

FEDERAL TRUST CORP  
Form 10-Q  
August 18, 2008  
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## U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2008.

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 001-31724.

## FEDERAL TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Florida

59-2935028

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(State or other jurisdiction of  
incorporation or organization)

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

312 West 1<sup>st</sup> Street

Sanford, Florida  
(Address of principal executive offices)

(407) 323-1833

32771  
(Zip Code)

Registrant's telephone number, including area code

Not applicable

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or 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

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

Common stock, par value \$.01 per share  
(class)

9,436,305 Shares  
Outstanding at August 8, 2008

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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

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**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Condensed Consolidated Balance Sheets**

(\$ in thousands, except share information)

|  | At                              |                                   |
|--|---------------------------------|-----------------------------------|
|  | June 30,<br>2008<br>(Unaudited) | December 31,<br>2007<br>(Audited) |
| <b>Assets</b>  |                                 |                                   |
| Cash and due from banks  | \$ 32,954                       | \$ 8,046                          |
| Interest-earning deposits  | 887                             | 1,131                             |
| Cash and cash equivalents  | 33,841                          | 9,177                             |
| Securities available for sale  | 37,347                          | 52,449                            |
| Loans, less allowance for loan losses of \$16,557 in 2008 and \$13,869 in 2007   | 500,613                         | 563,234                           |
| Accrued interest receivable  | 3,263                           | 4,509                             |
| Premises and equipment, net  | 18,500                          | 18,814                            |
| Foreclosed assets  | 12,228                          | 9,522                             |
| Federal Home Loan Bank stock   | 8,663                           | 8,129                             |
| Mortgage servicing rights, net   | 434                             | 444                               |
| Bank-owned life insurance  | 7,686                           | 7,504                             |
| Deferred tax asset, net of valuation allowance of \$11,813 in 2008 and \$0 in 2007   |                                 | 7,966                             |
| Other assets   | 5,458                           | 8,516                             |
| <b>Total assets</b>  | <b>\$ 628,033</b>               | <b>\$ 690,264</b>                 |
| <b>Liabilities and Stockholders' Equity</b>  |                                 |                                   |
| <b>Liabilities:</b>  |                                 |                                   |
| Noninterest-bearing demand deposits  | \$ 13,606                       | \$ 13,916                         |
| Interest-bearing demand deposits   | 49,114                          | 80,275                            |
| Money-market deposits  | 57,206                          | 57,608                            |
| Savings deposits   | 2,772                           | 2,422                             |
| Time deposits  | 302,819                         | 327,508                           |
| <b>Total deposits</b>  | <b>425,517</b>                  | <b>481,729</b>                    |
| Federal Home Loan Bank advances  | 163,500                         | 152,000                           |
| Other borrowings   |                                 | 16                                |
| Junior subordinated debentures   | 5,155                           | 5,155                             |
| Accrued interest payable   | 1,761                           | 2,597                             |
| Official checks  | 1,825                           | 2,238                             |
| Other liabilities  | 8,416                           | 6,843                             |
| <b>Total liabilities</b>   | <b>606,174</b>                  | <b>650,578</b>                    |
| <b>Stockholders' equity:</b>   |                                 |                                   |
| Common stock, \$.01 par value, 65,000,000 shares authorized at June 30, 2008, and 15,000,000 shares authorized at December 31, 2007; 9,436,305 shares outstanding in 2008 and 2007 | 94                              | 94                                |

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|  |            |            |
|--|------------|------------|
| Additional paid-in capital                               | 44,565     | 44,515     |
| Accumulated deficit                                      | (19,570)   | (3,755)    |
| Unallocated ESOP shares (42,386 shares in 2008 and 2007) | (440)      | (440)      |
| Accumulated other comprehensive loss                     | (2,790)    | (728)      |
| Total stockholders' equity                               | 21,859     | 39,686     |
| Total liabilities and stockholders' equity               | \$ 628,033 | \$ 690,264 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations (Unaudited)**

(\$ in thousands, except per share information)

|  | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|--|--------------------------------|---------------|------------------------------|---------------|
|  | 2008                           | 2007          | 2008                         | 2007          |
| <b>Interest income:</b>  |                                |               |                              |               |
| Loans  | \$ 7,213                       | \$ 9,704      | \$ 15,212                    | \$ 19,403     |
| Securities   | 559                            | 819           | 1,200                        | 1,663         |
| Other  | 274                            | 167           | 640                          | 343           |
| <b>Total interest income</b>   | <b>8,046</b>                   | <b>10,690</b> | <b>17,052</b>                | <b>21,409</b> |
| <b>Interest expense:</b>   |                                |               |                              |               |
| Deposits   | 4,124                          | 5,576         | 9,223                        | 10,943        |
| Other  | 1,801                          | 2,039         | 3,668                        | 4,167         |
| <b>Total interest expense</b>  | <b>5,925</b>                   | <b>7,615</b>  | <b>12,891</b>                | <b>15,110</b> |
| Net interest income  | 2,121                          | 3,075         | 4,161                        | 6,299         |
| Provision for loan losses  | 2,200                          | 5,145         | 4,165                        | 5,295         |
| Net interest (expense) income after provision for loan losses          | (79)                           | (2,070)       | (4)                          | 1,004         |
| <b>Other income:</b>   |                                |               |                              |               |
| Service charges and fees   | 125                            | 106           | 250                          | 213           |
| Gains on sales of loans held for sale                                  |                                | 33            | 199                          | 105           |
| Net gains (loss) on sales of securities available for sale             | (52)                           |               | 6                            | 35            |
| Rental income  | 100                            | 84            | 204                          | 169           |
| Increase in cash surrender value of bank owned life insurance policies | 73                             | 69            | 182                          | 136           |
| Other  | 58                             | 144           | 111                          | 254           |
| <b>Total other income</b>  | <b>304</b>                     | <b>436</b>    | <b>952</b>                   | <b>912</b>    |
| <b>Other expenses:</b>   |                                |               |                              |               |
| Salary and employee benefits   | 1,869                          | 2,111         | 3,855                        | 4,033         |
| Occupancy expense  | 679                            | 593           | 1,379                        | 1,104         |
| Professional services  | 419                            | 374           | 750                          | 634           |
| Deposit insurance premium  | 334                            | 33            | 641                          | 48            |
| Data processing  | 292                            | 225           | 577                          | 455           |
| Foreclosure expenses   | 119                            | 25            | 271                          | 27            |
| Net loss on sale and write downs of foreclosed assets                  | 667                            | 354           | 748                          | 354           |
| Marketing and advertising  | 80                             | 115           | 143                          | 231           |
| Other  | 398                            | 379           | 868                          | 762           |
| <b>Total other expenses</b>  | <b>4,857</b>                   | <b>4,209</b>  | <b>9,232</b>                 | <b>7,648</b>  |
| Loss before income taxes   | (4,632)                        | (5,843)       | (8,284)                      | (5,732)       |
| Income tax (benefit) expense   |                                | (2,291)       | 7,531                        | (2,340)       |

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|   |            |            |             |            |
|---|------------|------------|-------------|------------|
| Net loss  | \$ (4,632) | \$ (3,552) | \$ (15,815) | \$ (3,392) |
| Loss per share:   |            |            |             |            |
| Basic   | \$ (.49)   | \$ (.38)   | \$ (1.68)   | \$ (.36)   |
| Diluted   | \$ (.49)   | \$ (.38)   | \$ (1.68)   | \$ (.36)   |
| Weighted-average shares outstanding for (in thousands): |            |            |             |            |
| Basic   | 9,394      | 9,361      | 9,394       | 9,352      |
| Diluted   | 9,394      | 9,361      | 9,394       | 9,352      |
| Cash dividends per share                                | \$         | \$ .04     | \$          | \$ .08     |

See Accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Stockholders Equity****For the Six Months Ended June 30, 2008 and 2007**

(\$ in thousands)

|  | Common Stock |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Unallocated<br>ESOP<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders<br>Equity |
|--|--------------|--------|----------------------------------|--|-------------------------------|---|---------------------------------|
|  | Shares       | Amount |                                  |  |                               |   |                                 |
| Balance at December 31, 2006   | 9,351,542    | \$ 94  | \$ 43,858                        | \$ 11,160  | \$ (257)                      | \$ (235)                                      | \$ 54,620                       |
| Comprehensive income:  |              |        |                                  |  |                               |   |                                 |
| Net loss (unaudited)   |              |        |                                  | (3,392)  |                               |   | (3,392)                         |
| Change in unrealized loss on securities<br>available for sale, net of income taxes of<br>\$(546) (unaudited) |              |        |                                  |  |                               | (901)   | (901)                           |
| Comprehensive loss (unaudited)   |              |        |                                  |  |                               |   | (4,293)                         |
| Issuance of common stock - options<br>exercised (unaudited)  | 62,783       |        | 307                              |  |                               |   | 307                             |
| ESOP shares purchased (6,618 shares)<br>(unaudited)  |              |        | 116                              |  | (116)                         |   |                                 |
| Share based compensation (unaudited)   |              |        | 63                               |  |                               |   | 63                              |
| Dividends paid (unaudited)   |              |        |                                  | (752)  |                               |   | (752)                           |
| Balance at June 30, 2007 (unaudited)   | 9,414,325    | \$ 94  | \$ 44,344                        | \$ 7,016   | \$ (373)                      | \$ (1,136)                                    | \$ 49,945                       |
| Balance at December 31, 2007   | 9,436,305    | \$ 94  | \$ 44,515                        | \$ (3,755)                                       | \$ (440)                      | \$ (728)                                      | \$ 39,686                       |
| Comprehensive loss:  |              |        |                                  |  |                               |   |                                 |
| Net loss (unaudited)   |              |        |                                  | (15,815)   |                               |   | (15,815)                        |
| Change in unrealized loss on securities<br>available for sale, (unaudited)                                   |              |        |                                  |  |                               | (1,623)                                       | (1,623)                         |
| Deferred tax asset valuation allowance<br>related to securities available for sale                           |              |        |                                  |  |                               | (439)   | (439)                           |
| Comprehensive loss (unaudited)   |              |        |                                  |  |                               |   | (17,877)                        |
| Share based compensation (unaudited)   |              |        | 50                               |  |                               |   | 50                              |
| Balance at June 30, 2008 (unaudited)   | 9,436,305    | \$ 94  | \$ 44,565                        | \$ (19,570)                                      | \$ (440)                      | \$ (2,790)                                    | \$ 21,859                       |

See Accompanying Notes to Condensed Consolidated Financial Statements.



**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited)**

(\$ in thousands)

|   | <b>Six Months Ended<br/>June 30,</b> |                |
|---|--------------------------------------|----------------|
|   | <b>2008</b>                          | <b>2007</b>    |
| <b>Cash flows from operating activities:</b>                                    |                                      |                |
| Net loss  | \$ (15,815)                          | \$ (3,392)     |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                      |                |
| Depreciation and amortization   | 493                                  | 432            |
| Provision for loan losses   | 4,165                                | 5,295          |
| Net loss on sale and write downs of foreclosed assets                           | 719                                  | 354            |
| Capitalized costs on foreclosed assets  | (156)                                | (25)           |
| Net amortization of premiums and discounts on securities                        | (107)                                | (56)           |
| Net amortization of loan origination fees, costs, premiums and discounts        | 572                                  | 510            |
| Amortization of mortgage servicing rights                                       | 52                                   | 88             |
| Increase in cash surrender value of life insurance policies                     | (182)                                | (135)          |
| Proceeds from sales of loans held for sale                                      | 601                                  | 5,218          |
| Loans originated for resale   | (1,191)                              | (4,719)        |
| Gain on sale of loans held for sale   | (199)                                | (105)          |
| Net loss on sales of securities available for sale                              | (6)                                  | (35)           |
| Deferred income tax expense   | 7,531                                |                |
| Share based compensation  | 50                                   | 63             |
| Cash provided by (used in) resulting from changes in:                           |                                      |                |
| Accrued interest receivable   | 1,246                                | 355            |
| Other assets  | 2,952                                | (1,788)        |
| Accrued interest payable  | (836)                                | 752            |
| Official checks   | (413)                                | (667)          |
| Other liabilities   | 728                                  | 1,441          |
| <b>Net cash provided by operating activities</b>                                | <b>204</b>                           | <b>3,586</b>   |
| <b>Cash flows from investing activities:</b>                                    |                                      |                |
| Purchase of securities available for sale                                       | (1,005)                              | (14,010)       |
| Proceeds from principal repayments and sales of securities available for sale   | 14,593                               | 13,823         |
| Loan principal repayments, net of originations                                  | 39,446                               | 18,523         |
| Purchase of loans   |                                      | (25,270)       |
| Proceeds from sales of loans transferred to held for sale                       | 12,051                               | 2,491          |
| Purchase of premises and equipment  | (73)                                 | (660)          |
| (Purchase) redemption of Federal Home Loan Bank stock                           | (534)                                | 134            |
| Net proceeds from sales of foreclosed assets                                    | 3,865                                |                |
| <b>Net cash provided by (used in) investing activities</b>                      | <b>68,343</b>                        | <b>(4,969)</b> |
| <b>Cash flows from financing activities:</b>                                    |                                      |                |
| Net increase (decrease) in deposits   | (56,212)                             | 2,408          |
| Net increase in Federal Home Loan Bank advances                                 | 11,500                               | 1,800          |
| Net decrease in other borrowings  | (16)                                 | (1,335)        |
| Principal repayments under capital lease obligation                             |                                      | (2,504)        |
| Net increase in advance payments from borrowers for taxes and insurance         | 845                                  | 940            |
| Dividends paid  |                                      | (752)          |

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|   |           |          |
|---|-----------|----------|
| Net proceeds from the exercise of options on common stock |           | 307      |
| Net cash provided by (used in) financing activities       | (43,883)  | 864      |
| Net increase (decrease) in cash and cash equivalents      | 24,664    | (519)    |
| Cash and cash equivalents at beginning of period          | 9,177     | 8,680    |
| Cash and cash equivalents at end of period                | \$ 33,841 | \$ 8,161 |

(Continued)

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited), Continued**

(\$ in thousands)

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2008</b>                          | <b>2007</b> |
| <b>Supplemental disclosure of cash flow information:</b>   |                                      |             |
| Cash paid during the period for interest   | \$ 7,802                             | \$ 14,358   |
| Cash received during the period for income tax recoveries  | \$ 768                               | \$          |
| Cash paid during the period for income taxes   | \$                                   | \$          |
| <b>Noncash transactions:</b>   |                                      |             |
| Foreclosed assets acquired in settlement of loans  | \$ 7,134                             | \$ 2,731    |
| Other comprehensive loss, net change in unrealized loss on securities available for sale, net of tax | \$ (1,623)                           | \$ (901)    |
| Deferred tax asset valuation allowance related to securities available for sale                      | \$ (439)                             | \$          |
| Transfer of loans in portfolio to loans held for sale  | \$ 4,227                             | \$ 2,478    |
| Mortgage servicing rights recognized upon sale of loans held for sale                                | \$ 42                                | \$ 25       |
| ESOP shares purchased  | \$                                   | \$ 67       |
| Transfer from other assets to premises and equipment   | \$ 106                               | \$          |

See Accompanying Notes to Condensed Consolidated Financial Statements.

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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(1) Description of Business and Basis of Presentation**

**Organization.** Federal Trust Corporation ( Federal Trust ) is the sole shareholder of Federal Trust Bank (the Bank ) and Federal Trust Mortgage Company (the Mortgage Company ). Federal Trust operates as a unitary savings and loan holding company. Federal Trust 's primary business activity is the operation of the Bank and the Mortgage Company. The Bank is a federally-chartered stock savings bank. The Bank 's deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation. The Bank provides a wide range of banking services to individual and corporate customers through its 11 full-service branch offices located in Orange, Seminole, Volusia, Lake and Flagler Counties, Florida. Until April 2008, we operated a residential mortgage company, Federal Trust Mortgage Company, where we originated residential mortgage loan, purchased and sold mortgage loans in the secondary market, and serviced residential mortgage loans, including loans in Federal Trust Bank 's loan portfolio. In April 2008, Federal Trust Bank assumed the staff and operations of Federal Trust Mortgage Company.

The condensed consolidated financial statements include the accounts of Federal Trust, the Bank and the Mortgage Company (collectively referred to herein as, the Company ). All significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (principally consisting of normal recurring accruals) necessary to present fairly the financial position as of June 30, 2008, and the results of operations and cash flows for the three- and six-month periods ended June 30, 2008 and 2007. The results of operations for the six-month period ended June 30, 2008, are not necessarily indicative of the results to be expected for the entire year ending December 31, 2008. These statements should be read in conjunction with the condensed consolidated financial statements included in the Company 's Annual Report on Form 10-K for the year ended December 31, 2007.

***Recent Accounting Pronouncements.***

In March 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS 161 ). This standard requires enhanced disclosures regarding derivative instruments and hedging activities so as to enable investors to better understand their effects on an entity 's financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The adoption of SFAS 161 will have no impact on the Company 's financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ( SFAS 160 ) and SFAS No. 141(R), *Business Combinations* ( SFAS 141(R) ). The Standards will improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements. The statements are effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Management does not anticipate that SFAS 160 and SFAS 141(R) will have a material effect on the Company 's financial condition or results of operations.

In June 2007, the FASB ratified the Emerging Issues Task Force ( EITF ) consensus on Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* ( EITF No. 06-11 ). EITF No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock and restricted stock units which are expected to vest be recorded as an increase to additional paid-in capital. EITF No. 06-11 is to be applied prospectively for tax benefits on dividends declared by the Company on or after January 1, 2008. The adoption of EITF No. 06-11 will have no impact on the Company 's financial condition and results of operations.

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(2) Loans**

The components of loans are summarized as follows (\$ in thousands):

|  | At June 30,<br>2008<br>(unaudited) | At December 31,<br>2007 |
|--|------------------------------------|-------------------------|
| Residential lending:                             |                                    |                         |
| Mortgages (1)                                    | \$ 330,426                         | \$ 359,954              |
| Lot  | 40,100                             | 39,994                  |
| Construction                                     | 6,519                              | 21,926                  |
| <b>Total residential lending</b>                 | <b>377,045</b>                     | <b>421,874</b>          |
| Commercial lending:                              |                                    |                         |
| Real estate secured                              | 59,099                             | 85,492                  |
| Land, development and construction               | 64,039                             | 73,752                  |
| Commercial loans                                 | 23,871                             | 15,866                  |
| <b>Total commercial lending</b>                  | <b>147,009</b>                     | <b>175,110</b>          |
| Consumer loans                                   | 490                                | 214                     |
| <b>Total loans</b>                               | <b>524,544</b>                     | <b>597,198</b>          |
| Add (deduct):                                    |                                    |                         |
| Allowance for loan losses                        | (16,557)                           | (13,869)                |
| Net premiums, discounts, deferred fees and costs | 2,473                              | 3,033                   |
| Loans in process                                 | (9,847)                            | (23,128)                |
| <b>Loans, net</b>                                | <b>\$ 500,613</b>                  | <b>\$ 563,234</b>       |

(1) Includes approximately \$557,000 and \$7.6 million of loans held for sale at June 30, 2008, and December 31, 2007, respectively.

(Continued)

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(2) Loans, Continued**

During the second quarter of 2008, we continued to experience weakness in the real estate market throughout Florida and increases in loan delinquencies. As a result, we recorded a provision for loan losses in the 2008 second quarter of \$2.2 million. Our loan charge-offs during the 2008 second quarter were \$1.5 million, we recognized \$47,000 in recoveries and our allowance for loan losses increased from \$13.9 million at December 31, 2007, to \$16.6 million at June 30, 2008. In early July 2008, we received a \$344,000 recovery from the liquidation of Transland Financial Services, Inc. in settlement of the fraud loss we recognized in 2007. This amount will be recorded as a recovery to our allowance for loan losses in the 2008 third quarter.

The activity in the allowance for loan losses is as follows (\$ in thousands):

|                                | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                | 2008                           | 2007      | 2008                         | 2007      |
| Balance at beginning of period | \$ 15,793                      | \$ 5,248  | \$ 13,869                    | \$ 5,098  |
| Provision for loan losses      | 2,200                          | 5,145     | 4,165                        | 5,295     |
| Charge-offs                    | (1,483)                        | (102)     | (1,533)                      | (102)     |
| Recoveries                     | 47                             | 1         | 56                           | 1         |
| Balance at end of period       | \$ 16,557                      | \$ 10,292 | \$ 16,557                    | \$ 10,292 |

The following is a summary of information regarding nonaccrual and collateral dependent impaired loans (\$ in thousands):

|   | At June 30,<br>2008 | At December 31,<br>2007 |
|---|---------------------|-------------------------|
| Non-accrual loans   | \$ 56,755           | \$ 38,223               |
| Accruing loans past due ninety days or more   | \$                  | \$                      |
| Recorded investment in impaired loans for which there is a related allowance for loan losses  | \$ 16,491           | \$ 15,299               |
| Recorded investment in impaired loans for which there is no related allowance for loan losses | \$ 49,247           | \$ 22,903               |
| Allowance for loan losses related to impaired loans   | \$ 6,490            | \$ 5,556                |

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2008                           | 2007      | 2008                         | 2007      |
| Interest income recognized and received on impaired loans | \$ 1,245                       | \$        | \$ 1,663                     | \$ 22     |
| Average net recorded investment in impaired loans         | \$ 61,646                      | \$ 19,433 | \$ 56,791                    | \$ 15,001 |



**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(2) Loans, Continued**

|  | June 30,<br>2008 | December 31,<br>2007 |
|--|------------------|----------------------|
| Non-accrual loans:   |                  |                      |
| Residential loans:   |                  |                      |
| Mortgages  | \$ 12,100        | \$ 4,993             |
| Lot  | 9,642            | 6,578                |
| Construction   | 5,556            | 7,317                |
| Total residential loans                                    | 27,298           | 18,888               |
| Commercial loans:  |                  |                      |
| Real estate secured  | 3,009            | 7,520                |
| Land, development and construction                         | 22,032           | 11,063               |
| Commercial business  | 4,399            | 752                  |
| Total commercial loans                                     | 29,440           | 19,335               |
| Consumer loans   | 17               |                      |
| Total non-accrual loans                                    | 56,755           | 38,223               |
| Foreclosed assets  | 12,228           | 9,522                |
| Total non-performing assets                                | \$ 68,983        | \$ 47,745            |
| Total non-accrual loans to total loans                     | 10.8%            | 6.4%                 |
| Total non-accrual loans to total assets                    | 9.0%             | 5.5%                 |
| Total allowance for loan losses to total non-accrual loans | 29.2%            | 36.3%                |
| Total non-performing assets to total assets                | 11.0%            | 6.9%                 |

Total non-performing assets, which includes non-accrual loans and foreclosed properties, increased from \$47.7 million at December 31, 2007, to \$69.0 million at June 30, 2008. The increase in non-performing assets during 2008 included net increases of \$10.1 million in commercial loans, \$8.4 million in residential loans, of which \$5.0 million was to foreign national borrowers secured by investment homes in central Florida. Foreclosed properties also increased \$2.7 million from December 2007 to June 2008. In addition to our non-performing assets, at June 30, 2008, we had \$39.1 million in performing loans that exhibited weakness or concerns and were graded as classified or special mention; this total decreased \$17.5 million from \$56.6 million at December 31, 2007, due primarily to the loans transferred to non-accrual status and foreclosed properties.

During the 2008 second quarter, payments were received from two related borrowers with delinquent loans that totaled \$12.7 million. The payments brought all of the loans current and provided additional deposited reserves for one year of future interest payments. The majority of these loans are secured by vacant land in the Florida panhandle. One of the loans for \$6.0 million was already in our classified asset total, but was resolved before being transferred to non-accrual. Also during the quarter, we sold 11 foreclosed properties for \$3.4 million and acquired the title to an operating retail plaza in Georgia with a balance of \$4.8 million after recognizing a charge-off of \$400,000. We have already identified interested buyers for this plaza and believe that it could be sold before the end of 2008 with no additional loss.



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The additions to non-accrual loans during the second quarter included four borrowers with combined loan balances of \$9.2 million secured by vacant land and developed residential lots in Florida. The Bank is not originating any new land acquisition and development loans or financing vacant land. As the existing land loans on our books mature, we are aggressively working to develop plans for reduction or payoff of the loans to reduce our land exposure in the weak real estate market. We are experiencing increased delinquencies on these loans in part due to our strategy to work out of this exposure.

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(3) Deferred Tax Asset**

Federal Trust Corporation assessed the loss and trend over the past five quarters and the estimate of future earnings, and determined that it is more likely than not that the deferred tax asset may not be realized. Accordingly, a valuation allowance of \$11.8 million was established on the deferred tax asset as of June 30, 2008. This allowance is a non-cash charge to operations and has no effect on the Bank's liquidity.

**(4) Regulatory Capital**

The Bank is required to maintain certain minimum regulatory capital requirements. The following is a summary at June 30, 2008, of the Bank's actual capital on a percentage basis and the regulatory capital requirements for a financial institution to be classified as adequately capitalized or well capitalized. The Bank's capital ratios at June 30, 2008, resulted in the Bank being characterized as adequately capitalized for regulatory capital purposes.

|   | Actual | For Minimum<br>Capital<br>Adequacy<br>Purposes | To Be Well<br>Capitalized<br>Under Prompt<br>Corrective Action<br>Provisions |
|---|--------|--|--|
| Total capital to risk-weighted assets         | 8.24%  | 8.00%  | 10.00%   |
| Tier I capital to risk-weighted assets        | 6.98%  | 4.00%  | 6.00%  |
| Tier I capital to total assets-leverage ratio | 4.61%  | 4.00%  | 5.00%  |

**(5) Loss Per Share of Common Stock**

The Company follows the provisions of SFAS No. 128, *Earnings Per Share* (SFAS No. 128). SFAS No. 128 provides accounting and reporting standards for calculating loss per share. Basic loss per share of common stock, has been computed by dividing the net loss for the period by the weighted-average number of shares outstanding. Shares of common stock purchased by the Company's Employee Stock Ownership Plan (ESOP) are considered outstanding when the shares are allocated to participants. Diluted loss per share is computed by dividing net loss by the weighted-average number of shares outstanding including the dilutive effect of stock options computed using the treasury stock method and the restricted stock units. Outstanding stock options and restricted stock units are not considered dilutive securities for the three- and six-month periods ended June 30, 2008 and 2007, due to the net loss incurred by the Company.

(Continued)

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(5) Loss Per Share of Common Stock, Continued**

The following table presents the calculation of basic and diluted loss per share for the three- and six-month periods ending June 30, 2008 and 2007.

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2008                           | 2007     | 2008                         | 2007     |
| Weighted-average shares outstanding before adjustment for unallocated ESOP shares  | 9,436                          | 9,404    | 9,436                        | 9,389    |
| Adjustment to reflect the effect of unallocated ESOP shares  | (42)                           | (43)     | (42)                         | (37)     |
| Weighted-average shares outstanding for basic earnings per share   | 9,394                          | 9,361    | 9,394                        | 9,352    |
| Basic loss per share   | \$ (.49)                       | \$ (.38) | \$ (1.68)                    | \$ (.36) |
| Total weighted-average shares outstanding for basic earnings per share computation   | 9,394                          | 9,361    | 9,394                        | 9,352    |
| Additional dilutive shares using the average market value for the period utilizing the treasury stock method regarding stock options |                                |          |                              |          |
| Weighted-average shares and equivalents outstanding for diluted earnings per share   | 9,394                          | 9,361    | 9,394                        | 9,352    |
| Diluted loss per share   | \$ (.49)                       | \$ (.38) | \$ (1.68)                    | \$ (.36) |

**(6) Stock Compensation Plans**

The Company has three stock benefit plans. The Key Employee Stock Compensation Program (the Employee Plan) is authorized to issue up to 10% of the issued shares up to a maximum of 1,020,000 shares through the exercise of incentive stock options, compensatory stock options, stock appreciation rights or performance shares. All awards granted under the Employee Plan have been incentive stock options. These options have five to ten year terms and vest over various terms up to five years. At June 30, 2008, the Company had 427,301 options available for future grants under the Employee Plan.

The Directors Stock Option Plan (the Directors Plan) is authorized to issue up to 141,337 shares through the exercise of stock options. All options granted under the Directors Plan have five to ten-year terms, and vest over various terms up to five years. At June 30, 2008, the Company had 4,180 options available for future grants under the Directors Plan.

The 2005 Directors Stock Plan (2005 Directors Plan) is authorized to issue up to 91,800 shares through the exercise of stock options and the issuance of restricted stock shares. Awards made under the 2005 Directors Plan may be in the form of restricted shares, restricted stock units, or stock options. A restricted stock unit is the right to receive a share of common stock, after vesting, on a date selected by the director. While any restricted stock unit is outstanding the director holding the restricted stock unit will be entitled to receive a dividend in the form of additional restricted stock units, if cash or stock dividends are declared on outstanding shares of common stock. Each restricted stock unit, including fractional restricted stock units, will be converted to one share of common stock, after vesting, on the date which has been selected by the director or when the director no longer serves on the Board.

(Continued)



**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(6) Stock Compensation Plans, Continued**

Awards of restricted shares or restricted stock units may be granted to a director as an annual stock retainer, which is dependent upon the amount of the director's annual cash retainer. Under terms of those respective agreements, the units vest over periods from three to four years, unless there is a change in control, at which point the units vest immediately.

Options are granted to certain employees and directors at a price equal to the market value of the stock on the dates the options were granted. In accordance with SFAS No. 123, *Share-Based Payment* (SFAS 123(R)), the fair value of each option is amortized using the straight-line method over the requisite service period of each option. We have estimated the fair value of all option awards as of the grant date by applying the Black-Scholes pricing valuation model. The application of this valuation model involves assumptions that are judgmental and sensitive in the determination of compensation expense. There were no stock options issued during the second quarter of 2007 or 2008. The weighted average amounts for key assumptions used in determining the fair value of options granted during the six-months ended June 30, 2008 and 2007 are as follows:

|  | Six-Months Ended<br>June 30, 2008 | Six-Months Ended<br>June 30, 2007 |
|--|-----------------------------------|-----------------------------------|
| Expected stock price volatility  | 32.67%                            | 47.95%                            |
| Risk-free interest rate  | 2.64%                             | 4.66%                             |
| Weighted average expected life in years  | 4.0                               | 6.5                               |
| Expected dividend yield  | 0.00%                             | 1.58%                             |
| Per share weighted-average grant date fair value of options issued during the period | \$ 0.64                           | \$ 4.66                           |

As part of its adoption of SFAS 123(R), the Company examined its historical pattern of option exercises in an effort to determine if there was any pattern based on certain employee populations. From this analysis, the Company could not identify any patterns in the exercise of options. As such, the Company used the guidance in Staff Accounting Bulletin No. 110, issued by the Securities and Exchange Commission to determine the estimated life of options issued. Historical information was the primary basis for the selection of expected volatility and expected dividend yield. The risk-free rate was selected based upon yields of U.S. Treasury issues with a term equal to the expected life of the option being valued.

A summary of stock option transactions for the six-month period ended June 30, 2008, follows:

(\$ in thousands, except per share data):

|   | Number<br>of<br>Options | Weighted<br>Avg. Per Option<br>Exercise<br>Price | Weighted<br>Avg. Remaining<br>Contract Term<br>(in years) | Aggregate<br>Intrinsic<br>Value |
|---|-------------------------|--|---|---------------------------------|
| <b>Options Under the Employee Plan:</b> |                         |  |   |                                 |
| Outstanding at December 31, 2007        | 374,283                 | \$ 7.87  |   |                                 |
| Options exercised                       |                         |  |   |                                 |
| Options forfeited                       | (200,600)               | \$ 9.61  |   |                                 |
| Outstanding at June 30, 2008            | 173,683                 | \$ 5.87  | 4.26  | \$                              |
| Exercisable at June 30, 2008            | 84,727                  | \$ 7.28  | 4.34  | \$                              |

(Continued)



**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(6) Stock Compensation Plans, Continued**

|   | Number<br>of<br>Options | Weighted<br>Avg. Per Option<br>Exercise<br>Price | Weighted<br>Avg. Remaining<br>Contract Term<br>(in years) | Aggregate<br>Intrinsic<br>Value |
|---|-------------------------|--|---|---------------------------------|
| <b><i>Options Under the Directors Plans:</i></b>                        |                         |  |   |                                 |
| <b><i>(includes the Directors Plan and the 2005 Directors Plan)</i></b> |                         |  |   |                                 |
| Outstanding at December 31, 2007  | 144,146                 | \$ 7.17  |   |                                 |
| Options granted   | 5,000                   | \$ 2.15  |   |                                 |
| Options forfeited   | (9,792)                 | \$ 7.75  |   |                                 |
| Outstanding at June 30, 2008  | 139,354                 | \$ 6.95  | 7.37  | \$                              |
| Exercisable at June 30, 2008  | 71,554                  | \$ 5.99  | 3.55  | \$                              |

As of June 30, 2008, the Company had 156,756 nonvested options outstanding resulting in approximately \$294,000 of total unrecognized compensation expense related to these nonvested options. This expense is expected to be recognized monthly over the related vesting periods using the straight-line method through December 2011.

A summary of the Restricted Stock Unit transactions follows:

|   | Number<br>of<br>Units |
|---|-----------------------|
| <b><i>Restricted Stock Units under the 2005 Directors Plan:</i></b> |                       |
| Outstanding at December 31, 2007                                    | 11,815                |
| Stock unit dividends earned   |                       |
| Stock units forfeited   |                       |
| Stock issued  |                       |
| Outstanding at June 30, 2008  | 11,815                |

A summary of the status of the Company's nonvested restricted stock units as of December 31, 2007, and changes during the six-months ended June 30, 2008, is presented below:

|                                | Number<br>of<br>Units | Weighted-Average<br>Grant-Date<br>Fair Value |
|--------------------------------|-----------------------|--|
| <b>Nonvested Shares</b>        |                       |  |
| Nonvested at December 31, 2007 | 6,471                 | \$ 10.54                                     |
| Dividends credited             |                       |  |
| Forfeited                      |                       |  |
| Vested                         | (774)                 | \$ 11.26                                     |
| Nonvested at June 30, 2008     | 5,697                 | \$ 10.12                                     |





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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Unaudited), Continued**

**(7) Fair Value Measurements**

In the first quarter of 2008, we adopted SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), for financial assets and liabilities. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. This standard does not apply measurements related to share-based payments.

SFAS 157 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future cash flows), and the cost approach (cost to replace the service capacity of an asset or replacement cost), focusing on the price that would be received when selling an asset or paid to transfer a liability (exit price). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities that are not active. Such inputs may include interest rates and yield curves, volatilities, prepayment speeds, credit risks, and default rates.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

Our listing of financial assets and liabilities subject to fair value measurements on a recurring basis are as follows (in thousands):

|                               | <b>Fair Value Measurements at Reporting Date Using</b> |                    |                    |                     |
|-------------------------------|--|--------------------|--------------------|---------------------|
|                               | <b>Quoted Prices</b>                                   |                    | <b>Significant</b> | <b>Significant</b>  |
|                               | <b>Fair Value</b>                                      | <b>in Active</b>   | <b>Other</b>       | <b>Unobservable</b> |
|                               | <b>as of</b>   | <b>Markets for</b> | <b>Observable</b>  | <b>Inputs</b>       |
|                               | <b>6/30/08</b>   | <b>Identical</b>   | <b>Inputs</b>      | <b>Inputs</b>       |
|                               |  | <b>Assets</b>      | <b>(Level 2)</b>   | <b>(Level 3)</b>    |
|                               |  | <b>(Level 1)</b>   |                    |                     |
| Available for sale securities | \$ 37,347  | \$                 | \$ 33,712          | \$ 3,635            |

The fair values of our securities available for sale are determined by third-party service providers utilizing various methods dependent upon the specific type of investment.

(Continued)

**Table of Contents****FEDERAL TRUST CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Unaudited), Continued****(7) Fair Value Measurements, Continued**

The following is a summary of transactions for those financial assets and liabilities measured on a recurring basis using significant unobservable inputs for determining fair value for the six month period ended June 30, 2008 (in thousands):

|  | <b>Fair Value<br/>Measurements<br/>At June 30, 2008<br/>Using Significant<br/>Unobservable Inputs<br/>(Level 3)</b> |
|--|---|
| Fair value at December 31, 2007        | \$ 4,784  |
| Total gains or (losses):               |   |
| Included in other comprehensive income | (1,147)   |
| (Amortization) and accretion           | (2)   |
| Fair value at June 30, 2008            | \$ 3,635  |

Our listing of assets and liabilities subject to carrying value measurements on a non-recurring basis are as follows (in thousands):

|                   | <b>Carrying Value at June 30, 2008</b>      |                  |                  |                  | <b>Total<br/>Gains<br/>(Losses)</b> |
|-------------------|---|------------------|------------------|------------------|-------------------------------------|
|                   | <b>Carrying Value<br/>as of<br/>6/30/08</b> | <b>(Level 1)</b> | <b>(Level 2)</b> | <b>(Level 3)</b> |                                     |
| Impaired loans    | \$ 59,248                                   | \$               | \$               | \$ 59,248        | \$ 4,165                            |
| Foreclosed assets | \$ 12,228                                   | \$               | \$               | \$ 12,228        |                                     |

SFAS No. 157 applies to loans measured for impairment using the practical expedients permitted by SFAS 114, *Accounting by Creditors for Impairment of a Loan*, including impaired loans measured by an observable market price or at the fair value of the loan's collateral if the loan is collateral dependent. If a loan is determined to be collateral dependent, the fair value of the collateral is determined by appraisals or independent valuation adjusted for costs related to the liquidation of the collateral.

The fair value of foreclosed assets is determined by appraisals or independent valuations adjusted for the cost related to the liquidation of the foreclosed assets.

**(8) Legal Contingencies**

Various legal claims arise from time to time in the normal course of business. In the opinion of management of the Company, none have occurred that will have a material effect on the Company's condensed consolidated financial statements.

**(9) Reclassification**

Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the 2008 presentation.



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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Unaudited), Continued**

**(9) Reclassification, Continued**

As of June 30, 2007, \$2.5 million of proceeds from sales of loans transferred to loans held for sale were incorrectly reported on the Condensed Consolidated Statement of Cash Flows as net cash flows from operating activities rather than net cash flows from investing activities as required by generally accepted accounting standards in the United States of America. These loan sale proceeds were reclassified to cash flows from investing activities for the six months ended June 30, 2008. This change did not affect the previously reported amount of net decrease in cash and cash equivalents.

**(10) Subsequent Events**

Effective July 15, 2008, the Office of Thrift Supervision extended the deadline by which the Company must raise capital from July 15, 2008 to September 30, 2008. The Office of Thrift Supervision also extended until November 15, 2008, the deadline by which the Company must execute a merger agreement if its capital raising efforts are unsuccessful.

On August 11, 2008, Federal Trust entered into a non-binding letter of intent with Sidhu Advisors FDT, LLC, whereby Sidhu Advisors FDT, LLC, or a newly-formed affiliate, would invest at least \$30 million in Federal Trust Corporation and acquire control of the Company. The proposed transaction remains subject to entering into a definitive agreement between Federal Trust and Sidhu Advisors FDT, LLC and other conditions, including completion of an updated due diligence review of Federal Trust by Sidhu Advisors FDT, LLC. It is expected that the terms of a proposed transaction would be subject to shareholder approval, as well as approval by the Office of Thrift Supervision. The letter of intent expires August 25, 2008.

If Federal Trust is not successful in entering into a definitive agreement with Sidhu Advisors FDT, LLC, then Federal Trust would seek to capitalize the Bank in another private transaction, or otherwise sell control of part or all of the Company in a merger or other transaction. If the Company is not able to raise additional capital or sell control of all or part of the Company in a merger or other transaction, management believes that there is substantial doubt about the Bank's ability to continue as a going concern. The Bank's operating and capital requirements, the recurring losses due to recent increases in nonperforming loans, declining net interest margin and continuing high levels of operating expenses are contributing factors for this concern. In order to comply with its regulatory capital requirements, the Bank needs to raise substantial additional capital. There is no guarantee that sufficient capital will be available at acceptable terms, if at all.

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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

**Item 2. Management's Discussion and Analysis of**

**Financial Condition and Results of Operations**

**Forward Looking Statements**

This quarterly report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, expect and words of similar meaning. These forward-looking statements include, but are not limited to:

statements of our goals, intentions and expectations;

statements regarding our business plans, prospects, growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

general economic conditions and real estate values, either nationally or in our market areas, that are worse than expected;

competition among depository and other financial institutions;

inflation and adverse changes in the securities markets;

changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;

our ability to enter new markets successfully and capitalize on growth opportunities;

changes in consumer spending, borrowing and savings habits;

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changes in demand for new housing in our market area;

unfavorable changes in economic conditions affecting housing markets, credit markets, real estate values or oil and gas prices, either nationally or locally;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the Financial Accounting Standards Board; and

changes in our organization, compensation and benefit plans.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

### **Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the critical accounting policies upon which our financial condition and results of operation depend, and that involve the most complex subjective decisions or assessments, are included in Item 7,

Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Company's Amendment No. 2 to the Annual Report on Form 10-K/A for the fiscal year ended December 31, 2007, as filed with the Securities and Exchange Commission.

**Table of Contents****Allowance for Loan Losses**

While we did not change our methodology for calculating the adequacy of the allowance for loan losses in 2008, we added \$2.7 million to the allowance during the first six months of 2008 due to the continuing weakness in the Florida real estate market and the increases in our past due and non-accrual loans.

The activity in the allowance for loan losses is as follows (\$ in thousands):

|                                 | Three Months Ended |                  | Six Months Ended |                  |
|---------------------------------|--------------------|------------------|------------------|------------------|
|                                 | June 30,           |                  | June 30,         |                  |
|                                 | 2008               | 2007             | 2008             | 2007             |
| Balance at beginning of period  | \$ 15,793          | \$ 5,248         | \$ 13,869        | \$ 5,098         |
| Provision for loan losses       | 2,200              | 5,145            | 4,165            | 5,295            |
| Charge-offs                     | (1,483)            | (102)            | (1,522)          | (102)            |
| Recoveries                      | 47                 | 1                | 56               | 1                |
| <b>Balance at end of period</b> | <b>\$ 16,557</b>   | <b>\$ 10,292</b> | <b>\$ 16,557</b> | <b>\$ 10,292</b> |

We anticipate recognizing additional charge-offs during the remainder of 2008, but cannot predict the amount and timing of such charge-offs, if any. In early July 2008, we received a \$344,000 recovery from the liquidation of Transland Financial Services, Inc. in settlement of the fraud loss we recognized in 2007. This amount will be recorded as a recovery to our allowance for loan losses in the 2008 third quarter.

At June 30, 2008, the allowance for loan losses was \$16.6 million, or 29.2% of non-performing loans and 3.22% of total loans net of loans in process at that date. At December 31, 2007, the allowance for loan losses was \$13.9 million, or 36.3% of non-performing loans and 2.42% of total loans net of loans in process at that date. The allowance at June 30, 2008, consisted of reserves for performing loans in the portfolio and reserves against certain impaired loans based on management's evaluation of these individual loans.

Weakening economic conditions in the residential real estate sector have adversely affected, and may continue to adversely affect, our loan portfolio. Our percentage of non-performing assets relating to total assets continued to increase in 2008 to 11.0% at June 30, 2008 as compared to 6.9% at December 31, 2007. If loans that are currently non-performing further deteriorate or loans that are currently performing become non-performing loans, we may need to increase our allowance for loan losses. Such an increase would have an adverse impact on our financial condition and results of operations.

Based on our analysis, management believes that the allowance for loan losses was adequate to absorb estimated loan losses inherent in the loan portfolio at June 30, 2008. Actual results could differ from these estimates. However, since the allowance is affected by management's judgments and uncertainties, there is the likelihood that materially different amounts would be reported under different conditions or assumptions. To the extent that the economy, collateral values, reserve factors or the nature and volume of problem loans change, we may need to adjust the provision for loan losses. In addition, federal regulatory agencies, as an integral part of the examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance level based upon their judgment of the information available to them at the time of their examination. As we experienced in the first half of 2008, material additions to our provision for loan losses for the remainder of the year could result in an increase in our operating losses and capital.

**Liquidity and Capital Resources**

Like other financial institutions, we must ensure that sufficient funds are available to meet deposit withdrawals, loan commitments, investment needs and expenses. Control of our cash flow requires the anticipation of deposit flows and loan payments. Our primary sources of funds are deposit accounts, principal and interest payments on loans, maturities and calls of investment securities and sales of loans and investments. Historically, we have also relied on brokered deposits and Federal Home Loan Bank advances as funding sources, but we currently have no ability to renew, replace or accept brokered deposits without the prior approval of the Federal Deposit Insurance Corporation. In addition, we are not able to draw additional advances from the Federal Home Loan Bank.

We require funds in the short-term to finance ongoing operating expenses, pay liquidating deposits and invest in loans. We have changed our business strategy from purchasing pools of loans to focusing on originating in-market retail and small business loans to transition our asset and liability mix to that of a traditional community bank and to reduce our previous reliance on wholesale funding sources, such as brokered deposits

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and Federal Home Loan Bank advances. We believe this focus will build core relationships with our deposit and loan customers. As such, in the short term, we anticipate our cash flow requirements for in-market retail and business loan originations to be less than the cash used historically for purchases of pooled residential real estate loans.



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On August 7, 2008, we received conditional approval from the Federal Deposit Insurance Corporation to replace up to \$25.2 million of the \$30.2 million of brokered deposits maturing through November 30, 2008. As of June 30, 2008 we had a total of \$53.6 million of brokered deposits. The following table sets forth the maturities of those deposits (\$ in thousands):

| <b>Maturity Date</b> | <b>Amount</b>    |
|----------------------|------------------|
| August 8, 2008       | \$ 10,000        |
| August 11, 2008      | 7,040            |
| September 25, 2008   | 3,086            |
| September 26, 2008   | 5,028            |
| November 28, 2008    | 5,013            |
| April 22, 2009       | 3,004            |
| May 29, 2009         | 2,364            |
| August 11, 2009      | 1,500            |
| November 30, 2009    | 12,000           |
| June 15, 2010        | 4,599            |
|                      | <b>\$ 53,634</b> |

Long-term funds are required to invest in loans for our portfolio, purchase fixed assets and provide for the liquidation of deposits maturing in the future. Long-term funding requirements are obtained from principal payments from maturing loans, the sale of loans and the sale of investments. We have no plans to significantly change long-term funding requirements.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing and investing activities during any given period. At June 30, 2008, cash and cash equivalents totaled \$33.8 million. Also, at June 30, 2008, we had investment securities with a market value of \$10.1 million held at a correspondent bank that were available to secure short term borrowings and we also had a \$10.0 million unsecured federal funds line available with the same correspondent bank. We believe these sources of funds in the Bank, in addition to principal and interest payments on loans, will satisfy our short-term funding needs, and cover shortfalls in the event our operating cash flows are not sufficient to satisfy short-term emergencies, such as significant withdrawals of customer deposits.

During the six months ended June 30, 2008, our sources of funds came primarily from net loan principal repayments of \$39.4 million, proceeds from the sale of loans of \$12.1 million, proceeds from the sale and repayments of securities of \$14.6 million and an increase of \$11.5 million in Federal Home Loan Bank advances. We used \$56.2 million for brokered and other deposit maturities and withdrawals and \$24.7 million was retained in cash and cash equivalents for liquidity purposes. Management believes that, over the next 12 months, funds will primarily be obtained from deposit growth and principal and interest payments on loans.

At June 30, 2008, loans-in-process, or closed loans scheduled to be funded over a future period of time, totaled \$9.8 million. Available lines of credit totaled \$11.0 million, loans committed, but not closed, totaled \$843,000, and standby letters of credit totaled \$831,000. Funding for these amounts is expected to be provided by the sources described above (other than Federal Home Loan Bank advances).

For the month of June 2008, Federal Trust Bank's average liquidity ratio was 8.49%. This ratio is generally calculated by dividing average cash and other short-term investment securities by average borrowings and savings accounts. Federal Trust Bank's 11 Central Florida branches are expected to generate deposits along with loan principal and interest payments to provide liquidity for new loan originations and other investments. The Asset/Liability Management Committee meets regularly, and reviews liquidity levels to ensure that funds are available as needed.

**Off-Balance-Sheet Arrangements**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, standby letters of credit and loans in process. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the Condensed Consolidated Balance Sheet. The contract amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

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The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused lines of credit, standby letters of credit and loans in process is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

A summary of the amounts of the Company's financial instruments with off-balance-sheet risk at June 30, 2008, follows (\$ in thousands):

|                              | <b>Contract<br/>Amount</b> |
|------------------------------|----------------------------|
| Commitments to extend credit | \$ 843                     |
| Unused lines of credit       | \$ 11,006                  |
| Standby letters of credit    | \$ 831                     |
| Loans in process             | \$ 9,847                   |

Management believes the Company has adequate resources to fund all its commitments. At June 30, 2008, the Company had approximately \$243.4 million in time deposits maturing in one year or less. Management also believes that, if so desired, it can adjust the rates on time deposits to retain or obtain new deposits in a changing interest rate environment. Management believes the Bank was in compliance with all minimum capital requirements that it was subject to at June 30, 2008. See note 4 to the unaudited condensed consolidated financial statements.

The following tables set forth the Average balance sheets, the total dollar amount of interest income and expense and the resulting average yields for the periods indicated (\$ in thousands).

|   | <b>Three Months Ended June 30,</b> |                 |  |                            |                 |  |
|---|------------------------------------|-----------------|--|----------------------------|-----------------|--|
|   | <b>2008</b>                        |                 |  | <b>2007</b>                |                 |  |
|   | <b>Average<br/>Balance</b>         | <b>Interest</b> | <b>Average<br/>Yield/<br/>Cost (7)</b> | <b>Average<br/>Balance</b> | <b>Interest</b> | <b>Average<br/>Yield/<br/>Cost (7)</b> |
| <b>Interest-earning assets:</b>                   |                                    |                 |  |                            |                 |  |
| Loans (1)   | \$ 527,860                         | \$ 7,213        | 5.47%                                  | \$ 592,704                 | \$ 9,704        | 6.55%                                  |
| Securities  | 39,872                             | 559             | 5.61                                   | 63,623                     | 819             | 5.15                                   |
| Other interest-earning assets (2)                 | 37,047                             | 274             | 2.96                                   | 8,945                      | 167             | 7.47                                   |
| <b>Total interest-earning assets</b>              | <b>604,779</b>                     | <b>8,046</b>    | <b>5.32</b>                            | <b>665,272</b>             | <b>10,690</b>   | <b>6.43</b>                            |
| Other noninterest-earning assets                  | 38,649                             |                 |  | 44,478                     |                 |  |
| <b>Total assets</b>                               | <b>\$ 643,428</b>                  |                 |  | <b>\$ 709,750</b>          |                 |  |
| Noninterest-bearing demand deposits               | \$ 14,196                          |                 |  | \$ 12,427                  |                 |  |
| <b>Interest-bearing liabilities:</b>              |                                    |                 |  |                            |                 |  |
| Interest-bearing demand and money-market deposits | 116,744                            | 684             | 2.34                                   | 116,454                    | 1,118           | 3.84                                   |
| Savings deposits                                  | 2,411                              | 3               | 0.50                                   | 2,966                      | 12              | 1.62                                   |
| Time deposits                                     | 302,210                            | 3,437           | 4.55                                   | 338,758                    | 4,446           | 5.25                                   |

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|  |            |          |       |            |          |       |
|--|------------|----------|-------|------------|----------|-------|
| Total deposit accounts   | 435,561    | 4,124    | 3.79  | 470,605    | 5,576    | 4.74  |
| FHLB advances and other borrowings (3)   | 168,990    | 1,801    | 4.26  | 176,927    | 2,039    | 4.61  |
| Total interest-bearing liabilities (4)   | 590,355    | 5,925    | 4.01  | 635,105    | 7,615    | 4.80  |
| Other noninterest-bearing liabilities  | 12,602     |          |       | 7,948      |          |       |
| Stockholders' equity   | 26,275     |          |       | 54,270     |          |       |
| Total liabilities and stockholders' equity                                       | \$ 643,428 |          |       | \$ 709,750 |          |       |
| Net interest/dividend income   |            | \$ 2,121 |       |            | \$ 3,075 |       |
| Net interest margin (5)  |            |          | 1.40% |            |          | 1.85% |
| Interest-rate spread (6)   |            |          | 1.31% |            |          | 1.63% |
| Ratio of average interest-earning assets to average interest-bearing liabilities |            | 1.02     |       |            | 1.05     |       |

(1) Includes nonaccrual loans.

(2) Includes Federal Home Loan Bank stock and interest-earning deposits.

(3) Includes Federal Home Loan Bank advances, other borrowings and junior subordinated debentures.

(4) Total interest-bearing liabilities exclude noninterest-bearing demand deposits.

(5) Net interest margin is annualized net interest income divided by average interest-earning assets.

(6) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(7) Annualized

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|  | Six Months Ended June 30, |                 |                               |                    |                 |                               |
|--|---------------------------|-----------------|-------------------------------|--------------------|-----------------|-------------------------------|
|  | 2008                      |                 |                               | 2007               |                 |                               |
|  | Average<br>Balance        | Interest        | Average<br>Yield/<br>Cost (7) | Average<br>Balance | Interest        | Average<br>Yield/<br>Cost (7) |
| <b>Interest-earning assets:</b>  |                           |                 |                               |                    |                 |                               |
| Loans (1)  | \$ 542,528                | \$ 15,212       | 5.61%                         | \$ 598,784         | \$ 19,403       | 6.48%                         |
| Securities   | 42,436                    | 1,200           | 5.66                          | 64,133             | 1,663           | 5.19                          |
| Other interest-earning assets (2)  | 38,338                    | 640             | 3.34                          | 10,564             | 343             | 6.49                          |
| <b>Total interest-earning assets</b>   | <b>623,302</b>            | <b>17,052</b>   | <b>5.47</b>                   | <b>673,481</b>     | <b>21,409</b>   | <b>6.36</b>                   |
| Other noninterest-earning assets   | 41,424                    |                 |                               | 41,528             |                 |                               |
| <b>Total assets</b>  | <b>\$ 664,726</b>         |                 |                               | <b>\$ 715,009</b>  |                 |                               |
| Noninterest-bearing demand deposits  | \$ 14,292                 |                 |                               | \$ 12,688          |                 |                               |
| <b>Interest-bearing liabilities:</b>   |                           |                 |                               |                    |                 |                               |
| Interest-bearing demand and money-market deposits                                | 123,153                   | 1,757           | 2.85                          | 116,875            | 2,211           | 3.78                          |
| Savings deposits   | 2,424                     | 8               | 0.66                          | 3,052              | 26              | 1.70                          |
| Time deposits  | 313,552                   | 7,458           | 4.76                          | 337,096            | 8,706           | 5.17                          |
| <b>Total deposit accounts</b>  | <b>453,421</b>            | <b>9,223</b>    | <b>4.07</b>                   | <b>469,711</b>     | <b>10,943</b>   | <b>4.66</b>                   |
| FHLB advances and other borrowings (3)   | 170,534                   | 3,668           | 4.30                          | 183,486            | 4,167           | 4.54                          |
| <b>Total interest-bearing liabilities (4)</b>                                    | <b>609,663</b>            | <b>12,891</b>   | <b>4.23</b>                   | <b>640,509</b>     | <b>15,110</b>   | <b>4.72</b>                   |
| Other noninterest-bearing liabilities  | 12,304                    |                 |                               | 7,394              |                 |                               |
| Stockholders' equity   | 28,467                    |                 |                               | 54,418             |                 |                               |
| <b>Total liabilities and stockholders' equity</b>                                | <b>\$ 664,726</b>         |                 |                               | <b>\$ 715,009</b>  |                 |                               |
| <b>Net interest/dividend income</b>  |                           | <b>\$ 4,161</b> |                               |                    | <b>\$ 6,299</b> |                               |
| Net interest margin (5)  |                           |                 | 1.34%                         |                    |                 | 1.87%                         |
| Interest-rate spread (6)   |                           |                 | 1.24%                         |                    |                 | 1.64%                         |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 1.02                      |                 |                               | 1.05               |                 |                               |

(1) Includes nonaccrual loans.

(2) Includes Federal Home Loan Bank stock and interest-earning deposits.

(3) Includes Federal Home Loan Bank advances, other borrowings, junior subordinated debentures and capital lease obligation.

(4) Total interest-bearing liabilities exclude noninterest-bearing demand deposits.

(5) Net interest margin is annualized net interest income divided by average interest-earning assets.

(6) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(7) Annualized

**Table of Contents****Comparison of Financial Condition at June 30, 2008 and December 31, 2007**

Total assets at June 30, 2008 were \$628.0 million, a decrease of \$62.2 million, or 9%, from \$690.3 million at December 31, 2007. This decrease in total assets during 2008 was part of our strategy to improve our liquidity and shrink the balance sheet due to our losses and the need to strengthen our regulatory capital ratios, combined with our efforts to change our asset/liability mix through a reduction in wholesale loan purchases and borrowed funds. Our portfolio of securities available for sale decreased by \$15.1 million, or 29%, to \$37.3 million at June 30, 2008, from \$52.4 million at December 31, 2007. Total loans declined \$62.6 million, or 11%, to \$500.6 million at June 30, 2008, from \$563.2 million at December 31, 2007. Residential mortgage loans and residential construction loans declined \$29.5 million and \$15.4 million, or 8% and 70%, respectively, from December 31, 2007. In addition, commercial real estate secured loans and land, development and construction loans declined \$26.4 million and \$9.7 million, or 31% and 13%, respectively, while commercial loans increased \$8 million or 50% from December 31, 2007. The primary cause of the change in balances within the commercial loan portfolio is the result of the reclassification of certain individual loans to more accurately reflect the current classification of loans which comprise the portfolio. The funds provided by the sales and payoffs of loans and investments were used to repay brokered deposits and increase our liquidity. Cash and cash equivalents increased from \$9.2 million at December 31, 2007 to \$33.8 million at June 30, 2008.

Total deposits at June 30, 2008 were \$425.5 million, a decrease of \$56.2 million, or 12%, from \$481.7 million at December 31, 2007. This decrease was primarily the result of a \$31.2 million, or 39%, decrease in interest-bearing demand deposits from \$80.3 million at December 31, 2007, to \$49.1 million at June 30, 2008. Time deposits declined \$24.7 million, or 8%, to \$302.8 million at June 30, 2008, from \$327.5 million at December 31, 2007, primarily due to \$25.0 million in brokered deposits that matured and were not renewed. Federal Home Loan Bank advances increased \$11.5 million, or 8%, during 2008 to \$163.5 million at June 30, 2008. Total stockholders' equity decreased \$6.0 million in 2008 due primarily to the \$5.1 million loss for the six months ended June 30, 2008.

**Comparison of the Three-Month Periods Ended June 30, 2008 and 2007**

**General.** The Company had a net loss for the three-month period ended June 30, 2008, of \$4.6 million, or \$.49 per basic and fully diluted share, compared to a net loss of \$3.6 million or \$.38 per basic and fully diluted share for the same period in 2007. The loss for the three months ended June 30, 2008, is primarily attributable to a \$2.2 million provision for loan losses, together with interest income foregone as a result of the increase in nonperforming loans.

**Interest Income.** Interest income decreased \$2.6 million to \$8.0 million for the 2008 second quarter, from \$10.7 million for the quarter ended June 30, 2007. The decrease in interest income was primarily due to a decrease in market interest rates from the second quarter of 2007 to the second quarter of 2008, and \$745,000 in foregone interest for the three-months ended June 30, 2008 and a decrease in average interest-earning assets.

**Interest Expense.** Interest expense decreased \$1.7 million, or 22%, due to a decrease in the average rate paid on interest-bearing liabilities from 4.80% in the quarter ending June 2007 to 4.01% for the 2008 second quarter. In addition, average interest bearing liabilities decreased from \$635.1 million for the 2007 second quarter to \$590.4 million for the second quarter of 2008.

**Provision for Loan Losses.** A provision for loan losses is charged to earnings based upon management's evaluation of the loan portfolio. During the quarter ended June 30, 2008, the Bank recorded a provision for loan losses of \$2.2 million based on its evaluation of the loan portfolio, compared to a provision of \$5.1 million for the same period in 2007. The provision for the 2008 second quarter was due to the decline in real estate collateral values and an increase in nonaccrual loans. The allowance for loan losses at June 30, 2008, was \$16.6 million compared to \$10.3 million at June 30, 2007. Our evaluation of the allowance for loan losses at June 30, 2008, included an assessment of the current market values for the nonaccrual loans and an ongoing evaluation of the loan portfolio. As a percent of total loans outstanding, the allowance for loan losses increased to 3.16% at June 30, 2008 from 2.32% at December 31, 2007, and 1.62% at June 30, 2007. Management believes the allowance for loan losses at June 30, 2008, was adequate to absorb estimated loan losses in the loan portfolio at June 30, 2008. However, we can make no assurance that our allowance will be adequate to cover future loan losses given current and future market conditions, including the decline in real estate values and increase in loan delinquencies. In addition, our regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory agencies would have a negative effect on our operating results.

**Other Income.** Other income decreased 30% to \$304,000 for the quarter ended June 30, 2008, from \$436,000 for the 2007 second quarter due primarily to \$33,000 in gains on the sale of loans recognized during the second quarter of 2007 compared to no gain on sale of loans during the second quarter of 2008, and \$52,000 in losses on the sale of securities available for sale recognized in the second quarter of 2008.



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**Comparison of the Three-Month Periods Ended June 30, 2008 and 2007, Continued**

**Other Expenses.** Total other expenses for the 2008 second quarter were \$4.9 million, up \$648,000, or 15%, from the second quarter of 2007. The increase was partially due to a \$313,000 increase in net losses on the sale and write downs of foreclosed assets during the 2008 second quarter, compared to the second quarter of 2007. Other increases in operating expenses during the 2008 second quarter compared to the second quarter of 2007 were, a \$301,000 increase in the Bank's FDIC insurance premium, an \$86,000 increase in occupancy expense resulting from our two new branches and the relocation of our New Smyrna Beach branch in the second half of 2007, and a \$139,000 increase in expenses related to legal and foreclosure costs associated with our problem asset resolution efforts. Partially offsetting these second quarter expense increases was a decrease in personnel expense of \$242,000, or 11% in 2008 compared to 2007.

**Income Taxes.** The Company established a valuation allowance for the full amount of the deferred tax of \$9.1 million as of March 31, 2008 and therefore recognized no tax benefit relating to the operating loss for the three-months ended June 30, 2008. For the 2008 second quarter the tax benefit was offset by a \$2.7 million addition to the valuation allowance on our deferred tax assets because management believes that it is more likely than not that the Company may not have sufficient earnings in the near term to realize the deferred tax asset. A tax benefit of \$2.3 million (an effective rate of 39.2%) was recognized during the same period in 2007.



**Table of Contents****Comparison of the Six-Month Periods Ended June 30, 2008 and 2007**

**General.** The Company had a net loss for the six-month period ended June 30, 2008, of \$15.8 million, or \$1.68 per basic and diluted share, compared to a net loss of \$3.4 million, or \$.36 per basic and diluted share, for the same period in 2007. The 2008 loss was the result of an \$11.8 million valuation allowance on our deferred tax asset due to our assessment that it is more likely than not that the Company will not have sufficient future earnings to realize the deferred tax asset. Also included in the six-month loss, was a \$4.2 million provision for loan losses and interest income foregone as a result of the increase of \$35.4 million in non-performing assets from \$33.6 million at June 30, 2007 to \$69.0 million at June 30, 2008.

**Interest Income.** Interest income decreased by \$4.4 million or 20% to \$17.1 million for the six-month period ended June 30, 2008, from \$21.4 million for the same period in 2007. Interest income on loans decreased \$4.2 million or 22% to \$15.2 million in 2008 from \$19.4 million in 2007, as a result of a decrease in the average amount of loans outstanding from \$598.8 million in 2007 to \$542.5 million in 2008 and the negative effect of the \$56.8 million of nonaccrual loans at June 30, 2008, in addition to a decrease in the average yield earned on loans from 6.48% for the six-month period ended June 30, 2007, to 5.61% for the comparable period in 2008. Interest income on securities decreased by \$463,000 for the six-month period ended June 30, 2008, over the same period in 2007, primarily as a result of a decrease in the average balance of securities owned partially offset by an increase in the average yield. Interest income on other interest-earning assets increased \$297,000 to \$640,000 from \$343,000 primarily as a result of an increase in average balances of our short-term liquid assets from \$10.6 million for the six-month period ended June 30, 2007, to \$38.3 million for the comparable period in 2008. Management expects the rates earned on the portfolio to fluctuate with general market conditions.

**Interest Expense.** Interest expense decreased by \$2.2 million or 15% during the six-month period ended June 30, 2008, compared to the same period in 2007. Interest on deposits decreased \$1.7 million or 16% to \$9.2 million in 2008 from \$10.9 million in 2007, as a result of a decrease in the average cost of deposits from 4.66% for the six-month period ended June 30, 2007, to 4.07% for the comparable period in 2008 and a decrease in average deposits outstanding from \$469.7 million in 2007 to \$453.4 million in 2008. Interest on other borrowings decreased to \$3.7 million in 2008 from \$4.2 million in 2007, primarily as a result of a decrease in the average balance of other borrowings from \$183.5 million for the six-month period ended June 30, 2007 to \$170.5 million for the comparable 2008 period and a decrease in the average rate paid on other borrowings from 4.54% in 2007 to 4.30% in 2008.

**Provision for Loan Losses.** During the six months ended June 30, 2008, a \$4.2 million provision for loan losses was recorded, compared to \$5.1 million recorded for the same period in 2007. The allowance for loan losses at June 30, 2008, was \$16.6 million or 3.16% of total loans outstanding, up from \$10.3 million, or 1.62% of total loans outstanding at June 30, 2007. Management believes the allowance for loan losses at June 30, 2008, was adequate to absorb estimated loan losses in the loan portfolio at June 30, 2008. However, we can make no assurance that our allowance will be adequate to cover future loan losses given current and future market conditions, including the decline in real estate values and increase in loan delinquencies. In addition, our regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory agencies would have a negative effect on our operating results.

**Other Income.** Other income increased \$40,000, or 4%, from the six-month period ended June 30, 2007, to the same period in 2008. The increase in other income was primarily due to an increase of \$94,000 in gains on sales of loans, a \$46,000 increase in cash surrender values of life insurance policies and a \$37,000 increase in service charges and fees, partially offset by a decrease in other income of \$143,000, primarily caused by lower mortgage loan origination volumes and a decline in mortgage prepayment fees.

**Other Expense.** Other expense increased \$1.6 million or 21% to \$9.2 million for the six-month period ended June 30, 2008, from \$7.6 million for the same period in 2007. The year-over-year expense growth was due to an increase in our deposit insurance premium of \$593,000; net losses and writedowns on foreclosed assets of \$394,000; occupancy expense of \$275,000; foreclosure related expenses of \$244,000; data processing of \$122,000; professional fees of \$116,000, partially offset by a decrease in salaries and employee benefits of \$178,000 during the first six months of 2008.

**Income Taxes.** The Company's consolidated tax position resulted in a tax expense of \$7.5 million for the six months ending June 30, 2008, compared to a benefit of \$2.3 million (an effective rate of 40.8%) for the same period in 2007. Included in the tax expense for the first six months of 2008, was a \$11.8 million valuation allowance on our deferred tax assets because management believes it is more likely than not that the Company may not have sufficient future earnings to realize the deferred tax asset.

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**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

There has been no significant change in the Company's market risk exposure since December 31, 2007.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* Management, including the Company's Chief Executive Officer and Chief Financial Officer, has made an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report pursuant to Exchange Act Rule 13(a)-15. Based upon the evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by Federal Trust in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

*Changes in Internal Controls.* During the period covered by this report, there was no change in internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal controls over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

*In addition to the other information contained this Quarterly Report on Form 10-Q/A and the exhibits hereto, the following risk factors represent material changes from those previously disclosed in the Company's Amendment No. 2 to the Annual Report on Form 10-K/A, filed with the Securities and Exchange Commission on June 27, 2008. The risks disclosed below, either alone or in combination, could materially adversely affect our business, financial condition or results of operations. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations. Further, to the extent that any of the information contained in this Quarterly Report on Form 10-Q/A constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us.*

**We have terminated our proposed stock offering. We may not be able to raise capital or sell control of part or all of the Company in a merger or other transaction.**

Effective August 8, 2008, the Company terminated its proposed stock offering. In accordance with the terms of the previously disclosed Cease and Desist Order issued to the Company by the Office of Thrift Supervision, the Company is seeking to capitalize the Bank in a private transaction, or otherwise sell control of part or all of the Company in a merger or other transaction.

If the Company is not able to raise additional capital or sell control of all or part of the Company in a merger or other transaction, management believes that there is substantial doubt about the Company's ability to continue as a going concern. The Company's operating and capital requirements and recurring losses due to increases in non-performing loans are contributing factors for this concern. There is no guarantee that the Company will be able to raise additional capital or sell control of part or all of the Company in a merger or other transaction, either on terms and conditions acceptable to the Company or the Office of Thrift Supervision, or at all.

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

The Annual Meeting of Shareholders (the Annual Meeting) of Federal Trust was held on June 16, 2008, to consider the election of two Class III directors; the approval of an amendment to the Company's articles of incorporation to increase the number of shares of authorized capital stock to 65,000,000 shares of common stock; the approval of an issuance of shares and warrants in a non-public offering in an amount in excess of 20% of the Company's current outstanding shares of common stock; and the ratification of the appointment of the Company's independent registered public accounting firm for the year ending December 31, 2008. Incumbent Directors Samuel C. Certo, PhD and Dennis T. Ward were elected for three-year terms. The terms of Directors Robert G. Cox, Kenneth W. Hill, A. George Iglar, Eric J. Reinhold, and Charles R. Webb continued after the Annual Meeting.

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At the Annual Meeting, 8,249,887 shares were present in person or by proxy. With respect to Proposal I, each share was entitled to vote for up to two directors and as to the other proposals, each share was entitled to one vote on each proposal. The following is a summary and tabulation of the matters that were voted upon at the Annual Meeting:

**Item 4. Submission of Matters to a Vote of Security Holders, Continued**  
**Proposal I.**

The election of two Class III directors for a term of three years:

|                      | <b>For</b> | <b>Withheld</b> |
|----------------------|------------|-----------------|
| Samuel C. Certo, PhD | 6,770,236  | 1,479,651       |
| Dennis T. Ward       | 6,851,901  | 1,397,986       |

**Proposal II.**

The approval of an amendment to the Company's Restated Articles of Incorporation to increase the number of shares of authorized capital stock to 65,000,000 shares of common stock:

|  | <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker<br/>Non-Votes</b> |
|--|------------|----------------|----------------|-----------------------------|
|  | 7,444,953  | 797,376        | 7,558          | 0                           |

**Proposal III.**

The approval of an issuance of shares and warrants in a non-public offering in an amount in excess of 20% of the Company's current outstanding shares of common stock:

|  | <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker<br/>Non-Votes</b> |
|--|------------|----------------|----------------|-----------------------------|
|  | 4,245,529  | 869,676        | 9,640          | 3,090,367                   |

**Proposal IV:**

The ratification of the appointment of Hacker, Johnson & Smith PA, as the Company's independent registered public accounting firm for the year ending December 31, 2008:

|  | <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker<br/>Non-Votes</b> |
|--|------------|----------------|----------------|-----------------------------|
|  | 7,868,729  | 370,360        | 10,798         | 0                           |

**Item 6. Exhibits**

31.1 Certification of Chief Executive Officer, pursuant to Rule 13a-14(a)

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- 31.2 Certification of Chief Financial Officer, pursuant to Rule 13a-14(a)
- 32.1 Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**FEDERAL TRUST CORPORATION AND SUBSIDIARIES**

**SIGNATURES**

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

**FEDERAL TRUST CORPORATION**

(Registrant)

Date: August 15, 2008

By: /s/ Dennis T. Ward  
Dennis T. Ward  
President and Chief Executive Officer

Date: August 15, 2008

By: /s/ Gregory E. Smith  
Gregory E. Smith  
Executive Vice President and Chief Financial Officer