BAY NATIONAL CORP
Form 10-Q
May 15, 2003

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended March 31, 2003.

Commission file number: 333-87781

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

Maryland	52-2176710
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2328 West Joppa Road, Lutherville, MD 21093
Address of principal executive offices

(410) 494-2580
Issuer's telephone number

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 X No ____

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

At May 12, 2003, the issuer had 1,862,710 shares of Common Stock outstanding.

Transitional Small Business Disclosure Format (Check One):
Yes ____ No X

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BAY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

As of March 31, 2003 and December 31, 2002

		March 31, 2003
ASSETS		(Unaudited)
Cash and due from banks	$	102,780
Federal funds sold and other overnight investments		19,802,835
Loans held for sale		4,056,343
Investment securities available for sale (AFS) - at fair value		1,197,852
Other equity securities		444,340
Loans, net of unearned fees		81,654,513
Less: Allowance for credit losses		(1,021,000)
Loans, net		80,633,513
Premises and equipment, net		700,402
Accrued interest receivable and other assets		494,702
Total Assets	$	107,432,767
LIABILITIES		
Non-interest-bearing deposits	$	9,907,313
Interest-bearing deposits		85,891,796
Total deposits		95,799,109
Short-term borrowings		1,171,000
Accrued expenses and other liabilities		3,059,401
Total Liabilities		100,029,510
STOCKHOLDERS' EQUITY		
Common stock - $.01 par value, authorized: 9,000,000 shares authorized, 1,242,020 issued and outstanding as of March 31, 2003 and December 31, 2002, respectively:		12,420
Surplus		12,407,780
Accumulated deficit		(5,016,943)
Total Stockholders' Equity		7,403,257

Total Liabilities and Stockholders' Equity	$	107,432,767

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

For the three-months ended March 31, 2003 and 2002
(Unaudited)

	2003
INTEREST INCOME:	
Interest and fees on loans	$ 1,143,795
Interest on federal funds sold and other overnight investments	21,047
Taxable interest and dividends on investment securities	3,960
Total interest income	1,168,802
INTEREST EXPENSE:	
Interest on deposits	438,935
Interest on short-term borrowings	1,836
Total interest expense	440,771
Net interest income	728,031
Provision for credit losses	169,500
Net interest income after provision for credit losses	558,531
NON-INTEREST INCOME:	
Service charges on deposit accounts	40,566
Gain on sale of mortgage loans	147,554
Other income	9,697

Total non-interest income	197,817
NON-INTEREST EXPENSES:	
Salaries and employee benefits	580,744
Occupancy expenses	61,015
Furniture and equipment expenses	45,127
Legal and professional fees	36,169
Data processing and other outside services	118,988
Advertising and marketing related expenses	37,524
Other expenses	83,182
Total non-interest expenses	962,749
Loss before income taxes	(206,401)
Income tax benefit	-
NET LOSS	$ (206,401)
Per Share Data:	
Cash Dividends Paid	$ -
Net Loss (basic and diluted)	$ (.17)
Average shares outstanding (basic and diluted)	1,242,020

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three-months ended March 31, 2003 and 2002
(Unaudited)

	2003
Cash Flows From Operating Activities	
Net loss	$ (206,401)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation	43,992
Accretion of investment discounts	(2,986)
Provision for credit losses	169,500
Gain on sale of loans	(147,554)
Origination of loans held for sale	(10,200,548)
Proceeds from sale of loans	9,110,259
Net increase in accrued interest receivable and other assets	(59,920)
Net decrease in accrued expenses and other liabilities	(98,199)

Net cash used by operating activities	(1,391,857)
Cash Flows From Investing Activities	
Purchases of investment securities - AFS	(1,196,505)
Maturities of investment securities - AFS	950,000
Purchase of Federal Home Loan Bank of Atlanta stock	(88,500)
Net increase in loans	(13,576,252)
Capital expenditures	(35,191)
Net cash used by investing activities	(13,946,448)
Cash Flows From Financing Activities	
Net increase in deposits	20,021,253
Net increase in short-term borrowings	664,000
Stock subscriptions received	2,442,931
Net cash provided by financing activities	23,128,184
Net increase (decrease) in cash and cash equivalents	7,789,879
Cash and cash equivalents at beginning of period	12,115,736
Cash and cash equivalents at end of period	$ 19,905,615

See accompanying notes to consolidated financial statements.

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BAY NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. GENERAL

Organization

Bay National Corporation (the "Company") was incorporated on June 3, 1999 under the laws of the State of Maryland to operate as a bank holding company of a national bank with the name Bay National Bank (the "Bank"). On May 12, 2000, the Company purchased all the shares of common stock issued by the Bank. The Company's operations through that date were limited to taking the necessary actions to organize and capitalize the Company and the Bank. The Bank commenced operations on May 12, 2000 after successfully meeting the conditions of the Office of the Comptroller of the Currency (the "OCC") to receive its charter authorizing it to commence operations as a national bank, and obtaining the approval of the Federal Deposit Insurance Corporation to insure its deposit accounts, and meeting certain other regulatory requirements.

Basis of Presentation

The accompanying consolidated financial statements include the activity of Bay National Corporation and its wholly owned subsidiary, Bay National Bank. All significant intercompany transactions and balances have been eliminated in consolidation.

The foregoing consolidated financial statements are unaudited; however, in the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim period have been included. The balances as of December 31, 2002 have been derived from audited financial statements. These statements should be read in conjunction with the financial statements and accompanying notes included in Bay National Corporation's 2002 Annual Report on Form 10-KSB. There have been no significant changes to the Company's Accounting Policies as disclosed in the 2002 Annual Report. The results shown in this interim report are not necessarily indicative of results to be expected for the full year 2003.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America.

Reclassifications

Certain reclassifications have been made to amounts previously reported to conform to the current presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

2. REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios. Management believes, as of March 31, 2003, that the Bank meets all capital adequacy requirements to which it is subject.

As of March 31, 2003, the Bank has been categorized as "Well Capitalized" by the OCC under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios.

3. INCOME TAXES

The Company uses the liability method of accounting for income taxes as required by SFAS No. 109, "Accounting for Income Taxes". Under the liability method, deferred-tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse. Deferred income taxes will be recognized when it is deemed more likely than not that the benefits of such deferred income taxes will be realized; accordingly, no deferred income taxes or income tax benefits have been recorded by the Company.

4. EARNINGS PER SHARE

The Company's common stock equivalents were not considered in the computation of diluted earnings per share because the result would have been anti-dilutive.

5. STOCK-BASED COMPENSATION

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), but applies Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock option plan. No compensation expenses related to the Company's stock option plan was recorded during the three-month periods ended March 31, 2003 and 2002.

The following table illustrates the effect on net loss and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 and SFAS No. 148 to stock-based employee compensation for the three-months ended March 31:

	2003	2002
Net loss, as reported	$ (206,401)	$ (291,083)
Less pro forma stock-based compensation expense determined under the fair value method, net of related tax effects	(16,623)	-
Pro forma net loss	$ (223,024)	$ (291,083)
Net loss per share:		
Basic and Diluted - as reported	$ (.17)	$ (.23)
Basic and Diluted - pro forma	$ (.18)	$ (.23)

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

This discussion and analysis provides an overview of the financial condition and results of operations of Bay National Corporation (the "Parent") and its national bank subsidiary, Bay National Bank (the "Bank"), collectively (the "Company"), as of March 31, 2003 and December 31, 2002 and for the three month periods ended March 31, 2003 and 2002.

General

On May 12, 2000 the Parent became a bank holding company by purchasing all of the common stock of the Bank. The Bank opened its first office on May 12, 2000, and a second office on May 26, 2000.

The Bank was formed to serve the business communities of North Baltimore and Salisbury, Maryland.

Critical Accounting Policies

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial information contained within the financial statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. Management uses many factors including economic conditions and trends, the value and adequacy of collateral, the volume and mix of the loan portfolio, the performance of the portfolio, and internal loan processes of the Company in determining the inherent loss that may be present in the Company's loan portfolio. Actual losses could differ significantly from management's estimates. In addition, GAAP itself may change from one previously acceptable method to another. Although the economics of transactions would be the same, the timing of events that would impact the transactions could change.

The Company believes its most critical accounting policy relates to the allowance for credit losses. The allowance for credit losses is an estimate of the losses in the loan portfolio as of the balance sheet date. The allowance is based on two basic principles of accounting: (i) SFAS 5, "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and estimable; and (ii) SFAS 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued based on the differences between the loan balance and the value of collateral, present value of future cash flows, or values that are observable in the secondary market.

Financial Condition

As of March 31, 2003, total assets were $107,432,767. This represents growth of $22,823,584 or 26.98% since December 31, 2002. The growth in total assets included increases of $8,050,130 in federal funds sold and other overnight investments, $1,237,843 in loans held for sale, $249,491 in investment securities available for sale, $88,500 in other equity securities, and $13,406,752 in loans net of the allowance for credit losses. These increases were offset by a decrease of $209,132 in other non-earning assets.

As of March 31, 2003, loans excluding loans held for sale (net of a $1,021,000 allowance for credit losses) totaled $80,633,513. The increase of 19.94%, from a balance of $67,226,761 as of December 31, 2002, is a direct result of the ongoing marketing efforts of bank employees as

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well as members of the Board of Directors, and the Baltimore and Salisbury Advisory Boards. The composition of the loan portfolio as of March 31, 2003 was approximately $49.6 million of commercial loans, $4.8 million of consumer loans, and $27.3 million of real estate loans (excluding mortgage loans held for sale). The composition of the loan portfolio as of December 31, 2002 was approximately $42.6 million of commercial loans, $4.0 million of consumer loans, and $21.5 million of real estate loans (excluding mortgage loans held for sale). There were $4,056,343 and $2,818,500 of mortgage loans held for sale as of March 31, 2003 and December 31, 2002, respectively. The mix of loans is consistent with the initial plans for the business.

Funds not extended in loans are held in cash and due from banks, federal funds sold and other overnight investments, and short-term U.S. Treasury securities. At March 31, 2003, the Company had federal funds sold and other overnight investments totaling $19,802,835 as compared to $11,752,705 as of December 31, 2002. The Company held $275,940 of Federal Reserve Bank stock at both March 31, 2003, and December 31, 2002. The Company also held Federal Home Loan Bank of Atlanta stock of $168,400 and $79,900 as of March 31, 2003 and December 31, 2002, respectively, and United States Treasury bills with a maturity value of $1,200,000 and $950,000 as of March 31, 2003 and December 31, 2002, respectively. The Treasury securities are used to collateralize repurchase agreements under which $1,171,000 and $507,000 was outstanding as of March 31, 2003 and December 31, 2002, respectively.

The growth in assets was funded by deposit growth of $20,021,253 or 26.42%, an increase in short-term borrowings of $664,000, and an increase in accrued expenses and other liabilities of $2,344,732 resulting from the stock subscriptions received during the three-months ended March 31, 2003.

Deposits at March 31, 2003 were $95,799,109. A total of $8,344,989 or 41.68% of deposit growth was related to one customer. Total deposits for this customer were $14,892,414 as of March 31, 2003, as compared to $6,547,425 of deposits as of December 31, 2002. The deposits for this customer tend to fluctuate significantly; as a result, management monitors these deposits on a daily basis to ensure that liquidity levels are adequate to compensate for these fluctuations. The remaining deposit growth resulted from the continued marketing efforts of officers and directors, direct mail campaigns, and the listing of money market and certificate of deposit rates in print publications and on the Internet. Management has set the interest rates paid on deposits to be competitive in the market and will continue its marketing activities to generate growth in deposits.

While the Bank does not rely on or solicit brokered deposits, regulatory rules require that approximately $2.4 million of deposits at March 31, 2003, and $4.0 million of deposits at December 31, 2002 be classified as brokered deposits. These deposits were obtained through the listing of certificate of deposit rates on Internet-based listing services. These deposits were obtained at rates that are typically lower than or equal to the prevailing market rate for similar deposits in the Company's local markets. The brokered deposits outstanding at March 31, 2003 were issued with an average interest rate of 3.43% and an average term of 18.24 months. The Company has not paid broker fees for deposits as of March 31, 2003.

Short-term borrowings consist of repurchase agreements collateralized by pledges of U.S. Government Treasury Securities, based upon their market values, equal to 100% of the principal and accrued interest of its short-term borrowings. The outstanding balance of short-term borrowings increased from $507,000 at December 31, 2002 to $1,171,000 at March 31, 2003, due to increases in available funds of the customers participating in this program.

On October 31, 2002, Bay National Corporation commenced a private offering, to accredited investors only, of an aggregate of 550,000 shares of its common stock, which was subsequently increased to 620,690 shares of its common stock. The purchase price per share was

$7.25 for an aggregate purchase price of $4,500,002. The private offering closed on April 30, 2003 with 620,690 shares issued and net proceeds after offering costs of approximately $4,450,000. As of March 31, 2003 and December 31, 2002, Bay National Corporation had received and accepted subscriptions for 378,456 and 41,500 shares, respectively. The proceeds from these subscriptions of $2,743,806 and $300,875 as of March 31, 2003 and December 31, 2002, respectively, are included in accrued expenses and other liabilities.

Total capital at March 31, 2003 was $7,403,257 as compared to $7,609,658 at December 31, 2002. The decrease in capital is a result of the losses incurred in 2003 and is consistent with the initial expectations of management. The capital balances do not include the proceeds from the private offering, which will increase capital by approximately $4,450,000. Management believes that this capital and the capital raised in the private offering are adequate to support expected asset growth and losses in 2003.

Results of Operations

On a consolidated basis, the Company recorded a net loss of $206,401 for the three-months ended March 31, 2003, as compared to a net loss of $291,083 for the three-months ended March 31, 2002. The improvement in results for the three-month period as compared to the same period in 2002 is a direct result of the 102.35% growth in the loan portfolio from $40,352,194 at March 31, 2002 to $81,654,513 at March 31, 2003. The losses for the periods ended March 31, 2003 and 2002 were expected since loan and deposit growth initially were not expected to produce net interest income sufficient to cover operating expenses. On average, community banks do not achieve profitability for the first 24 to 36 months of operation. Management does not expect the Company to achieve monthly profitability, if at all, until sometime during the second or third quarter of 2003.

Net Interest Income

Net interest income is the difference between income on assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans, investments, and federal funds sold; while interest-bearing deposits and other short-term borrowings make up the cost of funds. Non-interest bearing deposits and capital are also funding sources. Changes in the volume and mix of earning assets and funding sources along with changes in associated interest rates determine changes in net interest income.

Net interest income for the three-month period ended March 31, 2003 was $728,031, as compared to $367,363 for the same period in 2002. The 98.18% increase for the three-month period is directly related to the increase in average earning assets during the period. Average earning assets increased $39,184,428 or 81.26% for the three-months ended March 31, 2003 as compared to the three-months ended March 31, 2002. The yield on these assets was 5.35% for the three-months ended March 31, 2003 and 5.44% for the three-months ended March 31, 2002.

The percentage of average earning assets represented by loans increased from 79.32% for the three-month period ended March 31, 2002, to 86.80% for the three-month period ended March 31, 2003. Growth in the percentage of interest-earning assets represented by the loan portfolio would normally be expected to result in an increase in average yields on earning assets. This would occur because the yields on loans are normally higher than yields on investment securities. However, the Bank's significant loan growth was partially offset by a reduction in loan and investment yields as a result of actions taken by the Federal Reserve to reduce its target for the federal funds rate from 1.75%, which was in effect for the entire three month period ending March 31, 2002, to 1.25% on November 6, 2002. Management expects that this action by the Federal Reserve will continue to suppress yields and margins, although the actual impact to the Company cannot be readily determined.

The market in which the Company operates is very competitive, and the rates of interest paid on deposits are affected by rates paid by other depository institutions. Management closely monitors rates offered by other institutions and seeks to be competitive within the market. The Company has chosen to selectively compete for jumbo certificates of deposits. The Company will choose to pursue such deposits when expected loan growth provides for adequate interest spreads to support the cost of those funds. During the three-month period ended March 31, 2003, the Company increased funding from the listing of certificate of deposit rates on Internet-based listing services by approximately $6.8 million. The outstanding certificates of deposit issued through Internet listings have an average interest rate of 3.00% and an average term of 23.52 months. As of March 31, 2003, total deposit balances from Internet listings were approximately $22.7 million, including the $2.4 million of deposits classified as brokered deposits.

The average rate on interest-bearing liabilities was 2.50% for the three-month period ended March 31, 2003, as compared to 3.19% for the same period in 2002. The decrease in average rate was the result of the declining rate environment discussed above. It is anticipated that interest expense will continue to increase during the remainder of 2003 based upon continued growth in deposits.

Comparing the three-month periods ended March 31, 2003 and 2002, the net interest margin on average earning assets increased by 28 basis points, to 3.33% in 2003, from 3.05% in 2002, reflecting the impact of the increase in loans as a percentage of average earning assets and declining rates in the deposit portfolio.

The following tables set forth, for the periods indicated, information regarding the average balances of interest-earning assets and interest-bearing liabilities, the amount of interest income and interest expense and the resulting yields on average interest-earning assets and rates paid on average interest-bearing liabilities. Average balances are also provided for non-interest-earning assets and non-interest-bearing liabilities.

Three Months Ended March 31, 2003

	Average Balance	Interest and fees
ASSETS		
Loans	$ 75,870,243	$ 1,143,795
Investment Securities	1,363,514	3,960
Federal funds sold and other overnight investments	10,172,444	21,047
Total Earning Assets	87,406,201	1,168,802
Less: Allowance for credit losses	(889,383)	
Cash and due from banks	801,374	
Premises and equipment, net	702,884	
Accrued interest receivable and other assets	418,902	
Total Assets	$ 88,439,978	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 28,171,458	93,094

Regular savings deposits	2,139,557	4,508
Time deposits	39,457,735	341,333
Short-term borrowings	652,482	1,836
Total interest-bearing liabilities	70,421,232	440,771
Net interest income and spread		$ 728,031
Non-interest-bearing demand deposits	8,427,739	
Accrued expenses and other liabilities	2,011,353	
Stockholders' equity	7,579,654	
Total Liabilities and Stockholders' Equity	$ 88,439,978	
Interest and fee income/earning assets	5.35 %	
Interest expense/earning assets	2.02	
Net interest margin	3.33 %	

Three Months Ended March 31, 2002

	Average Balance	Interest and fees
ASSETS		
Loans	$ 38,248,628	$ 624,789
Investment Securities	275,940	-
Federal funds sold and other overnight investments	9,697,205	31,190
Total Earning Assets	48,221,773	655,979
Less: Allowance for credit losses	(457,311)	
Cash and due from banks	748,164	
Premises and equipment, net	813,740	
Accrued interest receivable and other assets	242,819	
Total Assets	$ 49,569,185	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 19,877,308	152,200
Regular savings deposits	2,463,448	7,585
Time deposits	13,821,505	128,831
Total interest-bearing liabilities	36,162,261	288,616
Net interest income and spread		$ 367,363
Non-interest-bearing demand deposits	4,694,911	

Accrued expenses and other liabilities	227,241
Stockholders' equity	8,484,772
Total Liabilities and Stockholders' Equity	$ 49,569,185

Interest and fee income/earning assets	5.44 %
Interest expense/earning assets	2.39
Net interest margin	3.05 %

Allowance and Provision for Credit Losses

The provision for credit losses represents an expense to fund the allowance for credit losses. This allowance is established to absorb credit losses in the current loan portfolio as of the balance sheet date. The amount of the allowance is determined by management based on many factors, including economic conditions and trends, the value and adequacy of collateral, the volume and mix of the loan portfolio, the performance of the portfolio, and internal loan processes of the Company.

Management uses a loan grading system where all loans are graded based on management's evaluation of the risk associated with each loan. A factor, based on the loan grading, is applied to the loan balance to reserve for losses. In addition, management judgmentally establishes an additional unallocated reserve. The unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors.

Based upon management's analysis of the loan portfolio as of March 31, 2003, the allowance for credit losses increased to $1,021,000 as compared to $851,500 at December 31, 2002. The increase is reflective of the overall increase in the size of the loan portfolio. The amount equates to 1.25% of outstanding loans, net of loans held for sale, as of March 31, 2003

and December 31, 2002. This percentage has remained consistent because no additional information has indicated that the overall level of reserves is inappropriate. This is an estimate based on limited historical information, and may be revised over time for changes in economic conditions, experience with the portfolio, and other factors which may arise.

Management considers the allowance appropriate and adequate to cover possible losses inherent in the loan portfolio; however, management's judgment is based upon a number of assumptions, which are believed to be reasonable, but which may or may not prove valid. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for credit losses or that additional increases in the allowance will not be required. Management considers, among other things, the findings and recommendations of the Bank's primary regulator and an independent loan review service that evaluates management's underwriting decisions in determining the adequacy of the allowance.

As of March 31, 2003, the Company had loans totaling $246,780 that were more than 90 days past due and, therefore, were classified as non-accrual loans. The Company has had no loan charge-offs since inception.

Non-Interest Income

Non-interest income consists primarily of gains on the sale of mortgage loans, mortgage origination fees, deposit account service charges, and cash management fees. For the three-months ended March 31, 2003, the Company realized non-interest income in the amount of $197,817 as compared to $144,297 for the same period in 2002. Gains on the sale of mortgage loans of $147,554 are the most significant element of non-interest income, comprising 74.59% of the total for the three-months ended March 31, 2003. This compares to gains on the sale of mortgage loans of $117,693 or 81.56% of total non-interest income for the three-months ended March 31, 2002. The increase in gains on the sale of mortgage loans is due to the ongoing low interest rate environment, combined with a strong housing market, creating an exceptional market for mortgage products. An increase in interest rates or a slow down in the housing market could negatively impact the Company's ability to maintain the same level of income associated with mortgage loan production.

Service charges on deposit accounts totaled $40,566 for the three-months ended March 31, 2003, as compared to $18,398 for the same period in 2002. This increase of 120.49% can be directly attributed to the growth in the Company's deposit portfolio, and an increase in the level of fee-based cash management relationships.

The Company will continue to seek ways to expand its sources of non-interest income. The Company may enter into fee arrangements with strategic partners that offer investment advisory services, risk management and employee benefit services. No assurance can be given that such fee arrangements will be obtained or maintained.

Non-Interest Expense

Non-interest expense for the three-month periods ended March 31, 2003 and 2002 totaled $962,749 and $744,743, respectively. The increase of $218,006 or 29.27% for the three-month period is primarily a result of increased salaries and benefits of $132,763 related to planned staff growth initiated to increase marketing efforts, manage the growth of the loan and deposit portfolios and support increased operational volume. The increase in salaries and benefits also includes approximately $17,000 of increased mortgage commissions and benefits resulting from the heavy mortgage volume experienced during the period. The $52,944 or 80.16% increase in data processing and other outside services for the three months ended March 31, 2003 as compared to the same period in 2002 is the result of increased data and item processing costs paid

to external service providers. These costs are volume driven based upon the number of customer accounts and related transaction volume. As a result, these costs increase with the growth of the Company. The increase of $21,014, or 33.80%, in other expenses relates to various costs associated with the increased size and complexity of the Company.

Liquidity And Interest Rate Sensitivity

The Company's principal sources of liquidity are cash and assets that can be readily converted into cash, including investment securities. As of March 31, 2003, the Company had $102,780 in cash and due from banks, and $19,802,835 in federal funds sold and other overnight investments. This represents an increase in liquid assets of $7,789,879 or 64.30% since December 31, 2002, at which time liquid assets consisted of $363,031 in cash and due from banks, and $11,752,705 in federal funds sold and other overnight investments. As of March 31, 2003, the Company had approximately $32.4 million of unfunded loan commitments, of which various types of revolving credit facilities represented $25.1 million. Typically, revolving credit facilities are not fully funded. Growth in the Company's loan portfolio, without corresponding growth in deposits would reduce liquidity, as would reductions in the level of customer deposits.

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary earnings component, net interest income. Net interest income can fluctuate with significant interest rate movements. To minimize the risk associated with these rate swings, management works to structure the Company's balance sheet so that the ability exists to adjust pricing on interest-earning assets and interest-bearing liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

The measurement of the Company's interest rate sensitivity, or "gap," is one of the principal techniques used in asset/liability management. The interest sensitive gap is the dollar difference between assets and liabilities subject to interest rate pricing within a given time period, including both floating rate or adjustable rate instruments and instruments which are approaching maturity.

The following table sets forth the amount of the Company's interest-earning assets and interest-bearing liabilities as of March 31, 2003, which are expected to mature or reprice in each of the time periods shown:

				Maturity or repricing	
	Amount	Percent of Total	0 to 3 Months	4 to 12 Months	1 to 5 Years
Interest-earning assets					
Federal funds sold and other overnight investments	$19,802,835	18.48%	$19,802,835	$ -	$ -
Loans - Variable rate	55,035,440	51.35	55,035,440	-	-
Loans - Fixed rate	26,638,637	24.85	1,860,089	5,806,935	16,986,
Other earning assets	5,698,535	5.32	5,254,195	-	-
Total interest-earning assets	$107,175,447	100.00%	$81,952,559	$ 5,806,935	$16,986,
Interest-bearing liabilities					
Deposits - Variable rate	$42,123,833	48.38%	$42,123,833	$ -	$ -
Deposits - Fixed rate	43,767,963	50.27	4,334,179	16,187,319	23,246,
Short-term borrowings- Variable rate	1,171,000	1.35	1,171,000	-	-

Total interest-bearing liabilities	$87,062,796	100.00%	$47,629,012	$16,187,319	$23,246,
Periodic repricing differences			$34,323,547	$10,380,384)	$(6,260,
Cumulative gap			$34,323,547	$23,943,163	$17,683,
Ratio of rate sensitive assets to rate sensitive liabilities			172.06%	35.87%	73.

As indicated by the table, the excess of interest-earning assets over interest-bearing liabilities of $20,112,651 is concentrated in the categories of items maturing or repricing within twelve months. These items are somewhat offset by a large concentration of interest-bearing liabilities maturing or repricing in 1 to 5 years. These gaps exist as a result of differences in the demand for maturities on fixed rate loan products as compared to the demand for maturities on fixed rate deposit products. The excess of interest earning assets over interest-bearing liabilities maturing or repricing in the next 12 months would indicate that the Company would benefit from increases in interest rates during that period. However, since all interest rates and yields do not adjust at the same pace, the gap is only a general indicator of interest rate sensitivity. The analysis of the Company's interest-earning assets and interest-bearing liabilities presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration the fact that changes in interest rates do not affect all assets and liabilities equally. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities.

Management will constantly monitor and manage the structure of the Company's balance sheet, control interest rate exposure, and evaluate pricing strategies. Strategies to better match maturities of interest-earning assets and interest-bearing liabilities could include structuring loans with rate floors and ceilings on variable rate notes and by providing for repricing opportunities on fixed rate notes. Management believes that a lending strategy focusing on variable rate loans will best facilitate the goal of minimizing interest rate risk through the origination of variable rate and short term fixed rate products. However, management will opportunistically enter into fixed rate loans and/or investments when, in management's judgment, rates adequately compensate the Company for the interest rate risk. The Company's current investment concentration in federal

funds sold and other overnight investments provides the most flexibility and control over rate sensitivity since it generally can be restructured more quickly than the loan portfolio. On the liability side, deposit products can be restructured so as to offer incentives to attain the maturity distribution desired, although competitive factors sometimes make control over deposits difficult.

In theory, maintaining a nominal level of interest rate sensitivity can diminish interest rate risk. In practice, this is made difficult by a number of factors, including cyclical variation in loan demand, different impacts on interest sensitive assets and liabilities when interest rates change, and the availability of funding sources. Management generally will attempt to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Capital Resources

The Company had stockholders' equity at March 31, 2003 of $7,403,257 as compared to $7,609,658 at December 31, 2002. The decrease in capital is a result of the losses incurred in 2003 and is consistent with the initial expectations of management. The Company has declared no cash dividends since its inception. On April 30, 2003, the Company completed a private offering with 620,690 shares issued and net proceeds after offering costs of approximately $4,450,000.

Banking regulatory authorities have implemented strict capital guidelines directly related to the credit risk associated with an institution's assets. Banks and bank holding companies are required to maintain capital levels based on their "risk adjusted" assets so that categories of assets with higher "defined" credit risks will require more capital support than assets with lower risks. The Bank has exceeded its capital adequacy requirements to date.

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Regulatory approval is required to pay dividends that exceed the Bank's net profits for the current year plus its retained net profits for the preceding two years. The Bank could not have paid dividends to the Company without approval from bank regulatory agencies at March 31, 2003.

Item 3. Controls and Procedures

Within 90 days prior to the date of this report, Bay National Corporation's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of Bay National Corporation's disclosure controls and procedures. Based upon that evaluation, Bay National Corporation's Chief Executive Officer and Chief Financial Officer concluded that Bay National Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Bay National Corporation's reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

In addition, since the Chief Executive Officer's and Chief Financial Officer's most recent review of Bay National Corporation's internal controls, there have been no significant changes in Bay National Corporation's internal controls or in other factors that could significantly affect those controls.

Information Regarding Forward-Looking Statements

In addition to the historical information contained in Part I of this Quarterly Report on Form 10-QSB, the discussion in Part I of this Quarterly Report on Form 10-QSB contains certain forward-looking statements such as statements of Bay National Corporation's plans, objectives, expectations and intentions. These statements are based on Bay National Corporation's beliefs, assumptions and on information available to Bay National Corporation as of the date of this filing, and involve risks and uncertainties. These risks and uncertainties include, among others, those discussed in Bay National Corporation's Form 10-KSB under the caption "Factors Affecting Future Results", such as: Bay National Corporation's limited operating history and expectation of losses; dependence on key personnel; risks related to Bay National Bank's choice of loan portfolio; risks related to Bay National Bank's lending limit; risks of a competitive market; impact of government regulation on operating results; and effect of developments in technology.

Bay National Corporation's actual results could differ materially from those discussed herein and you should not put undue reliance on any forward-looking statements. All forward-looking statements speak only as of the date of this filing, and Bay National Corporation undertakes no obligation to make any revisions to the forward-looking statements to reflect events or circumstances after the date of this filing or to reflect the occurrence of unanticipated events.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities.

(a) Not applicable.

(b) Not applicable

(c) Recent Sales of Unregistered Securities

On October 31, 2002, Bay National Corporation commenced a private offering, to accredited investors, only of an aggregate of 550,000 shares of its common stock, which was subsequently increased to 620,690 shares of its common stock. The purchase price per share was $7.25 for an aggregate purchase price of $4,500,002. The private offering terminated on April 30, 2003 with all shares issued and net proceeds after offering costs of approximately $4,450,000. As of March 31, 2003, Bay National Corporation had received and accepted subscriptions from accredited investors to purchase 378,456 shares in the private offering.

There were and will be no underwriting discounts or commissions paid with respect to the private offering. Bay National Corporation believes that the private offering is exempt from the registration requirements of the Securities Act of 1933 by virtue of Section 4(2) of the Securities Act of 1933 and Rule 506 promulgated thereunder. The transaction is not being conducted by any form of general solicitation or general advertising and, in connection with the transaction, Bay National Corporation is taking reasonable care to assure that the investors are not underwriters within the meaning of Section 2(11) of the Securities Act by, among other things, making reasonable inquiry of each investor to confirm that the investor is taking his or her securities for investment only and not with a view to or for sale in connection with any distribution of the securities and will place appropriate legends on the share certificates.

(d) Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

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

None

Item 5. Other Information.

Not applicable.

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

(a) Exhibits.

99.1 Certification of Periodic Financial Report pursuant to 18 U.S.C. Section 1350

99.2 Certification of Periodic Financial Report pursuant to 18 U.S.C. Section 1350

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(b) Reports on Form 8-K.

Form 8-K filed, dated February 4, 2003, Item 9.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Bay National Corporation

Date: May 14, 2003

By: /s/ Hugh W. Mohler

Hugh W. Mohler, President
(Principal Executive Officer)

Date: May 14, 2003

By: /s/ Mark A. Semanie

Mark A. Semanie, Treasurer
(Principal Accounting and Financial Officer)

I, Hugh W. Mohler, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Bay National Corporation;

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

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

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to

significant deficiencies and material weaknesses.

Date: May 14, 2003

By: /s/ Hugh W. Mohler

Name: Hugh W. Mohler
Title: Chairman, President and Chief Executive Officer

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I, Mark A. Semanie, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Bay National Corporation;

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

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

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

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

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

By: /s/ Mark A. Semanie

Name: Mark A. Semanie
Title: Executive Vice President and Chief Financial Officer