	-	2,404	-
Charge-offs	(314)	(1,337)	(209)
Recoveries	4	395	-
Ending balance	$ 6,849	$ 6,059	$ 3,509
Ratios			
Allowance for loan losses to			
Loans, net of unearned income	1.45%	1.29%	1.01%
Nonaccrual loans	51.23%	71.05%	51.34%
Nonperforming assets to total assets	2.99%	2.00%	1.85%

Noninterest income

Noninterest income of $1,456,000 for the first quarter of 2009 is $698,000 higher than noninterest income of $758,000 for the first quarter of 2008. This increase in noninterest income is primarily a result of higher gain on loan sales and fees from increased loan production by our mortgage banking subsidiary attributable to a much higher volume of lending as a result of the refinance market.

Noninterest expense

Noninterest expense increased by $1,224,000 from the first quarter of 2008 to the first quarter of 2009, an increase of 39%. The increase was primarily a result of the merger with River City Bank. The most significant increases from the merger were in salaries and benefits of $618,000 and occupancy expenses of $191,000. Loan underwriting expenses also increased by $112,000 which was attributable to the increased loan volume by our mortgage company discussed previously.

Income taxes

The benefit for income taxes of $(39,000) for the three months ended March 31, 2009 is based upon the results of operations. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The Company must also evaluate the likelihood that deferred tax assets will be recovered from future taxable income. If any such assets are not likely to be recovered, a valuation allowance must be recognized. We determined that a valuation allowance was not required for deferred tax assets as of March 31, 2009. The assessment of the carrying value of deferred tax assets is based on certain assumptions, changes in which could have a material impact on the Company s financial statements.

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded a franchise tax expense of $30,000 and $59,000 for the three months ended March 31, 2009 and 2008, respectively.

Loan portfolio

The following table presents the composition of our loan portfolio (excluding mortgage loans held for sale) at the dates indicated.

Loan Portfolio, Net
(In thousands)

		March 31, 2009			December 31, 2008	
		Amount	%		Amount	%
Commercial	$	48,952	10.3%	$	52,438	11.1%
Real estate - residential		87,133	18.4%		84,612	18.0%
Real estate - commercial		225,437	47.7%		220,400	46.8%
Real estate - construction		102,595	21.7%		103,161	21.9%
Consumer		8,864	1.9%		10,307	2.2%
Total loans		472,981	100.0%		470,918	100.0%
Less: unearned income, net		(206)			(196)	
Less: Allowance for loan losses		(6,849)			(6,059)	
Total loans, net	$	465,926		$	464,663	

Allowance for loan losses

The allowance for loan losses at March 31, 2009 was $6,849,000, compared to $6,059,000 at December 31, 2008. The ratio of the allowance for loan losses to gross portfolio loans (net of unearned income and excluding mortgage loans held for sale) at March 31, 2009 and December 31, 2008 was 1.45% and 1.29%, respectively. The amount of the loan loss provision is determined by an evaluation of the level of loans outstanding, the level of non-performing loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions. See our discussion of the allowance for loan losses under *Critical accounting policies* below.

The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated.

Analysis of Allowance for Loan Losses
(In thousands)

	Three Months Ended March 31, 2009	2008
Beginning balance	$ 6,059	$ 3,469
Provision for loan losses	1,100	249
Charge-offs		
Commercial	-	(89)
Construction	(187)	(40)
Consumer	(127)	-
Mortgage	-	(81)
	(314)	(210)
Recoveries		
Commercial	-	-
Construction	3	-
Consumer	1	1
	4	1
Ending balance	$ 6,849	$ 3,509
Loans outstanding at end of year (1)	$ 472,775	$ 347,390
Ratio of allowance for loan losses as a percent of loans outstanding at end of year	1.45%	1.01%
Average loans outstanding for the period (1)	$ 474,420	$ 335,988
Ratio of net charge-offs to average loans outstanding for the period	0.07%	0.06%

(1) Loans are net of unearned income.

Investment portfolio

At March 31, 2009 and December 31, 2008, all of our securities were classified as available-for-sale. The following table presents the composition of our investment portfolio at the dates indicated.

Investment Securities Available-for-Sale
(Dollars in thousands)

		Par Value		Amortized Cost		Unrealized Gain (Loss)		Estimated Fair Value	Average Yield
March 31, 2009									
US Government Agencies									
Within one year	$	-	$	-	$	-	$	-	-
One to five years		-		-		-		-	-
More than five years		18,693		18,886		274		19,160	5.42%
Total		18,693		18,886		274		19,160	5.42%
Mortgage-backed securities									
One to five years		1,038		1,039		18		1,057	4.39%
More than five years		4,161		4,159		129		4,288	5.50%
Other investments									
More than five years		2,000		1,971		(669)		1,302	5.65%
Total investment securities	$	25,892	$	26,055	$	(248)	$	25,807	5.14%
December 31, 2008									
US Government Agencies									
Within one year	$	360	$	360	$	(4)	$	356	4.22%
One to five years		-		-		-		-	-
More than five years		16,577		16,506		184		16,690	4.64%
Total		16,937		16,866		180		17,046	5.42%
Mortgage-backed securities									
One to five years		1,100		1,100		15		1,115	4.39%
More than five years		4,346		4,392		(38)		4,354	5.53%
Other investments									
More than five years		2,000		1,970		(184)		1,786	5.65%
Total investment securities	$	24,383	$	24,328	$	(27)	$	24,301	5.14%

Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is evaluated at least annually for impairment by comparing its fair value with its recorded amount and is written down when appropriate. Projected net operating cash flows are compared to the carrying amount of the goodwill recorded and, if the estimated net operating cash flows are less than the carrying amount, a loss is recognized to reduce the carrying amount to fair value.

Goodwill of $7,422,000 at March 31, 2009 was made up of $689,000 related to the Bank s acquisition of Village Bank Mortgage Corporation in 2003, and $6,733,000 related to the merger with River City Bank in 2008. There was no impairment of goodwill at March 31, 2009.

Deposits

Total deposits increased by $16,207,000, or 4%, during the first three months of 2009 as compared to an increase of $5,615,000, or 2%, during the first three months of 2008. For the first three months of 2009, demand deposit accounts, including money market accounts, increased by $9,148,000 and time deposits increased by $5,414,000. We believe these increases reflect our increased branch network as a result of the merger with River City Bank as well as the general movement of cash to federally insured deposits from more risky investments. For the first quarter of 2008, demand deposit accounts, including money market accounts, increased by $12,823,000 while time deposits decreased by $7,377,000. This reflected management s strategy to allow higher yielding time deposits to decline to improve our cost of funds.

The mix of our deposits continues to be weighted toward time deposits, which represent 80% of our total deposits at March 31, 2009 as compared to 81% at December 31, 2008. However, as our branch network has increased and is more convenient to a larger segment of our targeted customer base, we have experienced a move to a higher percentage of our deposits in checking accounts. We are emphasizing checking account deposit growth at our existing branches.

The average cost of interest-bearing deposits for the first quarter of 2009 was 3.65% compared to 4.68% for the first quarter of 2008. This decrease in our average cost of interest-bearing deposits has mirrored the overall decrease in interest rates resulting from the actions by the Federal Reserve to decrease short-term interest rates. But just as importantly, our effort to increase checking accounts in our branches is working to reduce our cost of interest-bearing deposits. We expect this decrease in our cost of deposits to continue even if the Federal Reserve does not continue to decrease short-term interest rates, primarily due to repricing of time deposits.

The variety of deposit accounts that we offer has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and is expected to continue to be, significantly affected by money market conditions.

Borrowings

We use borrowings to supplement deposits when they are available at a lower overall cost to us or they can be invested at a positive rate of return.

As a member of the Federal Home Loan Bank of Atlanta (FHLB), the Bank is required to own capital stock in the FHLB and is authorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. Borrowings from the FHLB were $25,000,000 at March 31, 2009 and December 31, 2008. The FHLB advances are secured by the pledge of first mortgage loans, home equity loans and our FHLB stock.

Capital resources

Stockholders equity at March 31, 2009 was $45,976,000, compared to $46,163,000 at December 31, 2008. The $187,000 decrease in equity during the first three months of 2009 was primarily due to net loss of $(75,000) and a $(157,000) other comprehensive loss related to the available for sale investments.

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, under capitalized, significantly under capitalized, and critically under capitalized. The Bank meets the criteria to be categorized as a well capitalized institution as of March 31, 2009.

During the first quarter of 2005 and the third quarter of 2007, the Company issued $5.2 and $3.6 million, respectively in Trust Preferred Capital Notes. The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion.

On May 1, 2009, as part of the Capital Purchase Program established by the U.S. Department of the Treasury under the Emergency Economic Stabilization Act of 2008, the Company entered into a Letter Agreement and Securities Purchase Agreement Standard Terms (collectively, the Purchase Agreement) with the Treasury, pursuant to which the Company sold (i) 14,738 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $4.00 per share, having a liquidation preference of $1,000 per share (the Preferred Stock) and (ii) a warrant to purchase 499,029 shares of the Company s common stock at an initial exercise price of $4.43 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of $14,738,000 in cash. The Preferred Stock will qualify as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum. The Preferred Stock is generally non-voting, other than on certain matters that could adversely affect the Preferred Stock. Had this transaction occurred as of March 31, 2009, our tier 1 and total risk-based capital would have been $60,714,000 and $68,148,000, respectively.

The following table presents the composition of regulatory capital and the capital ratios at the dates indicated.

Analysis of Capital
(*In thousands*)

	March 31, 2009	December 31, 2008
Tier 1 capital		
Common stock	$ 16,922	$ 16,917
Additional paid-in capital	25,778	25,737
Retained earnings	3,379	3,454
Accumulated other comprehensive income	(103)	54
Total equity	45,976	46,162
Less: Net unrealized gains (losses) on available for sale securities	(103)	54
Qualifying restricted core capital elements	8,500	8,500
Less: goodwill	(7,422)	(7,422)
Total Tier 1 capital	47,157	47,186
Tier 2 capital		
Allowance for loan losses includible in Tier 2 (1)	6,253	6,059
Total Tier 2 capital	6,253	6,059
Total risk-based capital	53,410	53,245
Risk-weighted assets	$ 499,654	$ 500,689
Capital ratios		
Tier 1 capital to risk-weighted assets	9.44%	9.42%
Total capital to risk-weighted assets	10.69%	10.6%
Leverage ratio (Tier 1 capital to average assets)	8.23%	8.40%
Equity to total assets	7.93%	8.06%

(1) Amount is limited to 1.25 percent of the Company's gross risk weighted assets.

Liquidity

Liquidity provides us with the ability to meet normal deposit withdrawals, while also providing for the credit needs of customers. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide for reasonable growth, and fully comply with all regulatory requirements.

At March 31, 2009, cash, cash equivalents and investment securities available for sale totaled $50,603,000, or 8.7% of total assets, which we believe is adequate to meet short-term liquidity needs.

At March 31, 2009, we had commitments to originate $111,047,000 of loans as compared to $88,892,000 at December 31, 2008. The increase is primarily attributable to commitments to make mortgage loans by our mortgage company which will be sold in the secondary market.

Fixed commitments to incur capital expenditures were less than $25,000 at March 31, 2009. Time deposits scheduled to mature in the 12-month period ending March 31, 2010 totaled $317,352,000 at March 31, 2009. Based on past experience, we believe that a significant portion of such deposits will remain with us. We further believe that loan repayments and other sources of funds such as deposit growth will be adequate to meet our foreseeable short-term and long-term liquidity needs.

The receipt of $14,738,000 in new capital from the Capital Purchase Program established by the U.S. Department of the Treasury discussed in Note 9 to the interim financial statements will provide additional liquidity in the short term. However, it is anticipated that these funds will be used to fund new and existing loan commitments within twelve months.

Interest rate sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management s outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

Contractual principal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The average lives of mortgage loans are substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due and payable in the event, among other things, the borrower sells the real property subject to the mortgage and the loan is not repaid. In addition, certain borrowers increase their equity in the security property by making payments in excess of those required under the terms of the mortgage.

The sale of fixed rate loans is intended to protect us from precipitous changes in the general level of interest rates. The valuation of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the value of fixed rate loans. As with other investments, we regularly monitor the appropriateness of the level of adjustable rate mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest the proceeds in other adjustable rate investments.

The data in the following table reflects repricing or expected maturities of various assets and liabilities at March 31, 2009. The gap analysis represents the difference between interest-sensitive assets and liabilities in a specific time interval. Interest sensitivity gap analysis presents a position that existed at one particular point in time, and assumes that assets and liabilities with similar repricing characteristics will reprice at the same time and to the same degree.

Village Bank and Trust Financial Corp.
Interest Rate Sensitivity GAP Analysis
March 31, 2009
(*In thousands*)

	Within 3 Months	3 to 6 Months	6 to 12 Months	13 to 36 Months	More than 36 Months	Total
Interest Rate Sensitive Assets						
Loans (1)						
Fixed rate	$ 30,311	$ 14,933	$ 33,294	$ 18,862	$ 150,113	$ 247,513
Variable rate	154,677	5,866	5,361	11,027	48,537	225,468
Investment securities	-	-	-	860	24,947	25,807
Loans held for sale	9,532	-	-	-	-	9,532
Federal funds sold	11,382	-	-	-	-	11,382
Total rate sensitive assets	205,902	20,799	38,655	30,749	223,597	519,702
Cumulative rate sensitive assets	205,902	226,701	265,356	296,105	519,702	
Interest Rate Sensitive Liabilities						
Interest checking (2)	-	-	-	21,441	-	21,441
Money market accounts	31,546	-	-	-	-	31,546
Savings (2)	-	-	-	7,033	-	7,033
Certificates of deposit	64,116	98,465	154,771	57,304	9,689	384,345
FHLB advances	-	-		25,000	-	25,000
Trust Preferred Securities	-	-	-	-	8,764	8,764
Federal funds purchased	-	-	-	-	-	-
Other borrowings	15,090	-	-	-	-	15,090
Total rate sensitive liabilities	110,752	98,465	154,771	110,778	18,453	493,219
Cumulative rate sensitive liabilities	110,752	209,217	363,988	474,766	493,219	
Rate sensitivity gap for period	$ 95,150	$ (77,666)	$ (116,116)	$ (80,029)	$ 205,144	$ 26,483
Cumulative rate sensitivity gap	$ 95,150	$ 17,484	$ (98,632)	$ (178,661)	$ 26,483	
Ratio of cumulative gap to total assets	16.4%	3.0%	(17.0)%	(30.8)%	4.6%	
Ratio of cumulative rate sensitive assets to cumulative rate sensitive liabilities	185.9%	108.4%	72.9%	62.4%	105.4%	
Ratio of cumulative gap to cumulative rate sensitive assets	46.2%	7.7%	(37.2)%	(60.3)%	5.1%	

(1) Includes nonaccrual loans of approximately $13,369,000, which are spread throughout the categories.
(2) Management believes that interest checking and savings accounts are generally not sensitive to changes in interest rates and therefore has placed such deposits in the "13 to 36 months" category.

At March 31, 2009, our assets that reprice within six months exceeded liabilities that reprice within six months by $17,484,000 and therefore we were in an asset positive position. An asset positive position, or positive gap, can adversely affect earnings in periods of falling interest rates, but can improve earnings in periods of rising interest rates.

Critical accounting policies

The financial condition and results of operations presented in the financial statements, accompanying notes to the financial statements and management's discussion and analysis are, to a large degree, dependent upon our accounting policies. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change.

Presented below is a discussion of those accounting policies that management believes are the most important accounting policies to the portrayal and understanding of our financial condition and results of operations. These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood. See also Note 1 of the *Notes to Consolidated Financial Statements* filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. We maintain policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system.

We evaluate various loans individually for impairment as required by Statement of Financial Accounting Standards (SFAS) 114, *Accounting by Creditors for Impairment of a Loan*, and SFAS 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. If a loan evaluated individually is not impaired, then the loan is assessed for impairment under SFAS 5, *Accounting for Contingencies*, with a group of loans that have similar characteristics.

For loans without individual measures of impairment, we make estimates of losses for groups of loans as required by SFAS 5. Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. If the estimate of losses is

below the range of reasonable estimates, the allowance would be reduced by way of a credit to the provision for loan losses. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the financial statements.

Impact of inflation and changing prices and seasonality

The financial statements in this document have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars, without consideration of changes in the relative purchasing power of money over time due to inflation.

Unlike industrial companies, most of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution s performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4T CONTROLS AND PROCEDURES

Based upon an evaluation as of March 31, 2009 under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of the Company s disclosure controls and procedures, they have concluded that our disclosure controls and procedures, as defined in Rule 13a-15 and Rule 15d-15 under the Securities Exchange Act of 1934, as amended, are effective in ensuring that all material information required to be disclosed in reports that it files or submits under such Act is recorded, processed, summarized and is made known to management in a timely fashion.

Our management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in our internal control over financial reporting identified in connection with the evaluation of it that occurred during the Company s last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

Not applicable.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5 OTHER INFORMATION

Not applicable.

ITEM 6 EXHIBITS

31.1	Certification of Chief Executive Officer

31.2	Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

SIGNATURES

In accordance with 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.

VILLAGE BANK AND TRUST FINANCIAL CORP.
(Registrant)

Date: May 14, 2009

By: /s/ Thomas W. Winfree
Thomas W. Winfree
President and
Chief Executive Officer

Date: May 14, 2009

By: /s/ C. Harril Whitehurst, Jr.
C. Harril Whitehurst, Jr.
Senior Vice President and
Chief Financial Officer

Exhibit Index

Exhibit Number	Document
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350