

UNITED STATES
FEDERAL RESERVE BOARD OF GOVERNORS
Washington, DC 20551

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For Quarterly Period Ended: March 31, 2006

OR

TRANSITION REPORT UNDER SECTIONS 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: _____

MONARCH BANK

(Exact name of small business issuer as specified in its charter)

Virginia

54-1896433

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1101 Executive Drive, Chesapeake, Virginia

23320

(Address of principal executive offices)

(Zip Code)

(757) 389-5112

(Issuer's telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Number of shares of common stock of registrant outstanding at May 8, 2006: 3,150,729

MONARCH BANK
FORM 10-Q
MARCH 31, 2006

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

**Consolidated Balance Sheets
Monarch Bank and Subsidiaries**

	<u>Unaudited March 31, 2006</u>	<u>Audited December 31, 2005</u>
ASSETS:		
Cash and cash equivalents:		
Cash and due from banks	\$ 8,199,568	\$ 10,458,253
Interest bearing bank balances	8,363,767	2,669,852
Federal funds sold	<u>450,555</u>	<u>2,147,569</u>
Total cash and cash equivalents	17,013,890	15,275,674
Investment securities held-to-maturity, at cost	28,057,449	22,088,894
Investment securities available-for-sale, at fair value	13,851,797	14,309,928
Mortgages held for sale	3,661,772	4,253,542
Loans:		
Loans, net of unearned income	273,585,053	263,266,420
Less: allowance for loan losses	<u>(2,783,000)</u>	<u>(2,685,000)</u>
Loans, net	270,802,053	260,581,420
Interest receivable	1,237,797	1,206,998
Property and equipment, net	3,755,030	3,375,084
Restricted equity securities	2,535,250	2,327,750
Bank owned life insurance	6,114,936	6,056,548
Other assets	<u>1,687,782</u>	<u>1,698,207</u>
Total assets	<u>\$ 348,717,756</u>	<u>\$ 331,174,045</u>
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 59,584,287	\$ 55,502,545
Interest-bearing	<u>230,832,009</u>	<u>217,570,559</u>
Total deposits	290,416,296	273,073,104
Borrowings:		
Federal funds purchased	-	1,000
Federal Home Loan Bank advances	<u>26,950,049</u>	<u>26,975,025</u>
Total borrowings	26,950,049	26,976,025
Other liabilities	<u>778,350</u>	<u>1,315,576</u>
Total liabilities	<u>318,144,695</u>	<u>301,364,705</u>
STOCKHOLDERS' EQUITY:		
Preferred stock, \$5 par value, 2,000,000 shares authorized, none issued	-	-
Common stock, \$5 par value, 5,000,000 shares authorized, issued and outstanding 3,150,729 and 3,149,729 shares, respectively	15,753,645	15,748,645
Additional paid-in capital	13,622,721	13,621,409
Accumulated earnings	1,442,503	635,079
Accumulated other comprehensive loss	<u>(245,808)</u>	<u>(195,793)</u>
Total stockholders' equity	<u>30,573,061</u>	<u>29,809,340</u>
Total liabilities and stockholders' equity	<u>\$ 348,717,756</u>	<u>\$ 331,174,045</u>

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

Consolidated Statements of Income

Monarch Bank and Subsidiaries

Unaudited

	3 Months Ended March 31,	
	2006	2005
Interest income:		
Interest and fees on loans	\$ 5,039,086	\$ 2,915,642
Interest on investment securities		
Taxable	177,361	142,197
Nontaxable	-	1,765
Interest on federal funds sold	23,020	5,511
Dividends on equity securities	28,095	15,475
Other interest income	65,929	1,752
Total interest income	5,333,491	3,082,342
Interest expense:		
Interest on deposits	2,043,017	882,678
Interest on borrowings	125,468	128,307
Total interest expense	2,168,485	1,010,985
Net interest income	3,165,006	2,071,357
Provision for loan losses	96,257	173,000
Net interest income after provision for loan losses	3,068,749	1,898,357
Noninterest income:		
Mortgage banking income	632,898	446,801
Service charges and fees	202,433	172,137
Loss on sale of investment securities	-	(10,841)
Other	71,106	19,661
Total noninterest income	906,437	627,758
Noninterest expenses:		
Salaries and employee benefits	1,632,425	1,154,045
Occupancy expenses	231,849	145,340
Furniture and equipment expenses	122,723	118,521
Data processing services	131,032	111,944
Loan origination expenses	120,112	45,019
Advertising and marketing expenses	102,296	50,515
Professional fees	47,059	14,375
Virginia franchise tax	63,700	45,000
Stationery and supplies	63,121	38,297
Other	263,079	240,556
Total noninterest expenses	2,777,396	1,963,612
Net income before income taxes	1,197,790	562,503
Income tax expense	(390,366)	(190,650)
Net income	\$ 807,424	\$ 371,853
Basic net income per share	\$ 0.26	\$ 0.14
Diluted net income per share	0.24	0.14

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

Item 1. Financial Statements (Continued)

Consolidated Statements of Changes in Shareholders' Equity
Monarch Bank and Subsidiaries

Unaudited

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance - December 31, 2004	2,639,544	\$ 13,197,720	\$ 7,281,843	\$ 784,340	\$ (147,565)	\$ 21,116,338
Net income for three months ended March 31, 2005	-	-	-	371,853	-	371,853
Unrealized loss on available, for sale securities, net of income taxes	-	-	-	-	(124,965)	<u>(124,965)</u>
Total comprehensive income						<u>246,888</u>
Stock options exercised	6,864	34,320	30,680			65,000
Balance - March 31, 2005	<u>2,646,408</u>	<u>\$ 13,232,040</u>	<u>\$ 7,312,523</u>	<u>\$ 1,156,193</u>	<u>\$ (272,530)</u>	<u>\$ 21,428,226</u>
Balance - December 31, 2005	3,149,729	\$ 15,748,645	\$ 13,621,409	\$ 635,079	\$ (195,793)	\$ 29,809,340
Net income for three months ended March 31, 2006	-	-	-	807,424	-	807,424
Unrealized loss on available, for sale securities, net of income taxes	-	-	-	-	(50,015)	<u>(50,015)</u>
Total comprehensive income						<u>757,409</u>
Stock options exercised	1,000	5,000	1,312			6,312
Balance - March 31, 2006	<u>3,150,729</u>	<u>\$ 15,753,645</u>	<u>\$ 13,622,721</u>	<u>\$ 1,442,503</u>	<u>\$ (245,808)</u>	<u>\$ 30,573,061</u>

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

Item 1. Financial Statements (Continued)

Consolidated Statements of Cash Flows
Monarch Bank and Subsidiaries

Unaudited

	3 Months Ended March 31,	
	2006	2005
Operating activities:		
Net income	\$ 807,424	\$ 371,853
Adjustments to reconcile to net cash provided by operating activities:		
Provision for loan losses	96,257	173,000
Provision for depreciation	142,608	104,513
Accretion of discounts and amortization of premiums, net	1,086	36,130
Deferral of loan costs, net of deferred fees	33,410	(27,622)
Net loss on disposition of investment securities	-	10,841
Changes in:		
Mortgage loans held for sale	591,770	1,086,036
Interest receivable	(30,799)	(132,923)
Other assets	(22,198)	(419,223)
Other liabilities	(537,226)	119,863
Net cash provided by from operating activities	1,082,332	1,322,468
Investing activities:		
Purchases of held-to-maturity securities	(25,953,308)	(600,000)
Purchases of available-for-sale securities	(300,882)	(9,995,567)
Proceeds from sales and maturities of available-for-sale securities	666,900	16,158,600
Proceeds from maturities of held-to-maturity securities	20,000,000	-
Loan originations, net of principal repayments	(10,350,300)	(16,810,639)
Purchases of premises and equipment	(522,554)	(169,294)
Sale of restricted equity securities, net of redemptions	(207,500)	364,600
Net cash used by investing activities	(16,667,644)	(11,052,300)
Financing activities:		
Net increase in noninterest-bearing deposits	4,081,742	15,275,331
Net increase in interest-bearing deposits	13,261,450	6,447,376
Net decrease in federal funds purchased	(1,000)	(1,860,000)
Net repayments of FHLB advances	(24,976)	(10,000,000)
Proceeds from issuance of common stock, net of issuance costs	6,312	65,000
Net cash from financing activities	17,323,528	9,927,707
INCREASE IN CASH AND CASH EQUIVALENTS	1,738,216	197,875
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15,275,674	5,228,798
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 17,013,890	\$ 5,426,673
SUPPLEMENTAL SCHEDULES AND CASH FLOW INFORMATION		
Cash paid for:		
Interest on deposits and other borrowings	\$ 2,133,131	\$ 1,012,018
Income taxes	\$ 975,000	\$ 520,000

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

MONARCH BANK
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments consisting of normal recurring accruals necessary to present fairly Monarch Bank's financial position as of March 31, 2006; the consolidated statements of income for the three months ended March 31, 2006 and 2005; the consolidated statements of changes in shareholders' equity for the three months ended March 31, 2006 and 2005; and the consolidated statements of cash flows for the three months ended March 31, 2006 and 2005. These financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes required by generally accepted accounting principles. The financial statements include the accounts of Monarch Bank and its subsidiaries, and all significant intercompany accounts and transactions have been eliminated. Operating results for the three month period ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006.

NOTE 2. GENERAL

Monarch Bank ("Monarch" or the "Bank") is a Virginia chartered bank that offers a full range of banking services, primarily to individuals and businesses in the Hampton Roads area of Virginia. Incorporated in Virginia on May 1, 1998, Monarch commenced operations as a commercial bank on April 14, 1999, at its main office in the Greenbrier area in Chesapeake. In addition to its main office, Monarch has six other offices – in the Great Bridge area in Chesapeake, the Lynnhaven area in Virginia Beach, the Town Center area in Virginia Beach, the Oceanfront area in Virginia Beach, the Ghent area in Norfolk, and in downtown Norfolk.

In June 2000, Monarch formed a subsidiary mortgage company, Monarch Home Funding, LLC, ("MHF") to provide permanent residential mortgage loans. MHF began operations as a mortgage broker in September 2000, originating conventional, FHA and VA residential loans. On April 1, 2003, the Bank increased its ownership interest from 51% to 90% in MHF by purchasing interests from its partners. In the third quarter of 2003, MHF became a mortgage lender. As a mortgage lender, MHF can underwrite mortgage loans for its customers, providing additional mortgage related products and services with much more efficiency. MHF originates conventional, FHA and VA residential loans and offers a construction-permanent loan program. On April 1, 2004, Monarch purchased the remaining interest in MHF from its partners, to increase its ownership to 100%. MHF has two offices - one in Chesapeake and one in Norfolk.

In August 2001, the Bank formed Monarch Investments, LLC for the purpose of selling annuities and investment securities and services. The Bank owns a 100% interest in Monarch Investments, LLC. The Bank has invested in the formation of Bankers Investments Group, LLC, the parent company of BI Investments, LLC, a registered brokerage firm and investment advisor. BI Investments, LLC sells non-deposit investment products in various community banks in Virginia, which are partners in Bankers Investments Group, LLC with the Virginia Bankers Association Management Services Division.

In January 2003, the Bank purchased a partial ownership interest in Bankers Insurance, LLC. Owned by over 50 community banks, Bankers Insurance is a full service property/casualty and life/health agency that ranks as one of the largest agencies in Virginia. Bankers Insurance provides insurance to Monarch Bank customers and to the general public.

In February 2004, the Bank formed Monarch Capital, LLC for the purpose of engaging in the commercial real estate brokerage business. The Bank owns a 100% interest in Monarch Capital, LLC.

In November 2004, the Bank invested in a partial ownership interest in Bankers Title of Hampton Roads, LLC. Owned by 7 community banks, Bankers Title is a full service title insurance agency. Bankers Title provides title insurance products and services to Monarch Bank and Monarch Home Funding customers and to the general public.

NOTE 3. - EARNINGS PER SHARE (“EPS”)

Basic earnings per share (EPS) excludes dilution, and is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised, converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations.

	3 months ended March 31,	
	2006	2005
Net income (numerator, basic and diluted)	<u>\$ 807,424</u>	<u>\$ 371,853</u>
Weighted average shares outstanding (denominator)	<u>3,150,640</u>	<u>2,641,521</u>
Income per common share - basic	<u>\$ 0.26</u>	<u>\$ 0.14</u>
Weighted average shares - diluted (denominator)	<u>3,332,756</u>	<u>2,752,621</u>
Income per common share - diluted	<u>\$ 0.24</u>	<u>\$ 0.14</u>

The dilutive effect of stock options is 182,116 and 111,100 shares for the three months ended March 31, 2006 and 2005, respectively.

NOTE 4 – COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The only component of other comprehensive income consists of unrealized gains and losses on available-for-sale securities. The Bank accounts for comprehensive income in accordance with FASB Statement No. 130, Reporting Comprehensive Income. The following is a detail of comprehensive income for the three months ended March 31, 2006 and 2005:

	Three Months Ended	
	March 31,	
	2006	2005
Net Income	<u>\$ 807,424</u>	<u>\$ 371,853</u>
Change in unrealized gains (losses) on securities available for sale, net of tax expense	<u>(50,015)</u>	<u>(124,965)</u>
Total comprehensive income	<u>\$ 757,409</u>	<u>\$ 246,888</u>
Unrealized holding (losses) gains during the period	<u>\$ (75,780)</u>	<u>\$ (178,294)</u>
Less reclassification adjustment for losses included in income	<u>-</u>	<u>10,841</u>
Total other comprehensive (loss) income before income tax expense	<u>(75,780)</u>	<u>(167,453)</u>
Income tax benefit (expense)	<u>25,765</u>	<u>42,488</u>
Net unrealized (losses) gains	<u>\$ (50,015)</u>	<u>\$ (124,965)</u>

NOTE 5. STOCK BASED COMPENSATION

As of March 31, 2006, the Bank had a stock-based compensation plan. Prior to January 1, 2006, the Bank accounted for the plan under the recognition and measurement principles of APB Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. On January 1, 2006, the Bank adopted FAS Statement No. 123R "Share-Based Payment," (FAS 123R) that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. FAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic method and requires that such transactions be accounted for using a fair-value-based method and recognized as expense in the consolidated statement of income.

The following illustrates the effect on net income and earnings per share for the three month periods ended March 31, 2005 had the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, been adopted prior to January 1, 2006.

	Three Months Ended March 31, 2005
Net income, as reported	\$ 371,853
Deduct: total stock-based employee compensation expense based on fair value method of awards	<u>(3,976)</u>
Pro forma net income	<u>\$ 367,877</u>
Basic earnings per share:	
As reported	\$ 0.14
Pro forma	\$ 0.14
Diluted earnings per share:	
As reported	\$ 0.14
Pro forma	\$ 0.13

NOTE 6. SEGMENT REPORTING

Reportable segments include community banking and mortgage banking services. Community banking involves making loans to and generating deposits from individuals and businesses in the markets where the Bank has offices. Mortgage banking originates residential loans and subsequently sells them to investors. The mortgage banking segment is a strategic business unit that offers different products and services. It is managed separately because the segment appeals to different markets and, accordingly, requires different technology and marketing strategies. The segment's most significant revenue and expense is noninterest income and noninterest expense, respectively. The Bank does not have other reportable operating segments. The accounting policies of the segment are the same as those described in the summary of significant accounting policies. All intersegment sales prices are market based. The assets and liabilities and operating results of the Bank's other wholly owned subsidiary, Monarch Capital, LLC is included in the mortgage banking segment. Monarch Capital, LLC provides commercial mortgage brokerage services.

Segment information for the three months ended March 31, 2006 and 2005 is shown in the following table. The "Other" category includes corporate related items, results of insignificant operations and, as it relates to segment profit (loss), income and expense not allocated to reportable segments.

	<u>Community Banking</u>	<u>Mortgage Banking</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
Three Months Ended March 31, 2006				
Net interest income after provision for loan losses	\$ 3,119,255	\$ (50,506)	\$ -	\$ 3,068,749
Noninterest income	398,522	632,898	(124,983)	906,437
Noninterest expense	<u>(2,324,487)</u>	<u>(496,409)</u>	<u>43,500</u>	<u>(2,777,396)</u>
Net income before income taxes and minority interests	<u>\$ 1,193,290</u>	<u>\$ 85,983</u>	<u>\$ (81,483)</u>	<u>\$ 1,197,790</u>
Three Months Ended March 31, 2005				
Net interest income after provision for loan losses	\$ 1,924,225	\$ (25,869)	\$ -	\$ 1,898,356
Noninterest income	261,518	446,800	(80,560)	627,758
Noninterest expense	<u>(1,623,240)</u>	<u>(353,871)</u>	<u>13,500</u>	<u>(1,963,611)</u>
Net income before income taxes and minority interests	<u>\$ 562,503</u>	<u>\$ 67,060</u>	<u>\$ (67,060)</u>	<u>\$ 562,503</u>
Segment Assets				
2005	\$ 349,342,946	\$ 4,563,681	\$ (5,188,871)	\$ 348,717,756
2004	\$ 237,729,380	\$ 3,915,546	\$ (4,492,966)	\$ 237,151,960

CRITICAL ACCOUNTING POLICIES

The Bank's critical accounting policies are listed below. A summary of the Bank's significant accounting policies is set forth in Note 2 to the Consolidated Financial Statements in the Bank's 2005 Annual Report on Form 10-K.

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

The financial statements and related data presented herein were prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars, without considering the changes in relative purchasing power of money over time due to inflation. The effect of changing prices on financial institutions is typically different from other industries as the Bank's assets and liabilities are monetary in nature. Interest rates are significantly impacted by inflation, but neither the timing nor the magnitude of the changes are directly related to price level indices.

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement No. 154, ("SFAS No. 154") "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3." The new standard changes the requirements for the accounting for and reporting of a change in accounting principle. Among other changes, SFAS No. 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. SFAS No. 154 does not effect the Bank's financial statements at this time.

On December 16, 2004, FASB issued Statement No. 123R (revised 2004), “Share-Based Payment,” (FAS 123R) that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company’s equity instruments or that may be settled by the issuance of such equity instruments. FAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic method and requires that such transactions be accounted for using a fair-value-based method and recognized as expense in the consolidated statement of income. The effective date of FAS 123R (as amended by the SEC) is for annual periods beginning after June 15, 2005. The provisions of FAS 123R do not impact the Company’s consolidated financial position and results of operations currently and the Company anticipates that the application of this statement will not have a material effect on its financial statements in 2006.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107). SAB 107 expresses the views of the SEC staff regarding the interaction of FAS 123R and certain SEC rules and regulations and provides the SEC staff’s view regarding the valuation of share-based payment arrangements for public companies. SAB 107 does not impact the Bank’s results of operations at the present time.

In November 2004, the Emerging Issues Task Force (“EITF”) published Issue 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.” The Task Force discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The Task Force requested that the FASB staff consider other impairment models within U.S. Generally Accepted Accounting Principles (“GAAP”) when developing its views. The Task Force also requested that the scope of the impairment issue be expanded to include equity investments and investments subject to FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” and that the issue be addressed by the Task Force as a separate EITF issue. At the EITF meeting, the Task Force reached a consensus on one issue that certain quantitative and qualitative disclosures should be required for securities accounted for under Statement 115 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The Board ratified the consensus on that one issue at its November 25, 2004 meeting. In September 2004, the Financial Accounting Standards Board (“FASB”) directed the FASB staff to issue two proposed FASB Staff Positions (“FSP”): Proposed FSP EITF Issue 03-1-a, which provides guidance for the application of paragraph 16 of EITF Issue 03-1 to debt securities that are impaired because of interest rate and/or sector spread increases, and Proposed FSP EITF Issue 03-1-b, which delays the effective date of Issue 03-1 for debt securities that are impaired because of interest rate and/or sector spread increases. In June 2005, the FASB reach a decision whereby they declined to provide additional guidance on the meaning of other-than-temporary impairment. The Board directed the FASB staff to issue EITF 03-1a as final and to draft a new FSP that will replace EITF 03-01. The final FSP (retitled FAS 115-1, “The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments”) would be effective for other-than-temporary impairment analysis conducted in periods beginning after September 15, 2005. This revision does not have a material effect on the Bank’s financial statements at the present time.

On March 9, 2004, the SEC Staff issued Staff Accounting Bulletin No. 105, “*Application of Accounting Principles to Loan Commitments*” (“SAB 105”). SAB 105 clarifies existing accounting practices relating to the valuation of issued loan commitments, including interest rate lock commitments (“IRLC”), subject to SFAS No. 149 and Derivative Implementation Group Issue C13, “*Scope Exceptions: When a Loan Commitment is included in the Scope of Statement 133.*” Furthermore, SAB 105 disallows the inclusion of the values of a servicing component and other internally developed intangible assets in the initial and subsequent IRLC valuation. The provisions of SAB 105 were effective for loan commitments entered into after March 31, 2004. The Company has adopted the provisions of SAB 105. Since the provisions of SAB 105 affect only the timing of the recognition of mortgage banking income, management does not anticipate that this guidance will have a material adverse effect on either the Company’s consolidated financial position or consolidated results of operations.

EITF No. 03-16, “*Accounting for Investments in Limited Liability Companies*” was ratified by the Board and is effective for reporting periods beginning after June 15, 2004. APB Opinion No. 18, “*The Equity Method of Accounting Investments in Common Stock,*” prescribes the accounting for investments in common stock of corporations that are not consolidated. AICPA Accounting Interpretation 2, “*Investments in Partnerships Ventures,*” of Opinion 18, indicates that “many of the provisions of the Opinion would be appropriate in accounting” for partnerships. In *EITF Abstracts*, Topic No. D-46, “*Accounting for Limited Partnership Investments,*” the SEC staff clarified its view that investments of more than 3 to 5 percent are considered to be more than minor and, therefore, should be accounted for using the equity method. Limited liability companies (LLCs) have characteristics of both corporations and partnerships, but are dissimilar from both in certain respects. Due to those similarities and differences, diversity in practice exists with respect to accounting for non-controlling investments in LLCs. The consensus reached was that an LLC should be viewed as similar to a corporation or similar to a partnership for purposes of determining whether a non-controlling investment should be accounted for using the cost method or the equity method of accounting.

On July 30, 2002, Congress enacted the Sarbanes-Oxley Act of 2002 (the Act). Among other provisions, the Act provides for the establishment of the Public Company Accounting Oversight Board, rules with respect to auditor independence, corporate governance and responsibility, and enhanced financial disclosures. One of the more significant provisions of Section 404 of Sarbanes-Oxley involves internal control attestation by independent auditors. This provision was to first apply to the Company as of December 31, 2005. However, on March 2, 2005, the Securities and Exchange Commission extended the dates for non-accelerated filers to comply with Section 404 of the Act. As the Company is a non-accelerated filer, its compliance date was extended to December 31, 2007

ITEM 2.

MONARCH BANK
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

The purpose of this discussion is to focus on important factors affecting the Bank's financial condition and results of operations. The discussion and analysis should be read in conjunction with the Consolidated Financial Statements, and supplemental financial data.

This report contains forward-looking statements with respect to the financial condition, results of operations and business of the Bank. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Bank and on information available at the time these statements and disclosures were prepared. Factors that may cause actual results to differ materially from those expected include the following:

- General economic conditions may deteriorate and negatively impact the ability of borrowers to repay loans and depositors to maintain balances.
- Changes in interest rates could reduce income.
- Competitive pressures among financial institutions may increase.
- The businesses that the Bank is engaged in may be adversely affected by legislative or regulatory changes, including changes in accounting standards.
- New products developed or new methods of delivering products could result in a reduction in business and income for the Bank.
- Adverse changes may occur in the securities market.

A summary of the Bank's significant risk factors is set forth in Note 1A in the Bank's 2005 Form 10-K.

Earnings Summary

Monarch Bank reported net income of \$807,424 for the three-month period ending March 31, 2006, compared to \$371,853 for the same period in 2005, an increase of \$435,571, or 117.1%. Net interest income increased 52.8% or \$1,093,649, to \$3,165,006, during the first quarter of 2006, when compared to 2005. Noninterest income increased \$278,679 or 44.4% and noninterest expenses increased \$813,784, or 41.4%. Basic and diluted earnings per share of common stock were \$0.26 and \$0.24 for the first quarter of 2006 and \$0.14 and \$0.14 for 2005. The first quarter of 2006 was Monarch Bank's twenty-third consecutive profitable quarter and the most profitable quarter to-date.

For the three months ended March 31, 2006, profitability as measured by Monarch's annualized return on average assets (ROA) was 1.04% compared to 0.68% for the same period in 2005, an increase of 52.9%. Another measure of the Bank's profitability, the annualized return on average equity (ROE) increased to 10.80% for the first three months of 2006 compared to 6.86% for 2005.

Net Interest Income

Net interest income represents a principal source of earnings for the Bank. Increases in net interest income are primarily attributable to the overall growth of the Bank, arising from higher average outstanding balances in 2006 than 2005 and the increase in the net interest margin. The Federal Reserve Bank's Open Market Committee has been steadily increasing short-term interest rates since June 2004. These increases resulted in a Federal Fund rate of 4.75% at March 31, 2006 as compared to 2.75% at March 31, 2005. The increase in the Federal funds target rate raised the Wall Street Journal Prime Rate to 7.75% versus 5.75% for the same quarter ends, respectively. A majority of the Bank's loans use the Wall Street Journal Prime Rate as their rate index, and increases in this rate increase interest income.

Net interest income was \$3,165,006 for the first three months of 2006, compared to \$2,071,357 for the same period in 2005, an increase of \$1,093,649 or 52.8%. Total interest and fees on loans increased by \$2,123,444, or 72.8% for the three months ended March 31, 2006 compared to 2005. Interest on investment securities increased \$33,399 or 23.2% in the first quarter of 2006 compared to 2005. Early in 2005 a management decision was made to reduce the fixed rate securities portfolio in favor of higher yielding short-term securities and market sensitive, variable rate loans that produced higher yields with faster repricing. Interest on federal funds sold increased \$17,509 or 317.7% and other income, which is interest on interest

bearing bank accounts increased \$64,177 or 3663.1% due to higher balances coupled with higher rates. The Bank has utilized both areas for short-term excess funds placement with the aim of getting the most competitive overnight rate for investing of excess funds. Dividends on restricted equity securities increased \$12,620 or 81.6% for the first quarter of 2006 compared to 2005 as a result of increases in yields and higher balances of stock in the Federal Reserve and the Federal Home Loan Bank of Atlanta.

Interest expense on deposits increased \$1,160,339, or 131.5% for the first three months of 2006 compared to 2005. The increase in deposit expense is due to the increase in average deposits, arising from the overall growth of the Bank and an increase in the overall rates paid on deposits. The high deposit growth has resulted in generally lower borrowing needs and interest expense on borrowings decreased \$2,839 or 2.2% for the same periods, respectively.

Average Balances, Income and Expenses, Yields and Rates

The net interest spread on a tax-equivalent basis for first quarter of 2006 increased 16 basis points to 3.58% when compared to 3.42% for the same period in 2005. The yield on earning assets increased to 7.30% in 2006 compared to 5.90% for the first quarter of 2005, while the cost of interest bearing liabilities was 3.72% and 2.48%, respectively, for the same period. This resulted in the improved interest rate spread and net interest margin. The net interest margin for the first quarter of 2006 was 4.38% compared to 3.97% for the same period in 2005. The net interest margin was at its highest level since 2001.

Bank Owned Life Insurance (BOLI) has been included in interest earning assets. The Bank purchased \$6,000,000 in BOLI during the third quarter of 2005. The income on BOLI is not subject to Federal Income tax, giving it a tax-effective yield of 5.9%.

The following table sets forth average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, stockholders' equity and the related income, expense and corresponding weighted average yields and costs.

AVERAGE BALANCES, INCOME AND EXPENSE, YIELDS AND RATES

For Periods Ended March 31,

	2006			2005		
	Average Balance	Income/Expense	Yield Rate(1)	Average Balance	Income/Expense	Yield Rate(1)
ASSETS						
Securities, at amortized cost						
Taxable	\$ 17,798,418	\$ 177,361	4.04%	\$ 18,011,544	\$ 142,197	3.20%
Tax-exempt (2)	-	-	-	418,927	2,674	2.59%
Total securities	17,798,418	177,361	4.04%	18,430,471	144,871	3.19%
Loans, net	267,444,242	5,039,086	7.64%	190,582,788	2,915,642	6.20%
Federal funds sold	2,170,450	23,020	4.30%	803,760	5,511	2.78%
Dividend-earning restricted equity securities	1,749,314	28,095	6.51%	1,742,514	15,475	3.60%
Deposits in other banks	6,132,489	65,929	4.36%	382,164	1,752	1.86%
Bank owned life insurance (2)	6,079,040	88,467	5.90%			
Total earning assets	301,373,953	5,421,958	7.30%	211,941,697	3,083,251	5.90%
Less: Allowance for loan losses	(2,723,145)			(1,871,122)		
Total nonearning assets	17,598,237			10,503,790		
Total assets	\$ 316,249,045			\$ 220,574,365		
LIABILITIES and STOCKHOLDERS' EQUITY						
Interest-bearing deposits:						
Checking	\$ 10,333,795	\$ 5,275	0.21%	\$ 9,760,206	\$ 5,858	0.24%
Regular savings	9,050,619	14,396	0.65%	15,657,322	26,445	0.68%
Money market savings	131,687,999	1,319,433	4.06%	43,764,116	243,145	2.25%
Certificates of deposit						
\$100,000 and over	28,574,786	290,118	4.12%	43,225,262	343,389	3.22%
Under \$100,000	43,466,585	413,795	3.86%	34,514,653	263,841	3.10%
Total interest-bearing deposits	223,113,784	2,043,017	3.71%	146,921,559	882,678	2.44%
Borrowings	13,053,748	125,468	3.90%	18,368,421	128,307	2.83%
Total interest-bearing liabilities	236,167,532	\$ 2,168,485	3.72%	165,289,980	\$ 1,010,985	2.48%
Noninterest-bearing liabilities						
Demand deposits	48,656,978			32,855,056		
Other noninterest-bearing liabilities	1,111,675			430,834		
Total liabilities	285,936,185			198,575,870		
Shareholders' equity	30,312,860			21,998,495		
Total liabilities and stockholders' equity	\$ 316,249,045			\$ 220,574,365		
Net interest income (2)		\$ 3,253,473			\$ 2,072,266	
Interest rate spread (2)(3)			3.58%			3.42%
Net interest margin (2)(4)			4.38%			3.97%

(1) Yields are annualized and based on average daily balances.

(2) Income and yields are reported on a taxable equivalent basis assuming a federal tax rate of 34%, with a \$30,079 adjustment for 2006 and a \$909 adjustment for 2005.

(3) Represents the differences between the yield on total average earning assets and the cost of total interest-bearing liabilities.

(4) Represents the ratio of net interest-earnings to the average balance of interest-earning assets.

Noninterest Income

Total noninterest income, including security gains and losses, increased by \$278,679 or 44.4%, to \$906,437 during the three month period ending March 31, 2006, from \$627,758 for the same period in 2005. Gross mortgage banking income from the Bank's mortgage subsidiaries, Monarch Home Funding, LLC and Monarch Capital, LLC contributed the majority of the increase with growth of \$186,097 or 41.7%, over first quarter 2005. The number of loans closed for the first quarter of 2006 is 15.7% higher and the dollar volume is 18.8% higher than the same period in 2005. The mortgage market has been impacted by the softening of the new and existing home sale market in the Bank's primary trade area, with increases in mortgage interest rates late in 2005 and into 2006. A more competitive environment has emerged that requires more competitive pricing.

Service charges and fees on deposit accounts increased \$30,296 for the three month period ending March 31, 2006, or 17.6%, from the same period in 2005. The primary components in this increase were deposit account growth and ATM transaction fees. The Bank has an agreement with a third-party vendor to brand ATMs in Food Lion grocery stores in southeast Virginia and northeast North Carolina. This relationship plus the Bank's 7 office ATMs, creates a network that now includes 49 active ATMs. In return for supplying the cash for the machines and paying the machines' cash servicing fees, the Bank receives a portion of the transaction surcharge and the Bank's customers can withdraw cash from the machines without a fee or transaction surcharge. A portion of the ATM fee increase was also due to fees generated at the Bank's 7 ATMs located at the banking center sites.

Other non-interest income increased \$51,445 or 261.7%, to \$71,106 in the first three months of 2006 compared to \$19,661 for the same period in 2005. The source of this growth was income from Bank-Owned Life Insurance (BOLI). The bank purchased \$6.0 million in BOLI during the fourth quarter of 2005. The income from BOLI, which was \$58,388 in the first quarter of 2006, is not subject to tax, yielding tax-effective income of \$88,467.

There were no security sales in the first quarter of 2006. Net losses on the sales of investment securities amounted to \$10,841 in the first quarter of 2005. Management took these losses in certain security positions to improve future investment portfolio yield.

Noninterest Expense

Total noninterest expenses for the first quarter of 2006 were \$2,777,396, an increase of \$813,784, or 41.4%, compared to \$1,963,612 for the same period in 2005. This increase is attributable to following factors: 1) an increase in salaries and employee benefits of \$478,380, primarily arising from additional salaries due to two new banking offices, additional mortgage lenders, the addition of new production and support staff, and higher employee benefit costs; 2) an increase of \$86,509 in occupancy expenses related to the additional offices and an operations center; and 3) \$248,895 in other expenses related to the Bank's growth.

Income Taxes

The income tax provision for the first quarter of 2006 was \$390,366, an increase of \$199,716 from \$190,650 reported a year earlier. The effective tax rate for the first quarter of 2006 was 32.6% compared to 33.9% for the same period in 2005.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

GENERAL

Total assets increased 5.3% to \$348,717,756 at March 31, 2006 when compared to assets of \$331,174,045 at December 31, 2005. On an annual basis total assets increased 47.0% at March 31, 2006 when compared to assets of \$237,151,960 at March 31, 2005. Total loans as of March 31, 2006 were \$273.6 million, an increase of \$10.4 million, or 4.0%, from \$263.2 million at year-end 2005. On an annual basis total loans increased \$77.8 million, or 39.7%, from \$195.8 million in March 2005. Mortgages held for sale decreased \$592 thousand to \$3.7 million, or 13.9% from \$4.3 million at December 31, 2005. Investment securities increased 15.1% to \$41.9 million at March 31, 2006 compared to year-end 2005. Cash and cash equivalents were \$17.0 million, an increase of \$1.7 million, or 11.1% from \$15.3 million at December 31, 2005.

Deposits increased \$17.4 million, or 6.4%, during the three months ended March 31, 2006. Noninterest-bearing demand deposit accounts increased \$4.1 million to \$59.6 million, a 7.4% increase over December 31, 2005. Interest-bearing deposits totaled \$230.8 million at March 31, 2006, compared to \$217.6 million at year-end 2005. Money market deposits continue to be a major contributor to this growth due to attractive product pricing.

Stockholders' equity was \$30.6 million at March 31, 2006, compared to \$29.8 million at December 31, 2005. Components of the change in stockholders' equity include net income of \$807,424, increases in net unrealized losses on available-for-sale securities totaling \$50,015, and exercised stock options totaling \$6,312.

Asset Quality

The Bank had no nonperforming assets at March 31, 2006 and a recovery of a loan charged off in December 2005 totaling \$1,743. There were no nonperforming assets at December 31, 2005. Nonperforming assets traditionally consist of nonaccrual loans, loans past due 90 days or more and still accruing interest, restructured loans and other real estate owned. There were no impaired loans at March 31, 2006 and December 31, 2005. The Bank continues to demand a high level of credit quality on new loans.

Allowance for Loan Losses

The allowance for loan losses is to provide for losses inherent in the loan portfolio. The Bank's Loan Committee has responsibility for determining the level of the allowance for loan losses, subject to the review of the Board of Directors. Among other factors, the Committee on a quarterly basis considers the Bank's historical loss experience, the size and composition of the loan portfolio, the value and adequacy of collateral and guarantors, nonperforming credits, the Bank's loan "Watch" list, and national and local economic conditions.

While the Bank believes it has sufficient allowance for its existing portfolio, there can be no assurances that an additional allowance for losses on existing loans may not be necessary in the future. The allowance for loan losses totaled \$2,783,000 and \$1,977,000 at March 31, 2006 and 2005, respectively. The ratio of the allowance for loan losses to total loans outstanding at March 31, 2006 and 2005 was 1.02% and 1.01%, respectively.

During the first three months of 2006 and 2005, the Bank recorded \$96,257 and \$173,000 in provision expense, respectively. There were no charge offs in the first quarter of 2006 or 2005. Charge offs are charged directly to the allowance when they occur. Since it began business in 1999, the Bank has had one business charge off and two small consumer charge offs for a total of \$36.0 thousand. Recoveries during the first quarter of 2006 were \$1,743 and \$0 in 2005. The table below summarizes the activity in the allowance for loans losses for the three month periods ending March 31, 2006 and 2005.

Activity in the allowance for loan losses for the nine months ended March 31, was as follows:

	<u>2006</u>	<u>2005</u>
Balance, January 1	\$ 2,685,000	\$ 1,804,000
Provisions charged against income	96,257	173,000
Recoveries of loans charged off	1,743	0
Loans charged off	<u>0</u>	<u>0</u>
Balance at end of period	<u>\$ 2,783,000</u>	<u>\$ 1,977,000</u>

The Bank has developed a methodology to determine an allowance to absorb probable loan losses inherent in the portfolio based on evaluations of the potential collection of loans, historical loss experience, peer bank loss experience, delinquency trends, economic conditions, portfolio composition, and specific loss estimates for loans considered substandard or doubtful. All commercial and commercial real estate loans that exhibit probable or observed credit weaknesses are subject to individual review. If necessary, reserves would be allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral and other sources of cash flow. Any reserves for impaired loans are measured based on the present rate or fair value of the underlying collateral. The Bank evaluates the potential collection of both principal and interest when assessing the need for a loss accrual. A composite allowance factor that considers the Bank's and other peer bank loss experience ratios, delinquency trends, economic conditions, and portfolio composition are applied to the total of commercial and commercial real estate loans not specifically evaluated.

Homogenous loans, such as consumer installment, residential mortgage loans, home equity loans, and smaller consumer loans are not individually reviewed and are generally risk graded at the same levels. The risk grade and reserves are established for each homogenous pool of loans are based on the expected net charge offs from a current trend in delinquencies, losses or historical experience and general economic conditions. The Bank has no material delinquencies in these types of loans, and has not, since inception, had a trend or an indication of a trend that would guide the Bank in expected material losses in these types of homogenous pools of loans. Management believes that the allowance for loan losses is adequate to absorb any inherent losses on existing loans in the Bank's loan portfolio at March 31, 2006.

Liquidity

Management monitors and plans the Bank's liquidity position for future periods. Liquidity is provided from cash and due from banks, interest-bearing deposits in other banks, repayments from loans, increases in deposits, lines of credit from four correspondent banks and two federal agency banks and a planned structured continuous maturity of investments. Management believes that these factors provide sufficient and timely liquidity for the foreseeable future.

Management also takes into account any liquidity needs generated by off-balance sheet transactions such as commitments to extend credit, commitments to purchase securities and standby letters of credit.

The Bank has a line of credit that can equal to up to 40% of assets with the Federal Home Loan Bank of Atlanta (FHLB) that totaled approximately \$56,847,706 with \$26,897,657 available at March 31, 2006. This line is currently reduced by \$3.0 million, which has been pledged as collateral for public deposits. Should the Bank ever desire to increase their line of credit beyond the current 40% limit, the FHLB would allow borrowings of up to 50% of total assets once the bank meets specific eligibility requirements.

Borrowings outstanding under the FHLB line of credit were \$26,950,049 at March 31, 2006 and \$26,975,024 at December 31, 2005. The Bank had four borrowing advances outstanding as of March 31, 2006, with the following final maturities:

<u>Advance Amount</u>	<u>Expiration Date</u>
\$ 15,000,000	April 2006
5,000,000	March 2012
5,000,000	February 2013
<u>1,950,049</u>	September 2015
<u>\$26,950,049</u>	

The advance maturing in 2012 has a one time repayment option in 2007, whereby the Bank can repay the borrowing. If not paid at that time the borrowing converts to a fixed-term five year borrowing at the then current rates. This borrowing floats at a rate set below 90 day Libor rates until reset date. The interest rate is currently 4.39%.

The advance maturing in 2013 is a convertible advance that matures on February 27, 2013, but has a one-time call provision on February 27, 2008. At that date, the FHLB can call the borrowing; if it does, the Bank has the option of repaying the advance or refinancing at the then current rate. The interest rate is currently 2.97%.

The advance maturing in 2015 is a principal reducing credit that matures on September 28, 2015. Terms include 39 quarterly principal payments of \$25k beginning December 2005, with a final payment of \$1,025,500 in September 2015. The

bank is utilizing this advance to match-fund several long term fixed rate loans. The interest rate for this advance is fixed at 4.96%.

The advance maturing in 2006 is a daily rate credit that matures April 3, 2006. The rate on March 31, 2006 was 5.09%. The Bank uses borrowings at the end of each quarter to increase its investment securities that are not subject to taxation by the Commonwealth of Virginia. The Bank is not subject to state income tax but is subject to Virginia Franchise Tax, which is calculated on its capital level, less certain deductions. One deduction is the average balances of bonds that are not subject to taxation by the Commonwealth of Virginia, primarily certain qualified U.S. Government Agency bonds. The Bank has found that it can save more in taxes than it pays in interest expense. Shortly before the end of each calendar quarter, the Bank purchases FHLB discount notes that mature soon after the quarter-end. The proceeds from the maturity of the discount note are used to repay the borrowings. The Bank only enters into this type of agreement near the end of the quarter since that is the period used in the franchise tax calculation.

In the course of operations, due to fluctuations in loan and deposit levels, the Bank occasionally finds it necessary to purchase Federal Funds on a short-term basis. The Bank also has federal funds lines of credit facilities established with three other banks in the total amount of \$15,000,000. At March 31, 2006 there were no outstanding balances on these lines. The Bank also has access to the Federal Reserve Bank's discount window should a liquidity crisis occur.

The Bank has no material commitments or long-term debt for capital expenditures at the report date. The only long-term debt is for funding loans and is described below under Borrowings.

Off-Balance Sheet Arrangements

The Bank enters into certain financial transactions in the ordinary course of performing traditional banking services that result in off-balance sheet transactions. The off-balance sheet transactions recognized as of March 31, 2006 and December 31, 2005 were commitments to extend credit and standby letters of credit issued to customers and a line of credit from Federal Home Loan Bank for \$3 million to secure public deposits.

Commitments to extend credit, which amounted to \$124.7 million at March 31, 2006 and \$114.8 million at December 31, 2005, represent legally binding agreements to lend to customers with fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements.

There were no commitments by the Bank to purchase securities on March 31, 2006 or December 31, 2005.

Standby letters of credit are conditional commitments issued by the Bank guaranteeing the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. At March 31, 2006 and December 31, 2005, the Bank had \$1,078,000 and \$1,455,238 respectively, in outstanding standby letters of credit.

The Bank and its subsidiary, Monarch Home Funding, LLC, have nine non-cancelable leases for premises. The original lease terms are from two to thirty years and have various renewal and option dates.

Capital Adequacy

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

Management reviews the adequacy of the Bank's capital on an ongoing basis with reference to the size, composition, and quality of the Bank's resources and compliance with regulatory requirements and industry standards. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and absorb potential losses.

Federal regulatory risk-based capital ratio guidelines require percentages to be applied to various assets including off-balance-sheet assets in relation to their perceived risk. Tier 1 capital consists of stockholders' equity and minority interests in consolidated subsidiaries, less net unrealized gains on available-for-sale securities. Tier 2 capital, a component of total capital, consists of a portion of the allowance for loan losses, certain components of nonpermanent preferred stock and subordinated debt. Monarch's ratios exceed regulatory requirements. As of March 31, 2006 the Bank had a Tier 1 risk-based capital ratio of 9.75% and a Total risk-based capital ratio of 10.70%. At December 31, 2005 these ratios were 9.86% and 10.74%, respectively.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The effective management of market risk is essential to achieving the Bank's objectives. Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. This risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. The Corporation is not subject to currency exchange risk or commodity price risk.

As a financial institution, interest rate risk and its impact on net interest income is the primary market risk exposure. The Asset/Liability Management Committee ("ALCO") is primarily responsible for establishing asset and liability strategies and for monitoring and controlling liquidity and interest rate risk. The Bank evaluates interest sensitivity risk in accordance with its asset liability policies, and then formulates strategies regarding asset originations, pricing, funding sources, and off-balance sheet commitments in order to decrease sensitivity risk. These strategies are based on management's outlook regarding future interest rate movements, the state of the regional and national economy, and other financial and business risk factors. The Bank establishes prices for deposits and loans based primarily on local market conditions.

The interest sensitivity position ("gap") is the difference between interest sensitive assets and interest sensitive liabilities in a specific time interval. The gap can be managed by repricing assets or liabilities, affected by selling securities available for sale, by replacing an asset or liability at maturity, or by adjusting the interest rate or the life of an asset or liability. Matching of assets and liabilities repricing in the same interval helps to hedge the risk and minimize the impact on interest income in periods of rising and falling interest rates.

Generally, positive gaps affect net interest margins and earnings negatively in periods of falling rates, and conversely, higher negative gaps adversely impact net interest margin and earnings in periods of rising rates as a higher volume of liabilities will reprice quicker than assets over the period for which the gap is computed.

Impacts of changing interest rates on loans and deposits are reflected in the Bank's financial statements. Management believes that the mortgage banking operations of its subsidiary, Monarch Home Funding, LLC, provide somewhat of a natural interest rate hedge, in that the Bank is interest rate sensitive in the three-month period. When loan interest rates decline, the Company's earnings will be negatively impacted in the three-month period but the mortgage company's volume should increase as the demand for refinancing increases. The reverse should occur in rising interest rate.

Monarch is asset-sensitive, primarily due to its adjustable rate loan portfolio. The majority of these loans are indexed to the Wall Street Journal Prime rate and can adjust either daily or monthly. This asset-sensitive position positively impacts the Bank in a rising rate environment, as asset-yields rise faster than the cost of funding those assets.

ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. Within the 90 days prior to the date of this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Bank's management, including the Bank's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Bank's Chief Executive Officer and Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in periodic SEC filings. There have been no significant changes in the Bank's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Corporation carries out its evaluation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the course of its operations, Monarch Bank and its subsidiary are not aware of any material pending or threatened litigation, unasserted claims and/or assessments through March 31, 2006 or subsequent thereto.

Item 2. Changes in Securities

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K.

a. Exhibits

Exhibit 11 – Refer to EPS calculation in the Notes to Financial Statements

Exhibit 31.1 – Certification of CEO pursuant to Rule 13a-14(a)

Exhibit 31.2 – Certification of Principal Financial Officer pursuant to Rule 13a-14(a)

Exhibit 32.1 – Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 – Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

b. Form 8-K.

Form 8-K filed February 1, 2006 to announce the Bank's quarterly and annual financial performance

SIGNATURES

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

MONARCH BANK

/s/ William F. Rountree, Jr.
William F. Rountree, Jr.
President & Chief Executive Officer

Date: May 8, 2006

/s/ Brad E. Schwartz
Brad E. Schwartz
Executive Vice President & Chief Financial & Operating Officer

Date: May 8, 2006

SECTION 302 CERTIFICATION

I, William F. Rountree, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Monarch Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2006

/s/ William F. Rountree, Jr.
William F. Rountree, Jr.,
Chief Executive Officer

SECTION 302 CERTIFICATION

I, Brad E. Schwartz, certify that:

2. I have reviewed this quarterly report on Form 10-Q of Monarch Bank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2006

/s/ Brad E. Schwartz

Brad E. Schwartz

Executive Vice President & Chief Financial & Operating Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Monarch Bank (the "Bank") for the period ending September 30, 2005 as filed with the Federal Reserve Bank on the date hereof (the "Report"), I, William F. Rountree, Chief Executive Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2006

/s/ William F. Rountree, Jr.
William F. Rountree, Jr.,
Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION
906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Monarch Bank (the "Bank") for the period ending September 30, 2004 as filed with the Federal Reserve Bank on the date hereof (the "Report"), I, Brad E. Schwartz, Executive Vice President and Chief Financial Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2006

/s/ Brad E. Schwartz
Brad E. Schwartz
Executive Vice President and Chief Financial & Operating Officer