BAY NATIONAL CORP
Form 10KSB
March 29, 2005

[BAY NATIONAL LOGO OMMITED]

U.S. Securities and Exchange Commission
Washington, D.C. 20549

Form 10-KSB

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the year ended December 31, 2004

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 333-87781

Bay National Corporation
(Name of small business issuer 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, Maryland 21093
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: 410-494-2580

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: None

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 __

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [x]

The issuer's revenues for its most recent fiscal year were $8,162,411.

The aggregate market value of the common equity held by non-affiliates was $21,024,425 as of March 25, 2005, based on a sales price of $14.49 per share of Common Stock, which is the sales price at which shares of Common Stock were last sold in over the counter trading on March 16, 2005.

The number of shares outstanding of the issuer's Common Stock was 1,920,194 as of March 25, 2005.

Transitional Small Business Disclosure Format (check one):

Yes __ No X

PART I

Item 1. Description of Business

BUSINESS OF BAY NATIONAL CORPORATION AND BAY NATIONAL BANK

General

Bay National Corporation was incorporated under the laws of the State of Maryland on June 3, 1999, primarily to serve as a bank holding company for a proposed federally chartered commercial bank to be named Bay National Bank.

Bay National Bank commenced operations on May 12, 2000 with its main office in North Baltimore, Maryland and a branch office in Salisbury, Maryland. Bay National Bank accepts checking and savings deposits and offers a wide range of commercial and industrial, real estate, consumer and residential mortgage loans.

Marketing Focus

Bay National Bank was formed by a group of individuals active in business, professional, banking, financial and charitable activities in the Baltimore, Maryland metropolitan area and the Eastern Shore of Maryland. These individuals believed that the banking needs of certain segments of these communities were not being served adequately by existing banks. Specifically, as a result of bank mergers in the 1990's, many banks in the Baltimore metropolitan area and the Eastern Shore of Maryland became local branches of large regional and national banks. Although size gave the larger banks some advantages in competing for business from large corporations, including economies of scale and higher lending limits, the organizers believed that these "megabanks" were focused on a mass market approach which de-emphasized personal contact and service. The organizers also believed that the centralization of decision-making power at these large institutions had resulted in a lack of customer service. At many of these institutions, determinations were made at the "home office" by individuals who lacked personal contact with customers as well as an understanding of the customers' needs and scope of the relationship with the institution.

Bay National Bank's management believes that this trend is ongoing, and has been particularly frustrating to owners of small and mid-sized businesses, business professionals and high net worth individuals who traditionally were accustomed to dealing directly with a bank executive who had an understanding of their banking needs with the ability to deliver a prompt response.

Bay National Bank targets its commercial banking services to small and mid-sized businesses and targets its retail banking services to the owners of these businesses and their employees, to business professionals and high net worth individuals.

Bay National Bank seeks to distinguish itself by

- Developing personal relationships with its customers.
- Customizing its products to fit the needs of its customers instead of adopting a "one size fits all" mentality.
- Streamlining the decision making process.
- Offering its customers additional complementary services, such as insurance and investment advice, through relationships with strategic partners.

Bay National Bank's offices are not organized in the traditional retail branch structure, which is transaction and "bank teller" oriented. Instead, Bay National Bank has adopted a "sit-down" model where customers are greeted by a personal banker and taken to a private desk. Management believes that this approach makes service more individualized and enhances the banker's understanding of the customer's needs. Furthermore, Bay National Bank's branch locations do not focus on capturing every customer within the surrounding area. Instead, they are strategically located in areas convenient to Bay National Bank's target customer base.

Market Area and Facilities

Bay National Bank's headquarters and Baltimore branch office are located at 2328 West Joppa Road, Lutherville, Maryland 21093. Bay National Bank serves the Baltimore metropolitan area from that location, with its primary service area being Towson, Lutherville-Timonium, Cockeysville, Hunt Valley, Ruxton and Roland Park. Bay National Bank's Salisbury, Maryland branch office is located at 109 Poplar Hill Avenue, Salisbury, Maryland 21801, from which it serves Maryland's Eastern Shore.

Products and Services

<u>Loan Portfolio.</u>

Bay National Bank offers a full range of loans, including commercial and industrial loans, real estate loans, consumer loans and residential mortgage and home equity loans. Commercial business and commercial real estate loans for owner-occupied properties are Bay National Bank's primary loan products, accounting for approximately 74% of the loan portfolio as of December 31, 2004.

Generally, Bay National Bank is subject to a lending limit to any one borrower of 15% of Bay National Bank's unimpaired capital and surplus. However, management is able to originate loans and to participate with other lenders in loans that exceed Bay National Bank's lending limits.

The following is a description of the types of loans Bay National Bank has targeted in building its loan portfolio:

- Commercial and industrial loans for business purposes including working capital, equipment purchases, lines of credit and government contract financing. Asset-based lending, accounts receivable financing and lease financing are also available. As of December 31, 2004, these loans represented approximately 49% of Bay National Bank's loan portfolio. Bay National Bank is targeting small and mid-sized businesses in its market area with credit needs in the range of up to $5,000,000.

- Commercial real estate loans, including mortgage loans on non-residential properties, and land development and construction loan financing, primarily for owner-occupied premises. As of December 31, 2004, these loans represented approximately 25% of Bay National Bank's loan portfolio.

- Consumer loans including automobile and personal loans. In addition, Bay National Bank offers personal lines of credit. As of December 31, 2004, these loans represented approximately 1% of Bay National Bank's loan portfolio. Bay National Bank's consumer loans are targeted to business owners and their employees, business professionals and high net worth individuals.

- Mortgage loans and residential constructions loans secured by residential property, including first and second mortgage loans on owner occupied and investment properties (1 to 4

family and multi-family), and home equity loans secured by single-family owner-occupied residences. As of December 31, 2004, these loans represented approximately 25% of Bay National Bank's loan portfolio. The majority of these loans, approximately 16% of Bay National Bank's loan portfolio, are home equity loans. Like its consumer loans, Bay National Bank's home equity loans are targeted to business owners and their employees, business professionals and high net worth individuals.

Bay National Bank originates some of its Eastern Shore residential mortgage loans through BNB Mortgage, LLC, a Maryland limited liability company, which is a joint venture between Bay National Bank and an Ocean City, Maryland real estate investor. Bay National Bank is responsible for all of the operations of BNB Mortgage, LLC. Bay National Bank's share of net income from this entity amounted to $24,603 and $8,163 for the years ended December 31, 2004 and 2003, respectively. All loans originated by BNB Mortgage, LLC are immediately sold to Bay National Bank. These loans are then sold to third party investors in the same fashion as other conventional first and second residential mortgage loans originated by Bay National Bank.

Bay National Bank's conventional first and second residential mortgage loans adhere to standards developed by FNMA/FHLMC. Management requires private mortgage insurance for loans in excess of 80% of a property's value. Bay National Bank sells most of its first and second residential mortgage loans in the secondary market. Therefore, management sells those loans that have a lower degree of risk, and a lower yield, relative to the other types of loans that Bay National Bank is expected to make. Since these loans are typically sold, Bay National Bank offers these loans as well as certain residential construction loans to a broader array of individuals than its home equity loans and other consumer loan products. As of December 31, 2004, mortgage loans held for sale totaled $9,613,162.

Deposits.

Bay National Bank offers a wide range of interest-bearing and non-interest-bearing accounts, including commercial and retail checking accounts, money market accounts, individual retirement accounts, interest-bearing statement savings accounts and certificates of deposit with fixed and variable rates and a range of maturity date options.

Other Banking and Financial Services.

Bay National Bank offers commercial customers cash management services such as sweep accounts, account reconciliation, lockbox services and wire transfers of funds. Additionally, Bay National Bank makes available telephone banking, ATM/debit cards, safe keeping boxes, after-hours deposit services, travelers checks, direct deposit of payroll and automatic drafts for various accounts. These services are provided either directly by Bay National Bank or through correspondent banking relationships. Bay National Bank does not have it's own network of ATM machines. In general, Bay National Bank waives fees on a predetermined number of ATM transactions per month, thereby allowing its customers to use any ATM machine.

In addition, Bay National Bank's customers are able to access information about their accounts and view information about Bay National Bank's services and products on Bay National Bank's website, which is located at http://www.baynational.com. Bay National Bank's website also permits customers to make transfers of funds among accounts, pay bills and send e-mail to Bay National Bank personnel.

Bay National Bank offers, through strategic partners, investment advisory, risk management and employee benefit services. Through these affiliations, banking clients can receive a full range of financial services, including investment advice, personal and business insurance products and employee benefit products such as pension and 401(k) plan administration. To the extent permitted by applicable regulations,

the strategic partners may share fees and commissions with Bay National Bank. As of December 31, 2004, Bay National Bank had not entered in to any such fee arrangements. When sufficient volume is developed in any of these lines of business, Bay National Bank may provide these services if permitted by applicable regulations.

Competition

Deregulation of financial institutions and acquisitions of banks across state lines has resulted in widespread changes in the financial services industry. In both the Baltimore metropolitan area and on Maryland's Eastern Shore, Bay National Bank faces strong competition from large banks headquartered within and outside of Maryland. Bay National Bank also competes with other community banks, savings and loan associations, credit unions, mortgage companies, finance companies and others providing financial services. In addition, insurance companies, securities brokers and other non-bank entities or their affiliates may provide services, which historically have been considered banking in nature.

Many of Bay National Bank's competitors can finance extensive advertising campaigns, maintain extensive branch networks and technology investments, and offer services, which Bay National Bank cannot offer or will not offer initially. Also, larger institutions have substantially higher lending limits than Bay National Bank. Some of Bay National Bank's competitors have other advantages, such as tax exemption in the case of credit unions, and lesser regulation in the case of mortgage companies and finance companies.

Employees

As of March 25, 2005, Bay National Bank employed forty-four individuals. Thirty-three people operate from Bay National Bank's headquarters and banking office in North Baltimore and eleven people from the Salisbury, Maryland banking office. Bay National Corporation has no employees.

SUPERVISION AND REGULATION

General

Bay National Corporation and Bay National Bank are subject to extensive regulation under state and federal banking laws and regulations. These laws impose specific requirements and restrictions on virtually all aspects of operations and generally are intended to protect depositors, not stockholders. The following discussion is only a summary and readers should refer to particular statutory and regulatory provisions for more detailed information. In addition, management cannot predict the nature or the extent of the effect on business and earnings that new federal or state legislation may have in the future.

Bay National Corporation

Federal Bank Holding Company Regulation. Bay National Corporation is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to supervision by the Federal Reserve Board. As a bank holding company, Bay National Corporation is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require by statute. The Federal Reserve Board may also examine Bay National Corporation and each of its subsidiaries.

The Federal Reserve Board must approve, among other things, the acquisition by a bank holding company of control of more than five percent (5%) of the voting shares, or substantially all the assets, of any bank or bank holding company or the merger or consolidation by a bank holding company with another bank holding company. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, the restrictions on interstate acquisitions of banks by bank holding companies were repealed as of September 29,

1995. The effect of the repeal of these restrictions is that, subject to certain time and deposit base requirements, Bay National Corporation may acquire a bank located in Maryland or any other state, and a bank holding company located outside of Maryland can acquire any Maryland-based bank holding company or bank.

Unless it chooses to become a financial holding company, as further described below, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking, or managing or controlling banks or furnishing services for its authorized subsidiaries. There are limited exceptions. A bank holding company may, for example, engage in activities which the Federal Reserve Board has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be "properly incident thereto." In making such a determination, the Federal Reserve Board is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve Board is also empowered to differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the Federal Reserve Board has determined by regulation to be closely related to banking include servicing loans, performing certain data processing services, acting as a fiduciary, investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by statute on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in their stock or other securities, and on taking such stock or securities as collateral for loans to any borrower. Further, a bank holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit. In 1997, the Federal Reserve Board adopted amendments to its Regulation Y, creating exceptions to the Bank Holding Company Act's anti-tying prohibitions that give bank subsidiaries of holding companies greater flexibility in packaging products and services with their affiliates.

In accordance with Federal Reserve Board policy, Bay National Corporation is expected to act as a source of financial strength to Bay National Bank and to commit resources to support Bay National Bank in circumstances in which Bay National Corporation might not otherwise do so. The Federal Reserve Board may require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the Federal Reserve's determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a bank holding company to divest itself of any bank or non-bank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition.

On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act ("GLBA"). Effective March 11, 2000, pursuant to authority granted under the GLBA, a bank holding company may elect to become a financial holding company and thereby engage in a broader range of financial and other activities than are permissible for traditional bank holding companies. In order to qualify for the election, all of the depository institution subsidiaries of the bank holding company must be well capitalized and well managed, as defined by regulation, and all of its depository institution subsidiaries must have achieved a rating of satisfactory or better with respect to meeting community credit needs.

Pursuant to the GLBA, financial holding companies will be permitted to engage in activities that are "financial in nature" or incidental or complementary thereto, as determined by the Federal Reserve Board. The GLBA identifies several activities as "financial in nature," including, among others, insurance underwriting and agency, investment advisory services, merchant banking and underwriting, and dealing

or making a market in securities. Being designated a financial holding company will allow insurance companies, securities brokers and other types of financial companies to affiliate with and/or acquire depository institutions.

As a bank holding company with consolidated assets of more than $150,000,000, Bay National Corporation also is subject to certain risk-based capital guidelines imposed on bank holding companies by the Federal Reserve Board to insure the holding company's capital adequacy.

The status of Bay National Corporation as a registered bank holding company under the Bank Holding Company Act does not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

State Bank Holding Company Regulation. Bay National Corporation is a Maryland-chartered bank holding company and is subject to various restrictions on its activities as set forth in Maryland law, in addition to those restrictions set forth in federal law.

Under Maryland law, a bank holding company that desires to acquire a Maryland state-chartered bank or trust company, a federally chartered bank with its main office in Maryland, or a bank holding company that has its principal place of business in Maryland, must file an application with the Maryland Commissioner of Financial Regulation (the "Commissioner"). In approving the application, the Commissioner must consider whether the acquisition may be detrimental to the safety and soundness of the entity being acquired or whether the acquisition may result in an undue concentration of resources or a substantial reduction in competition in Maryland. The Commissioner may not approve an acquisition if, on consummation of the transaction, the acquiring company, together with all its insured depository institution affiliates, would control 30% or more of the total amount of deposits of insured depository institutions in Maryland. The Commissioner has authority to adopt by regulation a procedure to waive this requirement for good cause. In a transaction for which the Commissioner's approval is not required due to an exemption under Maryland law, or for which federal law authorizes the transaction without application to the Commissioner, the parties to the acquisition must provide written notice to the Commissioner at least 15 days before the effective date of the acquisition.

Bay National Bank

General. Bay National Bank, as a national banking association whose accounts are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to the maximum legal limits, is subject to regulation, supervision and regular examinations by the Office of the Comptroller of the Currency ("OCC"). Bay National Bank is a member of the Federal Reserve System and, as such, is subject to certain regulations issued by the Federal Reserve Board. Bay National Bank also is subject to applicable banking provisions of Maryland law insofar as they do not conflict with or are not preempted by federal law. The regulations of these various agencies govern most aspects of Bay National Bank's business, including setting required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends, and location and number of branch offices.

The GLBA authorizes expanded activities for national banks, but requires (with the exception of underwriting municipal revenue bonds and other state and local obligations) that any expanded activities be conducted in a new entity called a "financial subsidiary" that is a subsidiary of the bank rather than the bank itself. A financial subsidiary may engage in any activities in which a financial holding company or a financial holding company's non-bank subsidiaries can engage, except that a financial subsidiary may not underwrite most insurance, engage in real estate development or conduct merchant banking activities. A financial subsidiary may be established through acquisition or de novo.

In order for a national bank to operate a financial subsidiary, it must be well capitalized and well managed, have a satisfactory or better rating with respect to meeting community credit needs and the

aggregate assets of all of the bank's financial subsidiaries may not exceed 45% of the total assets of the bank, subject to certain exceptions. Existing authority of the OCC and the FDIC to review subsidiary activities are preserved.

Banking is a business which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of a bank's earnings. Thus, the earnings and growth of Bay National Bank will be subject to the influence of economic conditions generally, both domestic and foreign, and also on the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board, which regulates the supply of money.

Branching and Interstate Banking. Beginning on June 1, 1997, the federal banking agencies were authorized to approve interstate bank merger transactions without regard to whether such a transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Furthermore, under the Riegle-Neal Act, interstate acquisitions of branches are permitted if the law of the state in which the branch is located permits such acquisitions. The Riegle-Neal Act also authorizes the OCC and FDIC to approve interstate branching de novo by national and non-member banks, respectively, but only in states which specifically allow for such branching.

The District of Columbia, Maryland, Delaware and Pennsylvania have all enacted laws which permit interstate acquisitions of banks and bank branches and permit out-of-state banks to establish de novo branches.

Capital Adequacy Guidelines. The Federal Reserve Board, the OCC and the FDIC have all adopted risk-based capital adequacy guidelines by which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items.

Since December 31, 1992, national banks have been expected to meet a minimum ratio of total qualifying capital (the sum of core capital (Tier 1) and supplementary capital (Tier 2)) to risk-weighted assets (a "Total Risk-Based Capital Ratio") of 8%. At least half of this amount (4%) should be in the form of core capital. These requirements apply to Bay National Bank.

Tier 1 capital for national banks generally consists of the sum of common stockholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stock which may be included as Tier 1 capital), less goodwill, without adjustment in accordance with Statement of Financial Accounting Standards No. 115. Tier 2 capital consists of the following: hybrid capital instruments, perpetual preferred stock which is not otherwise eligible to be included as Tier 1 capital, term subordinated debt and intermediate-term preferred stock, and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no risk-based capital) for assets such as cash, to 100% for the bulk of assets which are typically held by a bank holding company, including certain multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Residential first mortgage loans on one-to-four-family residential real estate and certain seasoned multi-family residential real estate loans, which are not 90 days or more past-due or non-performing and which have been made in accordance with prudent underwriting standards, are assigned a 50% level in the risk-weighing system, as are certain privately issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

In addition to the risk-based capital requirements, the OCC has established a minimum 3% Leverage Capital Ratio (Tier 1 capital to total adjusted assets) requirement for the most highly-rated national banks, with an additional cushion of at least 100 to 200 basis points for all other national banks, which effectively increases the minimum Leverage Capital Ratio for such other banks to 4%-5% or more. Under the OCC's regulations, highest-rated banks are those that the OCC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, those which are considered a strong banking organization. A national bank that has less than the minimum Leverage Capital Ratio requirement must submit, to the applicable district office for review and approval, a reasonable plan describing the means and timing by which the bank will achieve its minimum Leverage Capital Ratio requirement. A national bank which fails to file such a plan is deemed to be operating in an unsafe and unsound manner and could be subject to a cease-and-desist order.

The OCC's regulations also provide that any insured depository institution with a Leverage Capital Ratio less than 2% is deemed to be operating in an unsafe or unsound condition. Operating in an unsafe or unsound manner could lead the FDIC to terminate deposit insurance. However, such an institution will not be subject to an enforcement proceeding solely on account of its capital ratios if it has entered into and is in compliance with a written agreement with the OCC to increase its Leverage Capital Ratio to such level as the OCC deems appropriate and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The capital regulations also provide, among other things, for the issuance by the OCC or its designee(s) of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital or to restore its capital to the minimum capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease-and-desist order.

Prompt Corrective Action. Each federal banking agency is required to implement a system of prompt corrective action for institutions which it regulates. Under applicable regulations, a bank will be deemed to be: (i) "well capitalized" if it has a Total Risk-Based Capital Ratio of 10% or more, a Tier 1 Risk-Based Capital Ratio of 6% or more, a Leverage Capital Ratio of 5% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a Total Risk-Based Capital Ratio of 8% or more, a Tier 1 Risk-Based Capital Ratio of 4% or more and a Leverage Capital Ratio of 4% or more (3% under certain circumstances); (iii) "undercapitalized" if it has a Total Risk-Based Capital Ratio that is less than 8%, a Tier 1 Risk-Based Capital Ratio that is less than 4% or a Leverage Capital Ratio that is less than 4% (3.3% under certain circumstances); (iv) "significantly undercapitalized" if it has a Total Risk-Based Capital Ratio that is less than 6%, a Tier 1 Risk-Based Capital Ratio that is less than 3% or a Leverage Capital Ratio that is less than 3%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2%. Bay National Bank is "well capitalized" as of December 31, 2004.

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate federal banking agency within 45 days of the date the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. The federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving the capital restoration plan, subject to extensions by the applicable agency.

An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. Such guaranty is limited to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution was notified or deemed to have notice that it was undercapitalized or (ii) the amount necessary at such time to restore the relevant capital measures of the institution to the levels required for the institution to be classified as adequately capitalized. Such a guaranty expires after the federal banking agency notifies the institution that it has remained adequately capitalized for each of four consecutive calendar quarters. An institution which fails to submit a written capital restoration plan within the requisite period, including any required performance guaranty, or fails in any material respect to implement a capital restoration plan, is subject to the restrictions

in Section 38 of the Federal Deposit Insurance Act which are applicable to significantly undercapitalized institutions.

A critically undercapitalized institution will be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the deposit insurance fund. Unless the FDIC or another appropriate federal banking regulatory agency makes specific further findings and certifies that the institution is viable and is not expected to fail, an institution that remains critically undercapitalized on average during the four calendar quarters after the date it becomes critically undercapitalized must be placed in receivership.

Immediately upon becoming undercapitalized, an institution becomes subject to statutory provisions which (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund, subject, in certain cases, to specified procedures. These discretionary supervisory actions include requiring the institution to raise additional capital, restricting transactions with affiliates, requiring divestiture of the institution or the sale of the institution to a willing purchaser, and any other supervisory action that the agency deems appropriate. Significantly undercapitalized and critically undercapitalized institutions are subject to these and additional mandatory and permissive supervisory actions.

Regulatory Enforcement Authority. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") included substantial enhancement to the enforcement powers available to federal banking regulators. This enforcement authority included, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined in FIRREA. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. FIRREA significantly increased the amount of and grounds for civil money penalties and requires, except under certain circumstances, public disclosure of final enforcement actions by the federal banking agencies.

Deposit insurance. The FDIC has adopted a risk-based deposit insurance assessment system. The FDIC assigns an institution to one of three capital categories based on the institution's financial information, as of the reporting period ending seven months before the assessment period, consisting of (i) well capitalized, (ii) adequately capitalized or (iii) undercapitalized, and one of three supervisory subcategories within each capital group. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. An institution's assessment rate depends on the capital category and supervisory subcategory to which it is assigned. Assessment rates for BIF deposits currently range from 0 basis points to 27 basis points. Bay National Bank is currently assigned to a capital and supervisory subcategory that has an assessment rate of 0. The FDIC is authorized to raise the assessment rates in certain circumstances, including to maintain or achieve the designated reserve ratio of 1.25%, which requirement the BIF currently meets. The FDIC has exercised its authority to raise rates in the past and may raise insurance premiums in the future. If such action is taken by the FDIC, it could have an adverse effect on the earnings of Bay National Bank.

Under the Federal Deposit Insurance Act, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition

to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Transactions with Affiliates and Insiders. Bay National Bank is subject to the provisions of Section 23A of the Federal Reserve Act, which place limits on the amount of loans or extensions of credit to affiliates, investments in or certain other transactions with affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. Section 23A limits the aggregate amount of transactions with any individual affiliate to ten percent (10%) of the capital and surplus of Bay National Bank and also limits the aggregate amount of transactions with all affiliates to twenty percent (20%) of capital and surplus. Loans and certain other extensions of credit to affiliates are required to be secured by collateral in an amount and of a type described in Section 23A, and the purchase of low quality assets from affiliates is generally prohibited.

Bay National Bank also is subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution and/or its subsidiaries, as those prevailing at the time for comparable transactions with non-affiliated entities. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards that in good faith would be offered to or would apply to non-affiliated companies.

Bay National Bank also is subject to the restrictions contained in Section 22(h) of the Federal Reserve Act and the Federal Reserve Board's Regulation O thereunder on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer or a greater-than-10% stockholder of a bank as well as certain affiliated interests of any of the foregoing may not exceed, together with all other outstanding loans to such person and affiliated interests, the loans-to-one-borrower limit applicable to national banks (generally 15% of the institution's unimpaired capital and surplus), and all loans to all such persons in the aggregate may not exceed the institution's unimpaired capital and unimpaired surplus. Regulation O also prohibits the making of loans in an amount greater than $25,000 or 5% of capital and surplus but in any event not over $500,000, to directors, executive officers and greater-than-10% stockholders of a bank, and their respective affiliates, unless such loans are approved in advance by a majority of the Board of Directors of the bank with any "interested" director not participating in the voting. Further, Regulation O requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as those that are offered in comparable transactions to other persons. Regulation O also prohibits a depository institution from paying overdrafts over $1,000 of any of its executive officers or directors unless they are paid pursuant to written pre-authorized extension of credit or transfer of funds plans.

Loans to One Borrower. As a national bank, Bay National Bank is subject to the statutory and regulatory limits on the extension of credit to one borrower. Generally, the maximum amount of total outstanding loans that a national bank may have to any one borrower at any one time is 15% of the bank's unimpaired capital and surplus. A national bank may lend an additional 10% on top of the 15% if the amount that exceeds 15% of the bank's unimpaired capital and surplus is fully secured by readily marketable collateral.

Liquidity. Bay National Bank is subject to the reserve requirements of Federal Reserve Board Regulation D, which applies to all depository institutions. Specifically, as of January 31, 2004, amounts in transaction accounts above $7,000,000 and up to $47,600,000 must have reserves held against them in the ratio of three percent of the amount. Amounts above $47,600,000 require reserves of $1,218,000 plus 10 percent of the amount in excess of $47,600,000. Bay National Bank is in compliance with the applicable liquidity requirements.

Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve Board, the FDIC, the OCC or the Office of Thrift Supervision shall evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. An institution's CRA activities are considered in, among other things, evaluating mergers, acquisitions and applications to open a branch or facility as well as determining whether the institution will be permitted to exercise certain of the powers allowed by the GLBA. The CRA also requires all institutions to make public disclosure of their CRA ratings. Bay National Bank received a "satisfactory" rating in its latest CRA examination in May 2003.

USA PATRIOT Act. On October 26, 2001, the President signed into law comprehensive anti-terrorism legislation known as the USA PATRIOT Act of 2001 (the "USA Patriot Act"). Title III of the USA Patriot Act substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department ("Treasury") has issued a number of implementing regulations that apply to various requirements of the USA Patriot Act to financial institutions such as Bay National Bank. Those regulations impose new obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Treasury may issue additional regulations that will further clarify the USA Patriot Act's requirements.

Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal and reputational consequences for the institution. The Company has adopted appropriate policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and Treasury's regulations.

FACTORS AFFECTING FUTURE RESULTS

Some of the matters discussed in this annual report including under the captions "Business of Bay National Corporation and Bay National Bank," and "Management's Discussion And Analysis Of Financial Condition And Results Of Operations" include forward-looking statements. These forward-looking statements include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk and financial and other goals. Forward-looking statements often use words such as "believe," "expect," "plan," "may," "will," "should," "project," "contemplate," "anticipate," "forecast," "intend", or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. When you read a forward-looking statement, you should keep in mind the risk factors described below and any other information contained in this annual report which identifies a risk or uncertainty. Bay National Corporation's actual results and the actual outcome of Bay National Corporation's expectations and strategies could be different from that described in this annual report because of these risks and uncertainties 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.

Bay National Corporation has a limited operating history upon which to evaluate future success. Bay National Corporation and Bay National Bank commenced operations in May 2000, and their operating history is limited. Bay National Corporation's profitability depends on the results of operations of its principal asset, Bay National Bank. Bay National Corporation incurred operating losses during each of the

years of its operations through December 31, 2002. Bay National Corporation reported net income of $802,264 and $7,581 for the years ended December 31, 2004 and 2003, respectively. Management expects that additional capital may be required in the future to support growth of Bay National Bank. Any additional capital, if available at all, may be on terms which are not as favorable to the Company as that desired by management and may result in dilution to the Company's shareholders. If adequate capital is not available, the Company may be required to curtail significantly its expected growth strategy.

If Bay National Bank decides to open additional offices, that decision may result in future operating losses, or slow the growth of operating profitability because of the increased expenses of expansion and because the new branch offices may not enhance the results of operations as anticipated. Bay National Bank has no current plans to open additional branch offices.

Bay National Corporation and Bay National Bank depend heavily on one key employee, Mr. Hugh W. Mohler, and business would suffer if something were to happen to Mr. Mohler. Mr. Mohler is the Chairman, President and Chief Executive Officer of Bay National Bank. If he were to leave for any reason, Bay National Corporation's and Bay National Bank's business would suffer because he has banking experience and relationships with clients and potential clients that would not be easy to replace. In addition, because Bay National Bank's business is relationship driven, the loss of an employee who has primary contact with one or more of Bay National Bank's clients could cause Bay National Bank to lose those clients' business, possibly resulting in a decline in revenues.

Bay National Bank's lending strategy involves risks resulting from the choice of loan portfolio. Bay National Bank's loan strategy emphasizes commercial business loans and commercial real estate loans. At December 31, 2004, such loans accounted for approximately 74% of the loan portfolio. Bay National Bank also offers construction loans, consumer loans and mortgage loans for residential properties, although most of the residential mortgage loans are sold in the secondary market. Commercial business and commercial real estate loans generally carry a higher degree of credit risk than do residential mortgage loans because of several factors including larger loan balances, dependence on the successful operation of a business or a project for repayment, or loan terms with a balloon payment rather than full amortization over the loan term.

Bay National Bank's lending limit may limit its growth and the growth of Bay National Corporation. Bay National Bank is limited in the amount it can loan to a single borrower by the amount of its capital. Specifically, under current law, Bay National Bank may lend up to 15% of its unimpaired capital and surplus to any one borrower. Bay National Bank's lending limit is significantly less than that of many of its competitors and may discourage potential borrowers who have credit needs in excess of Bay National Bank's lending limit from conducting business with Bay National Bank.

Bay National Bank faces substantial competition which could adversely affect its ability to attract depositors and borrowers. Bay National Bank operates in a competitive market for financial services and faces intense competition from other institutions both in making loans and in attracting deposits. Many of these institutions have been in business for many years, are significantly larger, have established customer bases, have greater financial resources and lending limits than Bay National Bank, and are able to offer certain services that Bay National Bank is not able to offer. If Bay National Bank cannot attract deposits and make loans at a sufficient level, its operating results will suffer, as will its opportunities for growth.

Government regulation could restrict Bay National Corporation's or Bay National Bank's growth or cause Bay National Corporation or Bay National Bank to incur higher costs. Bay National Corporation and Bay National Bank operate in a highly regulated environment and are subject to examination, supervision and comprehensive regulation by several federal and state regulatory agencies. Banking regulations, designed primarily for the safety of depositors, may limit the growth of Bay National Bank and the return to investors by restricting activities such as the payment of dividends; mergers with, or acquisitions by, other institutions; investments; loans and interest rates; interest rates paid on deposits; and the creation of branch offices. Laws

and regulations could change at any time, and changes could adversely affect Bay National Corporation's and Bay National Bank's business. In addition, the cost of compliance with regulatory requirements could adversely affect Bay National Corporation's and Bay National Bank's ability to operate profitably.

Bay National Bank's ability to compete may suffer if it cannot take advantage of technology to provide banking services or if its customers fail to embrace that technology. Bay National Bank's business strategy relies less on customers' access to a large branch network and more on access to technology and personal relationships. Further, the market for financial services is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking and, tele-banking. Bay National Bank's ability to compete successfully may depend on the extent to which Bay National Bank can take advantage of technological changes and the extent to which Bay National Bank's customers embrace technology to complete their banking transactions.

Because we currently serve limited market areas, we could be more adversely affected by an economic downturn in our market areas than our larger competitors which are more geographically diverse. Currently, our primary market area is limited to the Baltimore metropolitan area and Maryland's Eastern Shore. If either of these areas suffer an economic downturn, our business and financial condition may be severely affected. Our larger competitors serve a more geographically diverse market area, parts of which may not be affected by the same economic conditions that exist in our primary market areas.

If economic conditions deteriorate, our results of operations and financial condition could be adversely affected as borrowers' ability to repay loans declines and the value of the collateral securing our loans decreases. Our financial results may be adversely affected by changes in prevailing economic conditions, including decreases in real estate values, changes in interest rates which may cause a decrease in interest rate spreads, adverse employment conditions, the monetary and fiscal policies of the federal government and other significant external events. Because a significant portion of our loan portfolio is comprised of real estate related loans, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review, among other things, our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance.

We are particularly susceptible to this risk because we are a relatively new bank and have experienced significant growth over the past few years. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as "seasoning." As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because a large portion of our loan portfolio is relatively new, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned, which may be higher than current levels. If delinquencies and defaults increase, we may be required to increase our provision for loan losses.

Material additions to our allowance would materially decrease our net income. In addition, bank 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. Any increase in our allowance for loan losses or loan charge-offs may have a material adverse effect on our results of operations and financial condition.

Item 2. Description of Property

Baltimore

On July 16, 1999, Bay National Corporation entered into two lease agreements for its main office, which is located at 2328 West Joppa Road, Lutherville, Maryland 21093. These leases were amended during February and October 2004 to add additional space and extended in October 2004 to February 28, 2010. Bay National Corporation has the right to extend the leases for one additional five year term, to February 28, 2015. In January 2005, the leases were again amended to add additional space, effective March 1, 2005. The amendments also effectively combined both leases.

As of December 31, 2004, Bay National Corporation was leasing 6,206 square feet on the third floor of the building and 1,712 square feet on the first floor of the building, and was paying $19,425 in monthly rent, which includes Bay National Corporation's share of taxes and building operating costs. The space on the first floor is used as Bay National Bank's Baltimore branch office. The space on the third floor is used for Bay National Corporation and Bay National Bank's administrative offices.

The January 2005 lease amendment adds 1,429 square feet of space in the basement of the building, for a total of 9,347 square feet. This space will initially be used for Bay National Bank's Baltimore residential mortgage operation. Pursuant to this lease amendment, Bay National Corporation also agreed, beginning with the March 2005 to February 2006 lease year, to pay rent of $269,119.12 per year or $22,433.26 per month for all of the leased space in the building. For each lease year thereafter, including any lease years during any renewal term, the yearly base rent will increase by three percent. The rent includes Bay National Corporation's share of taxes and building operating costs.

On March 7, 2005, Bay National Corporation agreed to lease, effective September 1, 2005, 2,355 additional square feet of space on the first floor of the building. It is anticipated that this additional space will be used for Bay National Bank's Baltimore residential mortgage operation, which will be moved from the basement space. Once the mortgage operation moves, Bay National Corporation and Bay National Bank will likely use the basement space for administrative purposes.

Beginning November 15, 2004, Bay National Corporation sublet approximately 850 square feet of the space on the first floor for a term through December 31, 2006 at a monthly rent for the first year of $1,893, which amount increases at the rate of three percent per year.

The Landlord, Joppa Green II Limited Partnership, LLLP, is beneficially owned by the MacKenzie Companies. Gary T. Gill, who has been a director of Bay National Corporation and Bay National Bank since January 2003, is the president and chief executive officer of the MacKenzie Companies. See "Item 12 - Certain Relationships and Related Transactions."

Salisbury

On September 16, 1999, Bay National Corporation entered into a lease agreement for Bay National Bank's Salisbury, Maryland branch office, which is located at 109 Poplar Hill Avenue, Salisbury Maryland 21801 in a two-story building containing approximately 2,500 square feet of office space. This lease, which became effective as of September 1, 1999, was for a term of five years with Bay National Corporation having the option to extend the term for three five-year renewal terms. During the initial lease term, Bay National Corporation paid monthly rent of approximately $1,980, plus all real estate taxes and utilities.

Bay National Corporation exercised its option to extend this lease and it will now terminate on August 31, 2009, unless extended. During the new lease term, Bay National Corporation is paying monthly rent of approximately $2,292, plus all real estate taxes and utilities. Pursuant to this lease, Bay National Corporation

has a right of first refusal to purchase the building in the event the landlord receives a bona fide offer to sell. This property is owned by John R. Lerch, who has been a director of Bay National Corporation and Bay National Bank since their formation. See "Item 12 - Certain Relationships and Related Transactions."

On September 1, 2002, Bay National Corporation entered into a lease agreement for Bay National Bank's Salisbury, Maryland mortgage division office, which is located at 318 East Main Street, Salisbury Maryland 21801. The leased space consists of two office suites totaling approximately 420 square feet. This lease, which became effective as of January 1, 2003, was for a term of one year with Bay National Corporation having the option to extend the term for one additional one-year renewal term. Bay National Corporation renewed the lease for an additional one year term effective as of January 1, 2004. During the initial lease term and the renewal term, Bay National Corporation paid monthly rent of $700. On January 1, 2005, Bay National Corporation obtained an additional 200 square feet in the same building. The total space of 620 square feet is currently rented on a month to month basis at a cost of $1,000 per month. The landlord is responsible for all real estate taxes and utilities.

Item 3. Legal Proceedings

There are no pending legal proceedings to which Bay National Corporation or Bay National Bank is a party or to which any of their properties are subject, nor are there proceedings known to Bay National Corporation to be contemplated by any governmental authority. There are no material proceedings known to Bay National Corporation, pending or contemplated, in which any director, officer or affiliate or any principal security holder of Bay National Corporation is a party adverse to Bay National Corporation or Bay National Bank or has a material interest adverse to Bay National Corporation or Bay National Bank.

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

No matter was submitted during the fourth quarter of the year ended December 31, 2004 to a vote of security holders of Bay National Corporation.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

As of March 18, 2005, the number of holders of record of Bay National Corporation's common stock was approximately 428. Bay National Corporation's common stock is traded on the Over the Counter Bulletin Board ("OTCBB") under the symbol "BANI.OB."

Bay National Corporation completed an initial public offering ("IPO") of its common stock on April 30, 2000. Stock prices subsequent to the IPO are based upon limited trading on the OTCBB. The following table reflects the high and low sales information as reported on the OTCBB for the periods presented. Quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission and may not represent actual transactions.

	2004 Bid Price Range		2003 Bid Price Range	
Quarter	Low	High	Low	High
1st	$ 10.10	$ 14.00	$ 8.05	$ 9.00
2nd	11.75	14.00	8.10	11.00
3rd	10.00	12.50	9.05	9.75
4th	10.50	13.25	9.50	10.25

To date, Bay National Corporation has not declared or paid any dividends on its common stock. Management anticipates that Bay National Corporation will retain all earnings, if any, in order to provide more funds to operate and expand Bay National Corporation's business and, therefore, Bay National Corporation has no plans to pay any cash dividends at least until its profitability exceeds the level necessary to support capital growth in excess of regulatory capital needs. If Bay National Corporation decides to pay dividends in the future, its ability to do so will depend on the ability of Bay National Bank to pay dividends to Bay National Corporation. In addition, management would consider a number of other factors before deciding to pay dividends, including Bay National Corporation's earnings prospects, financial condition and cash needs.

The amount of dividends that may be paid by Bay National Bank to Bay National Corporation depends on Bay National Bank's earnings and capital position and is limited by statute, regulations and regulatory policies. As a national bank, Bay National Bank may not pay dividends from its permanent capital. All cash dividends must be paid out of undivided profits then on hand, after deducting expenses, including provisions for loan losses and bad debts. In addition, a national bank is prohibited from declaring a cash dividend on its shares of common stock until its surplus equals its stated capital, unless there has been transferred to surplus no less than one-tenth of the bank's net profits for the preceding two consecutive half-year periods (in the case of an annual dividend). The approval of the OCC is required if the total of all cash dividends declared by a national bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus. In addition, Bay National Bank may not pay a dividend if, after paying the dividend, it would be "undercapitalized" as defined in the applicable regulations.

Recent Sales of Unregistered Securities

From July 13, 2004 to November 12, 2004, Bay National Corporation issued 55,000 shares of its common stock, $0.01 par value per share, at a purchase price of $10.00 per share, and received aggregate proceeds of $550,000. The shares were issued upon the exercise of outstanding warrants.

On September 10, 1999, Bay National Corporation issued warrants to purchase 56,250 shares of its common stock, $0.01 par value per share, to purchasers in its organizational offering. The warrants became exercisable on April 30, 2001 and expire on November 16, 2004. 1,250 of the warrants were not exercised prior to their expiration.

There were no underwriting discounts or commissions paid with respect to the issuance of the common stock upon exercise of the warrants. Bay National Corporation believes that the issuance of the shares of common stock upon exercise of the warrants 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 was not 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 purchasers of the common stock upon exercise of the warrants are not underwriters within the meaning of Section 2(11) of the Securities Act by, among other things, placing appropriate restrictive legends on the share certificates.

SELECTED FINANCIAL DATA
AS OF DECEMBER 31, 2004, 2003, 2002, 2001 and 2000
(dollars in thousands, except per share data)

	2004	2003	2002	
Total assets	$ 170,763	$ 122,328	$ 84,609	$
Cash and due from banks	1,403	573	363	
Federal funds sold and other overnight investments	16,709	17,487	11,753	
Loans held for sale	9,613	924	2,819	
Investment securities available for sale	1,544	1,548	948	
Federal Reserve Bank stock	313	313	276	
Federal Home Loan Bank stock	243	168	80	
Loans, net	139,603	100,125	67,227	
Deposits	153,927	108,531	76,079	
Short-term borrowings	1,381	1,222	507	
Note payable	1,250	-	-	
Stockholders' equity	13,419	12,067	7,610	
Common shares outstanding	1,917,710	1,862,710	1,242,020	1,
Book value per share	$ 7.00	$ 6.48	$ 6.13	$
Ratio of interest earning assets to interest bearing liabilities	124.95%	127.61%	127.68%	
Stockholders' equity as a percentage of assets	7.86%	9.86%	8.99%	

SELECTED FINANCIAL RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003, 2002, 2001 and 2000

Weighted average yield/rate on:	2004	2003	2002
Loans and loans held for sale	5.89%	5.98%	6.52%
Investments and interest bearing cash balances	1.11%	.80%	1.36%

Deposits and short-term borrowings	2.17%	2.26%	2.84%
Net interest spread	3.14%	2.81%	2.80%
Net interest margin	3.60%	3.29%	3.43%

SELECTED OPERATIONAL DATA
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003, 2002, 2001 and 2000
(dollars in thousands, except per share data)

	2004	2003	2002	
Interest income	$ 7,624	$ 5,520	$ 3,486	$
Interest expense	2,464	1,937	1,367	
Net interest income	5,160	3,583	2,119	
Provision for credit losses	560	415	405	
Net interest income after provision for credit losses	4,600	3,168	1,714	
Non-interest income	539	626	479	
Non-interest expenses	4,337	3,786	3,185	
Income (loss) before income taxes	802	8	(992)	
Income taxes	-	-	-	
Net income (loss)	$ 802	$ 8	$ (992)	$
PER COMMON SHARE				
Basic net income (loss) per share	$ .43	$ .00	$ (.80)	$
Diluted net income (loss) per share	$ .41	$ .00	$ (.80)	$
Average shares outstanding (Basic)	1,877,929	1,660,348	1,242,020	1,
Average shares outstanding (Diluted)	1,936,693	1,682,905	1,242,020	1,

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Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of Bay National Corporation's financial condition and results of operations should be read in conjunction with Bay National Corporation's consolidated financial statements, the notes thereto and the other information included in this annual report.

This discussion and analysis provides an overview of the financial condition and results of operations of Bay National Corporation ("Parent") and its national bank subsidiary, Bay National Bank ("Bank"), (collectively the "Company"), as of December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003, and 2002.

General

The Parent was incorporated on June 3, 1999 under the laws of the State of Maryland to operate as a bank holding company of the Bank. The Bank commenced operations on May 12, 2000.

The principal business of the Company is to make loans and other investments and to accept time and demand deposits. The Company's primary market areas are in the areas North of Baltimore and the areas surrounding Salisbury, Maryland, although the Company's business development efforts generate business outside of these areas. The Company offers a broad range of banking products, including a full line of business and personal savings and checking accounts, money market demand accounts, certificates of deposit, and other banking services. The Company funds a variety of loan types including commercial and residential real estate loans, commercial term loans and lines of credit, consumer loans, and letters of credit with an emphasis on meeting the borrowing needs of small businesses. The Company's target customers are small closely held businesses, business owners, professionals and high net worth individuals.

Overview

The Company continued a pattern of strong growth during the year ended December 31, 2004. This growth has resulted in improved operating results as compared to prior years. Key measurements for the year ended December 31, 2004 include the following:

- Total assets at December 31, 2004 increased by 39.59% to \$170.8 million as compared to \$122.3 million as of December 31, 2003.

- Net loans outstanding increased by 39.43% from \$100.1 million as of December 31, 2003 to \$139.6 million as of December 31, 2004.

- There were no nonperforming loans at December 31, 2004. We believe appropriate reserves for loan losses continue to be maintained.

- Deposits at December 31, 2004 were \$153.9 million, an increase of \$45.4 million or 41.83% from December 31, 2003.

- On September 28, 2004, the Company entered into a \$5 million, three year unsecured non-revolving credit facility with another financial institution. The proceeds from the credit facility will be used to provide regulatory capital to the Bank. The loan bears interest at the prime rate as offered by the other financial institution. As of December 31, 2004, \$1,250,000 was outstanding under this facility.

- The Company realized net income of \$802,264 for the year ended December 31, 2004. This compares to net income of \$7,581 and a net loss of \$(992,494) for the years ended December 31, 2003 and 2002, respectively.

- Net interest income, the Company's main source of income, was \$5.2 million for the year ended December 31, 2004 compared to \$3.6 million and \$2.1 million for the years ended December 31, 2003 and 2002, respectively. This represents increases of 43.98% and 143.50% over the two prior years.

- Net loan charge-offs were \$16,096 for the year ended December 31, 2004. These represent the first charge-offs since the inception of the Bank in 2000.

- Non-interest income for the year ended December 31, 2004 declined by \$86,416 or 13.82% as compared to the year ended December 31, 2003, primarily as a result of a decline in mortgage loan originations.

- o Non-interest expenses increased by $550,318 or 14.54% for the year ended December 31, 2004, as compared to the year ended December 31, 2003.

- o The market price of common shares ended the year at $13.25, up 31.19% from the closing price of $10.10 on December 31, 2003.

A detailed discussion of the factors leading to these changes can be found in the discussion below.

Results of Operations

OVERVIEW

The Company recorded net income of $802,264 for the year ended December 31, 2004. This compares to the Company's first annual profit of $7,581 for the year ended December 31, 2003, an improvement of $794,683. The Company reported a net loss of $992,494 for the year ended December 31, 2002. This significant improvement in results for the periods is due to the continued strong growth of the loan portfolio, which reached the levels necessary to generate sufficient net interest income to cover operating expenses. The losses incurred through 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. The Company achieved marginal monthly profitability for the month of June 2003, its 37th full month of operations.

Bay National Bank's mortgage division, based in Salisbury, Maryland, originates conventional first and second residential mortgage loans. Bay National Bank sells most of its first and second residential mortgage loans in the secondary market and typically recognizes a gain on the sale of these loans after the payment of commissions to the loan origination officer. Since its inception in February 2001, the mortgage division has been a significant contributor to operating results. For the years ended December 31, 2004, 2003 and 2002, gains on the sale of mortgage loans totaled $244,716, $370,326 and $334,815, respectively. The level of gains on the sale of mortgage loans has declined in 2004 due to the strengthening of economic conditions and the resulting increase in long-term interest rates as compared to the rates in effect during the first half of 2003. An increase in rates traditionally has a negative impact on mortgage loan production due to a reduction in the incentive for borrowers to refinance existing mortgages or purchase new homes.

During the second quarter of 2004, the Company introduced a new loan program for conventional first lien and second lien residential mortgage loans. Under this program the Company purchases a 100% participation in mortgage loans originated by a mortgage company in the Baltimore metropolitan area. These

participations are for loans which a secondary market investor has committed to purchase. The participations are typically held for a period of three to four weeks before being sold to the secondary market investor. This holding period represents the amount of time taken by the secondary market investor to review the loan files for completeness and accuracy. During this holding period, the Company earns interest on these loans at a rate indexed to the prime rate.

The primary risk to the Company from this program is that the secondary market investor may decline to purchase the loans due to documentary deficiencies or errors. The Company attempts to manage this risk by conducting a thorough review of the documentation prior to purchasing the participation. If the secondary market investor declines to purchase the loan, the Company could attempt to sell the loan to other investors or hold the loan in its loan portfolio. As of December 31, 2004, the Company held $8.0 million of these loans which were classified as held for sale. The Company expects that all of these loans will be purchased by the secondary market investor. The Company earned $287,835 of interest on this program from inception through December 31, 2004.

Management expects continuous improvement in operating results as asset levels continue to grow. However, actual results will be subject to the volatility of the provision for credit losses, which is related to loan growth, and the volatility of mortgage loan production, which is sensitive to economic and interest rate fluctuations.

NET INTEREST INCOME / MARGINS

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. Interest-bearing deposits and other 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.

Interest income from loans and investments for the year ended December 31, 2004 was $7,623,564, compared to $5,520,068 and $3,486,302 for the years ended December 31, 2003 and 2002, respectively. The 38.11% increase over 2003, and the 118.67% increase over 2002, is directly related to the 31.89% increase in average interest earning assets from 2003, and the 132.22% increase in average interest earning assets from 2002. The change in interest income was also impacted by changes in average yields due to a rising interest rate environment in 2004 and a declining interest rate environment in 2003. The yields on these assets declined from 5.64% for the year ended December 31, 2002 to 5.07% for the year ended December 31, 2003 and rose to 5.31% for the year ended December 31, 2004.

The percentage of average interest-earning assets represented by loans was 88.0%, 82.5% and 83.0% for the years ended December 31, 2004, 2003, and 2002, respectively. For the year ended December 31, 2004, the average yield on the loan portfolio was 5.89%, as compared to 5.98% for the year ended December 31, 2003 and 6.52% for the year ended December 31, 2002. Loan yields have declined as a result of actions taken by the Federal Reserve to reduce its target for the federal funds rate from 1.75% at December 31, 2001, to 1.25% effective November 6, 2002, and finally to 1.00% effective June 25, 2003. The Federal Reserve reversed this trend during 2004 when it increased its target for the federal funds rate to: 1.25% effective June 30, 2004; 1.50% effective August 10, 2004; 1.75% effective September 21, 2004; 2.00% effective November 10, 2004; and 2.25% effective December 14, 2004. These actions began to have an impact on the Company's loan yields during the third quarter and the most recent increases began to have a measurable effect on the Company's results during the fourth quarter of 2004. The timing and amount of the impact on loan yields of changes to the federal funds rates varies from period to period as a result of differences in the mix of fixed rate loans to variable rate loans at any point in time.

The average yield on the investment portfolio and other earning assets such as federal funds sold was 1.11% for the year ended December 31, 2004 as compared to 0.80% and 1.36% for the years ended December 31, 2003 and 2002, respectively. The fluctuations in the average yields were a direct result of the Federal Reserve actions discussed above as well as an increase in the holdings of Federal Reserve and Federal Home Loan Bank of Atlanta stocks, which pay dividend yields greater than the prevailing federal funds rate. The percentage of average interest-earning assets represented by investments was 12.0%, 17.5% and 17.0% for the years ended December 31, 2004, 2003, and 2002, respectively.

Interest expense from deposits and borrowings for the year ended December 31, 2004 was $2,464,209, compared to $1,936,726 and $1,367,502 for the years ended December 31, 2003 and 2002, respectively. The 27.2% increase over 2003 and the 80.2% increase over 2002 are directly related to the 32.7% increase in average interest-bearing liabilities from 2003 and the 136.5% increase in average interest-bearing liabilities from 2002. Interest expense was also impacted by changes in average rates paid due to the fluctuating interest rate environment. The average rates paid on these liabilities changed from 2.84% for the year ended December 31, 2002 to 2.26% for the year ended December 31, 2003 as a result of the declining interest rate environment during these periods. Even though interest rates began to increase in 2004, the average rate on liabilities declined to 2.17% for the year ended December 31, 2004 because management was able to delay raising rates following the actions of the Federal Reserve. Management expects that pressure to increase rates paid on deposits will increase as the target for the federal funds rate continues to rise. In fact upward pressure began to appear on shorter term rates in the fourth quarter of 2004.

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.

No tax equivalent adjustments were made and no income was exempt from federal income taxes. All average balances are monthly average balances. We do not believe that the monthly averages differ materially from what the daily averages would have been. The amortization of loan fees is included in computing interest income, however, such fees are not material.

	Year Ended December 31, 2004	
	Average Balance	Interest and fees
ASSETS		
Loans and loans held for sale	$ 126,212,414	$ 7,431,368
Investment securities	2,038,432	45,173

Federal funds sold and other overnight investments	15,232,288	147,023
Total Earning Assets	143,483,134	7,623,564
Less: Allowance for credit losses	(1,473,985)	
Cash and due from banks	909,590	
Premises and equipment, net	641,550	
Accrued interest receivable and other assets	534,261	
Total Assets	$ 144,094,550	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 46,627,122	509,308
Regular savings deposits	4,363,244	28,396
Time deposits	61,184,843	1,901,183
Short-term borrowings	1,475,148	19,020
Note payable	129,098	6,302
Total interest-bearing liabilities	113,779,455	2,464,209
Net interest income and spread		$ 5,159,355
Non-interest-bearing demand deposits	17,391,401	
Accrued expenses and other liabilities	515,639	
Stockholders' equity	12,408,055	
Total Liabilities and Stockholders' Equity	$ 144,094,550	
Interest and fee income/earning assets	5.31%	
Interest expense/earning assets	1.71	
Net interest margin	3.60%	
Return on Average Assets	.56%	
Return on Average Equity	6.47%	
Average Equity to Average Assets	8.61%	

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Year Ended December 31, 2003

	Average Balance	Interest and fees
ASSETS		
Loans and loans held for sale	$ 89,721,871	$ 5,367,997
Investment securities	1,833,052	37,317
Federal funds sold and other overnight investments	17,238,474	114,754
Total Earning Assets	108,793,397	5,520,068

Less: Allowance for credit losses	(1,090,526)	
Cash and due from banks	903,675	
Premises and equipment, net	689,080	
Accrued interest receivable and other assets	396,583	
Total Assets	$ 109,692,209	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 33,884,963	381,985
Regular savings deposits	2,997,371	20,532
Time deposits	47,675,682	1,522,525
Short-term borrowings	1,172,658	11,684
Total interest-bearing liabilities	85,730,674	1,936,726
Net interest income and spread		$ 3,583,342
Non-interest-bearing demand deposits	13,158,325	
Accrued expenses and other liabilities	386,732	
Stockholders' equity	10,416,478	
Total Liabilities and Stockholders' Equity	$ 109,692,209	
Interest and fee income/earning assets	5.07%	
Interest expense/earning assets	1.78	
Net interest margin	3.29%	
Return on Average Assets	- %	
Return on Average Equity	- %	
Average Equity to Average Assets	9.50%	

Year Ended December 31, 2002

	Average Balance	Interest and fees
ASSETS		
Loans and loans held for sale	$ 51,267,330	$ 3,342,790
Investment securities	796,439	25,949
Federal funds sold and other overnight investments	9,724,297	117,563
Total Earning Assets	61,788,066	3,486,302
Less: Allowance for credit losses	(607,823)	
Cash and due from banks	688,916	
Premises and equipment, net	770,440	
Accrued interest receivable and other assets	287,930	
Total Assets	$ 62,927,529	

LIABILITIES AND STOCKHOLDERS' EQUITY		
Interest-bearing demand deposits	$ 22,882,007	495,510
Regular savings deposits	2,530,480	30,352
Time deposits	22,379,802	836,763
Short-term borrowings	325,786	4,877
Total interest-bearing liabilities	48,118,075	1,367,502
Net interest income and spread		$ 2,118,800
Non-interest-bearing demand deposits	6,512,685	
Accrued expenses and other liabilities	226,776	
Stockholders' equity	8,069,993	
Total Liabilities and Stockholders' Equity	$ 62,927,529	
Interest and fee income/earning assets	5.64%	
Interest expense/earning assets	2.21	
Net interest margin	3.43%	
Return on Average Assets	(1.58)%	
Return on Average Equity	(12.30)%	
Average Equity to Average Assets	12.82%	

RATE/VOLUME ANALYSIS

A rate/volume analysis, which demonstrates changes in taxable-equivalent interest income and expense for significant assets and liabilities, appears below. The calculation of rate, volume and rate/volume variances is based on a procedure established for bank holding companies by the Securities and Exchange Commission. Rate, volume and rate/volume variances presented for each component may not total to the variances presented on totals of interest income and interest expense because of shifts from year to year in the relative mix of interest-earning assets and interest-bearing liabilities.

	Year ended December 31,		
	2004 vs. 2003		
		Due to variances in	
	Total	Rates	Volumes

	Total	Rates	Volumes
Interest earned on:			
Loans and loans held for sale	$ 2,063,371	$ (85,187)	$ 2,183,204
Investment Securities	7,856	3,305	4,181
Federal funds sold and other overnight investments	32,269	51,633	(13,355)
Total interest income	2,103,496	(30,249)	2,174,030
Interest paid on:			
Interest-bearing demand deposits	127,323	(11,860)	143,642
Regular savings deposits	7,864	(1,025)	9,356
Time deposits	378,658	(41,109)	431,416
Short-term borrowings	7,336	3,436	3,014
Note payable	6,302	-	-
Total interest expense	527,483	(50,558)	587,428
Net interest earned	$ 1,576,013	$ 20,309	$ 1,586,602

	Year ended December 31,		
	2003 vs. 2002		
		Due to variances in	
	Total	Rates	Volumes
Interest earned on:			
Loans and loans held for sale	$ 2,025,207	$ (275,501)	$ 2,507,356
Investment Securities	11,368	(9,735)	33,774
Federal funds sold and other overnight investments	(2,809)	(52,830)	90,844
Total interest income	2,033,766	(338,066)	2,631,974
Interest paid on:			
Interest-bearing demand deposits	(113,525)	(237,561)	238,269
Regular savings deposits	(9,820)	(13,018)	5,600
Time deposits	685,762	(122,063)	945,793
Short-term borrowings	6,807	(1,631)	12,678
Total interest expense	569,224	(374,273)	1,202,340
Net interest earned	$ 1,464,542	$ 36,207	$ 1,429,634

PROVISION FOR CREDIT LOSSES

The provision for loan losses was $559,596 for the year ended December 31, 2004, as compared to $415,000 for the year ended December 31, 2003, and $404,500 for the year ended December 31, 2002. The provisions for each year were the direct result of growth in loan balances outstanding in all segments of the portfolio. For additional information regarding the methodology used to determine the provision for credit losses see the Management Discussion and Analysis section entitled "Allowance for Credit Losses and Credit Risk Management."

NON-INTEREST INCOME

Non-interest income consists primarily of gains on the sale of mortgage loans, deposit account service charges and cash management fees. For the year ended December 31, 2004, the Company realized non-interest income in the amount of $538,847 as compared to $625,263 and $478,516 for the years ended December 31, 2003 and 2002, respectively.

Gains on the sale of mortgage loans of $244,716 represented 45.42% of non-interest income for the year ended December 31, 2004. This compares to gains on the sale of mortgage loans of $370,326 or 59.23% of total non-interest income for the year ended December 31, 2003 and $334,815 or 69.97% of total non-interest income for the year ended December 31, 2002. The level of gains on the sale of mortgage loans has declined due to recent increases in long-term interest rates driven by stronger economic conditions. Additional increases in interest rates, or a slow down in the housing market, could further impact the Company's ability to generate non-interest income associated with mortgage loan production.

In February 2005, the Company added additional residential construction and mortgage capability in the Baltimore market area. It is expected that these additional capabilities will increase future levels of gains on the sale of mortgage loans, while also providing interest income on construction loans. This capability was added through the hiring of a team of eight individuals, including originators, processors and servicers from another financial institution. These individuals have extensive experience in the industry and the Company's market area.

Service charges on deposit accounts totaled $237,980 for the year ended December 31, 2004, as compared to $212,787 and $105,766 for the years ended December 31, 2003 and 2002, respectively. The increases of 11.84% over 2003 and 125.01% over 2002 can be directly attributed to the growth in the Company's deposit portfolio and to the fact that the Company introduced additional fee based commercial deposit products in 2002.

The Company will continue to seek ways to expand its sources of non-interest income. In the future, 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

2004 compared to 2003

Non-interest expense for the year ended December 31, 2004 totaled $4,336,342 compared to $3,786,024 for the year ended December 31, 2003. The increase of $550,318, or 14.54%, was primarily due to increases in staffing and employee benefit expenses, occupancy expenses, data processing and other outside services, furniture and equipment expenses and other expenses.

Salaries and benefits increased by $327,423 or 15.48% as a result of staffing growth initiated to increase marketing efforts, manage the growth of the loan and deposit portfolios and support increased operational volume. Occupancy expenses increased by $52,831, or 20.34% due in part to scheduled rent increases as well as a reduction in sublease income of approximately $10,900 due to expansion of the Company's corporate office into previously sublet space and $20,400 of rental expenses associated with new space obtained to facilitate the expansion of the Company's corporate offices. The $45,963, or 8.57%, increase in data processing and other outside services resulted from 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 $40,293, or 18.72%, increase in furniture and equipment expenses is related to increased costs associated

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with expanded staffing and facilities. The increase of $83,808, or 12.71%, in all other expenses relates to various costs associated with the increased size and complexity of the Company.

Substantially all of the occupancy costs are paid to directors of Bay National Corporation or entities controlled by directors of Bay National Corporation. Management believes that the terms of these leases are at least as favorable as could be obtained from independent third parties. However, management has not conducted a recent market analysis to confirm this fact. For a discussion of the terms of the leases with these persons, see "Item 12 - Certain Relationships and Related Transactions."

The growth of the Company's customer base will continue to require additional staffing in order to service customers, and manage the business properly. Management believes that continued growth in the customer base can be accommodated without proportionate increases in these costs.

The rate of increase in non-interest expenses is substantially less than the 43.98% increase in net interest income for the year ended December 31, 2004 as compared to year ended December 31, 2003. Management believes this indicates that the Company is continuing to effectively leverage its cost structure to generate profitable growth. While management expects that the ongoing growth of the Company's customer base will continue to require additional staffing in order to appropriately service customers and manage the business effectively, management believes that additional growth in the customer base can continue to be accomplished without proportionate increases in these costs.

2003 compared to 2002

Non-interest expense for the year ended December 31, 2003 totaled $3,786,024 compared to $3,185,310 for the year ended December 31, 2002. The increase of $600,714, or 18.86%, was primarily due to increases in staffing and employee benefit expenses, data processing and other outside services, advertising and marketing related expenses, and other expenses.

Salaries and benefits increased by $301,722, or 16.64% as a result of staffing growth initiated to increase marketing efforts, manage the growth of the loan and deposit portfolios, and support increased operational volume. Occupancy expenses increased by $47,052, or 22.12%, due to scheduled rent increases as well as a reduction in sublease income of approximately $17,000 due to expansion of the Company's corporate office into previously sublet space, and $8,400 of rental expense associated with new space obtained for the mortgage division. The $136,731, or 34.21%, increase in data processing and other outside services resulted from increased courier expenses incurred to facilitate commercial deposit gathering with a limited branch presence, and increased data and item processing costs paid to external service providers. The data and item processing 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 $36,435, or 20.96% increase in advertising and marketing related expenses is related to increased efforts to enhance the visibility of the Bank and attract new customers. The increase of $41,792, or 16.80%, in other expenses relates to various costs associated with the increased size and complexity of the Company.

Substantially all of the occupancy costs are paid to directors of Bay National Corporation or entities controlled by directors of Bay National Corporation. Management believes that the terms of these leases are at least as favorable as could be obtained from independent third parties. However, management has not conducted a recent market analysis to confirm this fact. For a discussion of the terms of the leases with these persons, see "Item 12 - Certain Relationships and Related Transactions."

INCOME TAXES

The Company has not incurred any income tax liability since its inception. At December 31, 2004 and 2003, the Company had net operating loss carryforwards of approximately $2.5 million and $3.9 million available to offset future taxable income, respectively. If not utilized, the carryforwards at December 31, 2004 will expire beginning in 2019.

When the realization of deferred income taxes is deemed to be more likely than not, the Company will be required to record previously unrecorded net deferred income tax assets, which have a positive effect on the earnings in the period when such determination is made. As of December 31, 2004, the Company had net deferred tax assets of approximately $1.4 million that were eliminated through a valuation allowance. Subsequent to the recordation of deferred taxes, the Company will begin to record income tax expense at the statutory rate. Since inception, the Company has not recorded any income tax expense or benefit. Recognizing income tax expense in future periods will have a detrimental effect on reported earnings.

Financial Condition

COMPOSITION OF THE BALANCE SHEET

Total assets of the Company were $170,763,474 as of December 31, 2004, compared to total assets of $122,328,256 as of December 31, 2003. This represents growth of approximately $48.4 million or 39.6% since December 31, 2003. The growth in assets was funded by growth in deposits. Deposits at December 31, 2004 were $153,927,042 compared to deposits of $108,530,901 at December 31, 2003. Deposit growth resulted from the marketing efforts of officers and directors of the Bank and the use of two Internet based listing services for certificates of deposit. Management has set the interest rates paid on deposits to be competitive in the market and has continued to increase marketing activities throughout the year.

As of December 31, 2004, loans including loans held for sale (net of a $1,810,000 allowance for credit losses), totaled $149,216,599. This represents an increase of $48,167,299, or 47.67%, from December 31, 2003. The composition of the loan portfolio as of December 31, 2004 was approximately $73.8 million of commercial loans (excluding real estate loans), $2.2 million of consumer loans and $65.4 million of real estate loans excluding $9,613,162 of mortgage loans held for sale. The composition of the loan portfolio as of December 31, 2003 was approximately $61.9 million of commercial loans (excluding real estate loans), $1.7 million of consumer loans and $37.8 million of real estate loans excluding $923,825 of mortgage loans held for sale. Growth in the loan portfolio is a direct result of the marketing efforts of bank employees as well as members of the Board of Directors and the Baltimore and Salisbury Advisory Boards. The mix of loans is consistent with the plans for the business.

The Company continues to emphasize prudent growth through the hiring of experienced commercial lenders, and the development and use of referral sources including accountants, lawyers and existing customers, as well as members of the Board of Directors and the Baltimore and Salisbury Advisory Boards.

Funds not extended in loans are held in cash and due from banks, and various investments including federal funds sold and other overnight investments, United States Treasury securities, Federal Reserve Bank stock and Federal Home Loan Bank stock. These investments totaled $18,809,114 as of December 31, 2004 compared to $19,515,869 as of December 31, 2003. Other than the investments in Federal Reserve Bank stock and Federal Home Loan Bank stock, totaling $556,090 and $481,090 at December 31, 2004 and 2003, respectively, all investments have maturities of 90 days or less. The Treasury securities are used to collateralize repurchase agreements which are classified as short-term borrowings under which $1,381,000

and $1,222,000 were outstanding as of December 31, 2004 and December 31, 2003, respectively. Management has made a decision to maintain liquidity in the investment portfolio in order to ensure that funds are readily available to fund the growth of the loan portfolio.

As of December 31, 2004, the Company had borrowed $1,250,000 under a $5 million, three-year unsecured non-revolving credit facility executed on September 28, 2004 with another financial institution. Borrowings under the credit facility are used to provide regulatory capital to the Bank. The loan bears interest at the prime rate as offered by the financial institution.

Total capital at December 31, 2004 was $13,418,764 as compared to $12,066,500 at December 31, 2003. The increase in capital is a result of the positive operating results for the year ended December 31, 2004 and $550,000 received upon the issuance of 55,000 shares of common stock upon the exercise of warrants. Management believes that the Company will need additional capital, in excess of the $3.75 million still available under the credit facility, to support projected asset growth over the next 12 months. Management and the Capital Committee of the Board of Directors are currently evaluating available alternatives. Any additional capital, if available at all, may be on terms which are not as favorable to the Company as that desired by management and may result in dilution to the Company's shareholders. If adequate capital is not available, the Company may be required to curtail significantly its expected growth strategy.

COMPOSITION OF LOAN PORTFOLIO

Because yields on loans typically exceed the yields on investments, the

Company's business strategy is to continue to increase the overall level of loans, as well as maintain a relatively high percentage of loans to total earning assets. Increasing loans and loans as a percentage of total earning assets will maximize net interest margin. As of December 31, 2004 and 2003, loans represented 88.93% and 83.98% of total earning assets, respectively.

The following table sets forth the composition of the principal balances of Company's loan portfolio as of December 31, 2004 and 2003, respectively.

	2004		2003
Real Estate - Home Equity Line of Credit	$ 24,548,506	17.36%	$ 16,078,166
Real Estate - Construction	12,968,251	9.17	8,101,017
Real Estate - Mortgage	27,854,130	19.70	13,687,709
Commercial	73,836,994	52.21	61,868,002
Consumer	2,205,556	1.56	1,657,081
Total loans	$ 141,413,437	100.00%	$ 101,391,975

The following table sets forth the maturity distribution for the Company's loan portfolio at December 31, 2004. Some of the loans may be renewed or repaid prior to maturity. Therefore, the following table should not be used as a forecast of future cash flows.

	Within one year	One to three years	Three to five years
Real Estate - Home Equity Line of Credit	$ 24,093,174	$ 455,332	$ -
Real Estate - Construction	12,762,671	136,566	69,014
Real Estate - Mortgage	19,017,874	4,167,229	4,669,027
Commercial	58,621,806	6,540,270	7,846,632
Consumer	1,782,351	401,968	21,237
Total	$ 116,277,876	$ 11,701,365	$ 12,605,910
Fixed interest rate	$ 8,634,237	$ 11,701,365	$ 12,605,910
Variable interest rate	107,643,639	-	-
Total	$ 116,277,876	$ 11,701,365	$ 12,605,910

The scheduled repayments as shown above are reported in the maturity category in which the payment is due, except for the adjustable rate loans, which are reported in the period of repricing.

The Company's loan portfolio composition as of December 31, 2004 reflects a 76.12% concentration in variable rate loans. Fixed rate loans total $33,769,798 or 23.88% of the Company's loan portfolio. Interest rates on variable rate loans adjust to the current interest rate environment, whereas fixed rates do not allow this flexibility. If interest rates were to increase in the future, the interest earned on the variable rate loans would improve, and, if rates were to fall, the interest earned would decline. See "Liquidity and Interest Rate Sensitivity."

The officers and directors of the Company have loans from the Bank of $5,828,095 at December 31, 2004. All loans made to officers and directors are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unaffiliated third parties and do not involve more than the normal risk of repayment or present other unfavorable features.

ALLOWANCE FOR CREDIT LOSSES AND CREDIT RISK MANAGEMENT

Originating loans involves a degree of risk that credit losses will occur in varying amounts according to, among other factors, the type of loans being made, the credit-worthiness of the borrowers over the term of the loans, the quality of the collateral for the loan, if any, as well as general economic conditions. The Company charges the provision for credit losses to earnings to maintain the total allowance for credit losses at a level considered by management to represent its best estimate of the losses known and inherent in the portfolio that are both probable and reasonable to estimate, based on, among other factors, prior loss experience, volume and type of lending conducted, estimated value of any underlying collateral, economic conditions (particularly as such conditions relate to the Company's market area), regulatory guidance, peer statistics, management's judgment, past due loans in the loan portfolio, loan charge off experience and concentrations of risk (if any). The Company charges losses on loans against the allowance when it is believed that collection of loan principal is unlikely. Recoveries on loans previously charged off are added back to the allowance.

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 potential losses. In addition, management judgmentally establishes an additional

nonspecific reserve. The nonspecific 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.

The reserve factors used are based on management's judgment as to appropriate reserve percentages for various categories of loans, and adjusts those values based on the following: historical losses in each category, historical and current delinquency in each category, underwriting standards in each category, comparison of losses and delinquencies to peer group performance and an assessment of the likely impact of economic and other external conditions on the performance of each category.

A test of the adequacy of the allowance for credit losses is performed and reported to the Board of Directors on a monthly basis. Management uses the information available to make a determination with respect to the allowance for credit losses, recognizing that the determination is inherently subjective and that future adjustments may be necessary depending upon, among other factors, a change in economic conditions of specific borrowers or generally in the economy and new information that becomes available. However, there are no assurances that the allowance for credit losses will be sufficient to absorb losses on nonperforming assets or that the allowance will be sufficient to cover losses on nonperforming assets in the future.

The allowance for credit losses as of December 31, 2004 and December 31, 2003 was $1,810,000 and $1,266,500, respectively. The amount equates to 1.20% and 1.24% of outstanding loans, including loans held for sale, as of December 31, 2004 and 2003, respectively. This percentage has fluctuated based upon changes in the level of loans held for sale. These loans are secured by residential real estate and, as a result, have a lower risk of loss. Bay National Corporation has no exposure to foreign countries or foreign borrowers. Management believes that the allowance for loan losses is adequate for each period presented.

The following table represents an analysis of the activity in the allowance for credit losses for the periods presented:

	2004	2003	2002
Balance at beginning of year	$ 1,266,500	$ 851,500	$ 447,000
Provision for credit losses	559,596	415,000	404,500
Loan charge-offs			
Commercial	(15,222)	-	-
Consumer	(2,134)	-	-
Loan recoveries			
Commercial	1,260	-	-
Net charge-offs	(16,096)	-	-
Balance at end of year	$ 1,810,000	$ 1,266,500	$ 851,500

There were no loans that were considered impaired under Statements of Financial Accounting Standards No. 114 ("SFAS No. 114") as of December 31, 2004, 2003 and 2002 and for the years then ended.

The ratio of net charge-offs during 2004 to average loans outstanding, net, during 2004 was .01%.

The following table presents the allocation of the allowance for credit losses, reflecting use of the methodology presented above, along with the percentage of total loans in each category as of December 31, 2004 and 2003.

As of December 31, 2004

	Amount	Loan Mix
Real Estate - Home Equity Line of Credit	$ 122,918	17.36%
Real Estate - Construction	150,346	9.17
Real Estate - Mortgage	179,798	19.70
Commercial	1,279,472	52.21
Consumer	11,032	1.56
Nonspecific	66,434	-
Total Allowance	$ 1,810,000	100.00%

As of December 31, 2003

	Amount	Loan Mix
Real Estate - Home Equity Line of Credit	$ 80,370	15.86%
Real Estate - Construction	86,252	7.99
Real Estate - Mortgage	133,109	13.50
Commercial	954,623	61.02
Consumer	10,324	1.63
Nonspecific	1,822	-
Total Allowance	$ 1,266,500	100.00%

The unallocated portion of the allowance for credit losses increased in 2004. This occurred because the Company calculates an overall reserve level while the underlying portfolio experienced a moderate shift in the mix of loans by risk grade. The shift in the mix of loans by risk grade is a normal result of the addition of new loans, the decrease in balances of more mature loans and the ongoing reassessment of all loans.

NONPERFORMING LOANS AND OTHER DELINQUENT ASSETS

Management performs reviews of all delinquent loans. Management will generally classify loans as non-accrual when collection of full principal and interest under the original terms of the loan is not expected or payment of principal or interest has become 90 days past due. Classifying a loan as non-accrual results in the Company no longer accruing interest on such loan and reversing any interest previously accrued but not collected. A non-accrual loan may be restored to accrual status when delinquent principal and interest payments are brought current and future monthly principal and interest payments are expected to be collected. The Company will recognize interest on non-accrual loans only when received. As of December 31, 2004, the Company did not have any non-accrual loans. As of December 31, 2003 the Company had one loan with a balance of $4,087 classified as a non-accrual loan. This loan was subsequently charged off in January 2004.

Any property acquired by the Company as a result of foreclosure on a mortgage loan will be classified as "real estate owned" and will be recorded at the lower of the unpaid principal balance or fair value at the date of acquisition and subsequently carried at the lower of cost or net realizable value. Any required write-down of the loan to its net realizable value will be charged against the allowance for credit losses. Upon foreclosure, the Company generally will require an appraisal of the property and, thereafter, appraisals of the property on at least an annual basis with external inspections on at least a quarterly basis. As of December 31, 2004, and December 31, 2003, the Company held no real estate acquired as a result of foreclosure.

The Company applies the provisions of Statements of Financial Accounting Standards No. 114 ("SFAS No. 114"), "Accounting by Creditors for Impairment of a Loan," as amended by Statements of Financial Accounting Standards No. 118 ("SFAS No. 118"), "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosure." SFAS No. 114 and SFAS No. 118 require that impaired loans, which consist of all modified loans and other loans for which collection of all contractual principal and interest is not probable, be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, an impairment is recognized through a valuation allowance and corresponding provision for credit losses. The Company considers consumer loans as homogenous loans and thus does not apply the SFAS No. 114 impairment test to these loans. Impaired loans will be written off when collection of the loan is doubtful.

Other than the one non-accrual loan as of December 31, 2003 discussed above, the Company had no impaired loans as of December 31, 2004 or December 31, 2003.

INVESTMENT PORTFOLIO

The Company has chosen to invest its available funds primarily in federal funds sold and other overnight investments. As a result, investment securities as of December 31, 2004, consisted of $312,690 of Federal Reserve Bank stock, $243,400 of Federal Home Loan Bank stock and $1,544,496 of U.S. Treasury securities which mature within three months. Investment securities for the year ended December 31, 2003, consisted of $312,690 of Federal Reserve Bank stock, $168,400 of Federal Home Loan Bank stock and $1,547,798 of U.S. Treasury securities which matured within three months.

Management has made the decision to maintain its available funds in highly liquid assets because it wishes to ensure that funds are readily available to fund the growth of the loan portfolio. Management believes that this strategy will allow the Company to maximize interest margins while maintaining appropriate levels of liquidity to fund loan growth.

SOURCES OF FUNDS

General

Deposits, short-term borrowings in the form of repurchase agreements, borrowings under the credit facility, scheduled amortization and prepayment of loans, funds provided by operations and capital are the current sources of funds utilized by the Company for lending and investment activities, and other general business purposes.

Deposits

The Company offers a variety of deposit products having a range of interest rates and terms. The Company's deposits consist of checking accounts, savings accounts, money market accounts and certificates of deposit.

The following table sets forth the composition of the Company's deposits as of December 31, 2004 and December 31, 2003:

	2004		2003
Demand Deposits	$ 52,121,451	33.86%	$ 36,345,970
Savings	5,255,422	3.41	3,202,587
Money Market and sweep	28,304,367	18.39	18,554,644
Certificates of deposit	68,245,802	44.34	50,427,700
Total deposits	$ 153,927,042	100.00%	$ 108,530,901

The mix of deposits has remained relatively steady from year to year. The slight increase in the percentage of deposits represented by money market and sweep accounts is due to an effort to attract more commercial depositors to interest bearing money-market accounts.

Of the total deposits at December 31, 2004, $16.6 million, or 10.79% were related to two customers in one industry and a third customer in another industry. Of the total deposits at December 31, 2003, $7.7 million or 7.14% were related to the two customers in one industry. The deposits for these customers 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 following table sets forth the maturity distribution for the Company's deposits at December 31, 2004. Some of the deposits may be renewed or withdrawn prior to maturity. Therefore, the following table should not be used as a forecast of future cash flows.

	Within one year	One to three years	Three to five years
Demand deposits	$ 52,121,451	$ -	$ -
Savings	5,255,422	-	-
Money Market and sweep	28,304,367	-	-
Certificates of deposit	33,253,349	20,687,755	14,304,698
Total	$ 118,934,589	$ 20,687,755	$ 14,304,698

Certificates of deposit in amounts of $100,000 or more, and their remaining maturities at December 31, 2004, are as follows:

Three months or less	$ 4,285,752
Over three months through six months	3,553,729
Over six months through twelve months	3,351,703
Over twelve months	10,745,359
Total	$ 21,936,543

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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 large certificates of deposits. The Company will choose to pursue such deposits when expected loan growth provides for adequate spreads to support the cost of those funds. As of December 31, 2004, the Company had outstanding certificates of deposit of approximately $29 million that were obtained through the listing of certificate of deposit rates on two Internet-based listing services. These certificates of deposit were issued with an average yield of 2.91% and an average term of 31.5 months. Included in the $29 million of Internet-originated certificates of deposit is $394,666 that has been classified as "Brokered Deposits" for bank regulatory purposes. These "Brokered Deposits" were issued in average amounts of

approximately $99,000 with an average yield of 3.62% and an average term of 40.3 months. As of December 31, 2003, the total certificates of deposit obtained through the listing of certificate of deposit rates on the Internet-based listing services was approximately $25 million, of which $790,157 were classified as "Brokered Deposits." The Company has never paid broker fees for deposits and has not accepted any new "Brokered Deposits" since August 2002.

Core deposits, which management categorizes as all deposits other than national market certificates of deposit and all but $5.0 million of deposits from the three large customers described above (which management considers to be a stable deposit amount from these customers based upon historical trends), stood at $113,412,507 as of December 31, 2004, up 45.88% from $77,742,030 as of December 31, 2003. Core deposits are closely monitored by management because they consider such deposits not only a relatively stable source of funding but also reflective of the growth of commercial and consumer depository relationships.

Borrowings.

On September 28, 2004, the Company entered into a five million, three year unsecured non-revolving credit facility with Drovers Bank of York, Pennsylvania, a division of Fulton Bank. The loan bears interest at the prime rate as offered by Drovers Bank. The credit facility will expire on September 28, 2007, at which time all outstanding amounts under the credit facility, including accrued but unpaid interest, will be due and payable. The Company may repay interest and principal under the credit facility at any time without premium or penalty.

The credit facility agreement contains usual and customary covenants for transactions of this type. In addition, the credit facility provides for the following additional covenants:

- The Bank's Total Risk-Based Capital Ratio (as defined for bank regulatory purposes) will be maintained at a minimum of 10%;

- The Bank's Tier 1 Risk-Based Capital Ratio (as defined for bank regulatory purposes) will be maintained at a minimum of 6%; and o The bank will maintain Loan Loss Reserves at a level required by federal regulatory agencies, provided that such Loan Loss Reserve also equals not less than three hundred percent (300.00%) of the sum of the balances of loans in a non-accrual status, loans more than 90 days past due, and renegotiated loans.

In the event of a default by the Company under the credit facility, Drovers Bank may terminate the credit facility, declare the amount outstanding, including all accrued interest and unpaid fees, payable immediately, and enforce any and all rights created and existing under the credit facility documents, and other rights available under applicable law. Upon default, interest on the outstanding loan balance bears interest at 5% over the prime rate.

The Company was in compliance with all covenants for this credit facility as of December 31, 2004. The Company has borrowed $1,250,000 under the credit facility as of December 31, 2004.

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 $1,222,000 at December 31, 2003 to $1,381,000 at December 31, 2004, due to increases in the balance of available funds for customers participating in this program.

In addition, during 2004, the Company received commitments for a total of $7.0 million of borrowing availability under unsecured Federal funds lines of credit with three separate financial institutions,

one of which is Fulton Bank. The Company also had approximately $10 million of borrowing capacity with the Federal Home Loan Bank of Atlanta as of December 31, 2004.

INTEREST RATE SENSITIVITY

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 which are 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 December 31, 2004, which are expected to mature or reprice in each of the time periods shown:

	Amount	Percent of Total	Maturity or repricing 0 to 3 Months	4 to 12 Months	1 Y
Interest-earning assets					
Federal funds sold and other overnight investments	$ 16,708,52	9.84%	$ 16,708,528	-	$
Loans held for sale	9,613,162	5.66	9,613,162	-	
Investment securities available for sale	1,544,496	.91	1,544,496	-	
Loans - Variable rate	107,643,639	63.38	107,643,639	-	
Loans - Fixed rate	33,769,798	19.88	3,460,872	5,173,365	2
Other earning assets	556,090	.33	-	-	
Total interest-earning assets	$ 169,835,713	100.00%	$ 138,970,697	5,173,365	$ 2
Interest-bearing liabilities					
Deposits - Variable rate	$ 65,042,644	47.85%	$ 65,042,644	-	$
Deposits - Fixed rate	68,245,802	50.21	15,673,714	17,579,635	3
Short-term borrowings	2,631,000	1.94	2,631,000	-	
Total interest-bearing liabilities	$ 135,919,446	100.00%	$ 83,347,358	17,579,635	$ 3
Periodic repricing differences					
Periodic gap			$ 55,623,339	(12,406,270)	$ (1
Cumulative gap			$ 55,623,339	43,217,069	$ 3
Ratio of rate sensitive assets to rate sensitive liabilities			166.74%	29.43%	

The Company has 73.22% of its interest-earning assets and 49.79% of its interest-bearing liabilities in variable rate balances. The excess of interest-earning assets over interest-bearing liabilities of $43,217,069 in the categories of items maturing or repricing within 12 months comprises the majority of the overall gap.

This gap is generally reflective of the Company's emphasis on originating variable rate loans and the demand in the market for higher yielding fixed rate deposits. This analysis indicates that the Company generally will benefit from rising market rates of interest. 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 constantly monitors and manages the structure of the Company's balance sheet, seeks to control interest rate exposure and evaluate pricing strategies. Strategies to better match maturities of interest-earning assets and interest-bearing liabilities 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 and short-term fixed rate loans will best facilitate the goal of minimizing interest rate risk. However, management will opportunistically enter into longer term 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 deposit maturity 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 attempts 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.

LIQUIDITY

The Company's overall asset/liability strategy takes into account the need to maintain adequate liquidity to fund asset growth and deposit runoff. Management monitors the liquidity position daily.

The Company's primary sources of funds are deposits, short-term borrowings in the form of repurchase agreements, borrowings under the credit facility, scheduled amortization and prepayment of loans, funds provided by operations and capital. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competition.

The Company's most liquid assets are cash and assets that can be readily converted into cash, including investment securities maturing within one year. As of December 31, 2004, the Company had $1,403,424 in cash and due from banks, $16,708,528 in federal funds sold and other overnight investments and $1,544,496 in three-month U.S. Treasury Securities. As of December 31, 2003, the Company had $573,124 in cash and due from banks, $17,486,981 in federal funds sold and other overnight investments and $1,547,798 in three-month U.S. Treasury Securities.

The stability in the overall level of liquid assets is the result of an ongoing effort by management to maintain adequate liquidity to fund loan growth and declines in deposit levels. Growth in the Company's loan portfolio, without corresponding growth in deposits, would reduce liquidity, as would reductions in the level of customer deposits.

During 2004, the Company received commitments for a total of $7.0 million of borrowing availability under unsecured Federal funds lines of credit with three separate financial institutions. The Company also has approximately $10 million of borrowing capacity with the Federal Home Loan Bank of Atlanta as of December 31, 2004. These credit facilities can be used in conjunction with the normal deposit strategies, which include pricing changes to increase deposits as necessary. From time to time, the Company may sell or participate out loans to create additional liquidity as required.

The Company has sufficient liquidity to meet its loan commitments as well as fluctuations in deposits. The Company will choose to retain maturing certificates of deposit, when necessary, by offering competitive rates.

Management is not aware of any known trends, events or uncertainties that will have or are reasonably likely to have a material effect on our liquidity, capital or operations, nor are we aware of any current recommendation by regulatory authorities, which if implemented, would have a material effect on liquidity, capital or operations.

CONTRACTUAL OBLIGATIONS, COMMITMENTS, CONTINGENT LIABILITIES, AND OFF-BALANCE SHEET ARRANGEMENTS

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments primarily include commitments to extend credit, lines of credit and standby letters of credit. The Company uses these financial instruments to meet the financing needs of its customers. These financial instruments involve, to varying degrees, elements of credit, interest rate and liquidity risk. In addition, the Company also has operating lease obligations and purchase commitments.

Outstanding loan commitments and lines and letters of credit at December 31 of 2004 and 2003 are as follows:

	2004	2003
Loan commitments	$ 9,867,893	$ 11,458,333
Unused lines of credit	40,423,986	32,234,145
Letters of credit	1,578,379	2,167,501

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 interest rates fixed at current market amounts, fixed expiration dates or other termination clauses and may require payment of a fee. Unused lines of credit represent the unused portion of lines of credit previously extended and available to the customer as long as there is no violation of any contractual condition. These lines generally have variable interest rates. Since many of the commitments are expected to expire without being drawn upon, and since it is unlikely that customers will draw upon their line of credit in full at any time, the total commitment amount or line of credit amount does not necessarily represent future cash requirements. The Company is not aware of any loss it would incur by funding its commitments or lines of credit.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the customer is the contract amount of the commitment.

In general, loan commitments, lines of credit and letters of credit are made on the same terms, including with respect to collateral, as outstanding loans. Each customer's credit-worthiness and the collateral required is evaluated on a case-by-case basis.

The increase in the overall level of loan commitments and unused lines of credit as of December 31,

2004 as compared to loan commitments and unused lines of credit as of December 31, 2003, is a direct result of the same marketing activities that resulted in the 39.5% increase in outstanding loans.

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments.

The following table presents, as of December 31, 2004, significant fixed and determinable contractual obligations to third parties by payment date.

	Within one year	One to three years	Three to five years
Deposits without a stated maturity(a)	$ 85,681,646	$	$
Certificates of deposit(a)	33,475,545	20,687,755	14,304,698
Other borrowings	1,381,000	1,250,000	-
Operating leases	290,684	615,136	640,081
Purchase obligations	205,060	-	-
Total	$ 121,033,935	$ 21,304,141	$ 14,944,779

(a) Includes accrued interest payable.

The Company's operating lease obligations represent short and long-term lease and rental payments for facilities. Purchase obligations represent estimated obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company. The purchase obligation amounts presented above primarily relate to estimated obligations under data and item processing contracts and accounts payable for goods and services received through December 31, 2004.

CAPITAL RESOURCES

The Company had stockholders' equity at December 31, 2004 of $13,418,764 as compared to $12,066,500 at December 31, 2003. The increase in capital is a result of the positive operating results and $550,000 received upon the issuance of 55,000 shares of common stock upon the exercise of warrants. The Company has declared no cash dividends since its inception.

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 it's 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 December 31, 2004.

The tables below present the Bank's capital position relative to its various minimum regulatory capital requirements as of December 31, 2004, and 2003. For a discussion of these capital requirements, see "Item 1 Description of Business - Supervision and Regulation - Bay National Bank - Capital Adequacy Guidelines."

December 31, 2004

	Actual		For Capital Adequacy Purpose		
	Amount	Ratio	Amount	Ratio	
Total Capital (to Risk Weighted Assets):	$ 16,242,797	10.32%	$ 12,592,000	8.00%	$
Tier I Capital (to Risk Weighted Assets):	14,432,797	9.17%	6,296,000	4.00%	
Tier I Capital (to Average Assets):	14,432,797	8.98%	4,821,000	3.00%	

December 31, 2003

	Actual		For Capital Adequacy Purpose		
	Amount	Ratio	Amount	Ratio	
Total Capital (to Risk Weighted Assets):	$ 11,729,127	10.16%	$ 9,238,000	8.00%	$

Tier I Capital (to Risk Weighted Assets):	10,462,627	9.06%	4,619,000	4.00%
Tier I Capital (to Average Assets):	10,462,627	8.93%	3,516,000	3.00%

Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Unlike most industrial companies, nearly all the assets of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

Reconciliation of Non-GAAP Measures

Below is a reconciliation of total deposits to core deposits as of December 31, 2004 and December 31, 2003, respectively:

	December 31, 2004	December
Total deposits	$ 153,927,042	$ 10
National market certificates of deposit	(28,908,592)	(2
Variable balance accounts (3 customers in 2004; 2 customers in 2003)	(16,605,943)	(
Portion of variable balance accounts considered to be core	5,000,000	
Core deposits	$ 113,412,507	$ 7

Application of Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability must be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for credit losses as the accounting area that requires the most subjective or complex judgments, and, as such, could be most subject to revision as new information becomes available.

The allowance for credit losses represents management's best estimate of losses known and inherent in the loan portfolio that are both probable and reasonable to estimate, based on, among other factors: prior loss experience of the Company and peer institutions; current economic conditions, review of the ongoing financial conditions of borrowers; and the views of the Company's regulators and the firm that conducts an annual independent loan review. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant estimates, assumptions and judgments. The loan portfolio also represents the largest asset type on the consolidated balance sheets.

The Company uses a loan grading system where 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 nonspecific reserve. The nonspecific 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.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including the valuation of collateral and the financial condition of the borrower, and in establishing allowance percentages and risk ratings. The establishment of allowance factors is a continuing exercise and allowance factors may change over time, resulting in an increase or decrease in the amount of the provision or allowance based upon the same volume and classification of loans.

Changes in allowance factors or in management's interpretation of those factors will have a direct impact on the amount of the provision and a corresponding effect on income and assets. Also, errors in management's perception and assessment of the allowance factors could result in the allowance not being adequate to cover losses in the portfolio and may result in additional provisions or charge-offs, which would adversely affect income and capital. For additional information regarding the allowance for loan and lease losses, see the "Provision for Credit Losses and Credit Risk Management" section of this financial review.

Recent Accounting Pronouncements And Developments

Note 1 to the consolidated financial statements discusses new accounting policies adopted by the Company during 2004 and the expected impact of accounting policies, recently issued or proposed, but not yet required to be adopted. To the extent the adoption of new accounting standards materially affects the Company's financial condition, results of operations or liquidity, the impacts are discussed in the applicable section(s) of this financial review and notes to the consolidated financial statements.

Risk Management

The Board of Directors is the foundation for effective corporate governance and risk management. The Board demands accountability of management, keeps stockholders' and other constituencies' interests in focus and fosters a strong internal control environment. Through its Executive, Asset/Liability and Audit Committees, the Board actively reviews critical risk positions, including market, credit, liquidity and operational risk. The Company's goal in managing risk is to reduce earnings volatility, control exposure to unnecessary risk and ensure appropriate returns for risk assumed. Senior management actively manages risk at the line of business level, supplemented with corporate-level oversight through the Asset/Liability Committee, the internal audit process and quality control functions and other risk management groups within the Company. This risk management structure is designed to uncover risk issues through a systematic process, enabling timely and appropriate action to avoid and mitigate risk. The risk management process establishes risk limits and other measurement systems, with a focus on risk reduction strategies and capital allocation practices.

Item 7. Financial Statements

The following consolidated financial statements are filed with this report:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets - December 31, 2004 and 2003

Consolidated Statements of Operations - For the years ended December 31, 2004, 2003 and 2002

Consolidated Statements of Changes in Stockholders' Equity - For the years ended December 31, 2004, 2003 and 2002

Consolidated Statements of Cash Flows - For the year ended December 31, 2004, 2003 and 2002

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Audit Committee of the
Board of Directors and Stockholders
Bay National Corporation

We have audited the accompanying consolidated balance sheets of Bay National Corporation and subsidiary as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bay National Corporation and subsidiary as of December 31, 2004 and 2003, and the results of their operations and cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ Stegman & Company

Baltimore, Maryland
February 2, 2005

BAY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31, 2004 and 2003

	2004
ASSETS	

Cash and due from banks	$	1,403,424
Federal funds sold and other overnight investments		16,708,528
Loans held for sale		9,613,162
Investment securities available for sale (AFS) - at fair value		1,544,496
Other equity securities		556,090
Loans, net of unearned fees		141,413,437
Less: Allowance for credit losses		(1,810,000)
Loans, net		139,603,437
Premises and equipment, net		593,583
Accrued interest receivable and other assets		740,754
Total Assets	$	170,763,474
LIABILITIES		
Non-interest-bearing deposits	$	20,638,596
Interest-bearing deposits		133,288,446
Total deposits		153,927,042
Short-term borrowings		1,381,000
Note payable		1,250,000
Accrued expenses and other liabilities		786,668
Total Liabilities		157,344,710
STOCKHOLDERS' EQUITY		
Common stock - $.01 par value, authorized: 9,000,000 shares authorized, 1,917,710 and 1,862,710 issued and outstanding as of December 31, 2004 and 2003, respectively:		19,177
Additional paid in capital		17,400,284
Accumulated deficit		(4,000,697)
Total Stockholders' Equity		13,418,764
Total Liabilities and Stockholders' Equity	$	170,763,474

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended December 31, 2004, 2003 and 2002

	2004	2003
INTEREST INCOME:		
Interest and fees on loans	$ 7,431,368	$ 5,367,99
Interest on federal funds sold and other overnight investments	147,023	114,75
Taxable interest and dividends on investment securities	45,173	37,31
Total interest income	7,623,564	5,520,06
INTEREST EXPENSE:		
Interest on deposits	2,438,887	1,925,04
Interest on short-term borrowings	19,020	11,68
Interest on note payable	6,302	-
Total interest expense	2,464,209	1,936,72
Net interest income	5,159,355	3,583,34
Provision for credit losses	559,596	415,00
Net interest income after provision for credit losses	4,599,759	3,168,34
NON-INTEREST INCOME:		
Service charges on deposit accounts	237,980	212,78
Gain on sale of mortgage loans	244,716	370,32
Other income	56,151	42,15
Total non-interest income	538,847	625,26
NON-INTEREST EXPENSE:		
Salaries and employee benefits	2,442,774	2,115,35
Occupancy expenses	312,550	259,71
Furniture and equipment expenses	255,547	215,25
Legal and professional fees	175,757	158,40
Data processing and other outside services	582,396	536,43
Advertising and marketing related expenses	212,237	210,28
Other expenses	355,081	290,57
Total non-interest expenses	4,336,342	3,786,02
Income (Loss) before income taxes	802,264	7,58
Income tax (expense) benefit	-	-
Net Income (Loss)	$ 802,264	$ 7,58
Per Share Data:		
Net Income (Loss) (Basic)	$ .43	$ .0
Net Income (Loss) (Diluted)	$ .41	$ .0
Average Shares Outstanding (Basic)	1,877,929	1,660,34
Effect of dilution - Stock options and Warrants	58,764	22,55

Average Shares Outstanding (Diluted)	1,936,693	1,682,90

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the years ended December 31, 2004, 2003 and 2002

	Common Stock	Additional Paid in Capital	Accumulated Deficit
Balances at December 31, 2001	$ 12,420	$ 12,407,780	$ (3,818,048)
Net Loss	-	-	(992,494)
Balances at December 31, 2002	12,420	12,407,780	(4,810,542)
Issuance of Common Stock	6,207	4,443,054	-
Net Income		-	7,581
Balances at December 31, 2003	18,627	16,850,834	(4,802,961)
Issuance of Common Stock	550	549,450	-
Net Income	-	-	802,264
Balances at December 31, 2004	$ 19,177	$ 17,400,284	$ (4,000,697)

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2004, 2003 and 2002

	2004	2003
Cash Flows From Operating Activities:		
Net Income (Loss)	$ 802,264	$ 7,581
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation	204,204	189,858
Loss on disposal of equipment	17,018	-
Amortization of investment (discounts) premiums, net	(19,251)	(14,804)
Provision for credit losses	559,596	415,000
Gain on sale of loans	(244,716)	(370,326)
Origination of loans held for sale	(108,988,138)	(35,629,285)
Proceeds from sale of loans	100,543,517	37,894,286
Net increase in accrued interest receivable and other assets	(188,403)	(117,569)
Net increase in accrued expenses and other liabilities	277,813	95,061
Net cash (used) provided by operating activities	(7,036,096)	2,469,802
Cash Flows From Investing Activities:		
Purchases of investment securities	(6,177,447)	(6,284,633)
Maturities of investment securities	6,200,000	5,700,000
Purchase of Federal Reserve Bank stock	-	(36,750)
Purchase of Federal Home Loan Bank of Atlanta stock	(75,000)	(88,500)
Loan disbursements in excess of principal payments	(40,037,558)	(33,313,714)
Expenditures for premises and equipment	(177,193)	(118,267)
Net cash used by investing activities	(40,267,198)	(34,141,864)
Cash Flows From Financing Activities:		
Net increase in deposits	45,396,141	32,452,170
Net increase in short-term borrowings	159,000	715,000
Proceeds from notes payable	1,250,000	-
Issuance of common stock	550,000	4,449,261
Net cash provided by financing activities	47,355,141	37,616,431
Net increase in cash and cash equivalents	51,847	5,944,369
Cash and cash equivalents at beginning of year	18,060,105	12,115,736
Cash and cash equivalents at end of year	$ 18,111,952	$ 18,060,105
Cash paid for:		
Interest	$ 2,366,155	$ 1,926,169
Income taxes	$ -	$ -

See accompanying notes to consolidated financial statements.

BAY NATIONAL CORPORATION
Notes to Consolidated Financial Statements
For the years ended December 31, 2004, 2003 and 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of Bay National Corporation and its subsidiary, Bay National Bank (the "Bank"), collectively (the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation. The investment in subsidiary is recorded on the parent's books on the basis of its equity in the net assets. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry.

Certain reclassifications have been made to amounts previously reported to conform to the classifications made in 2004.

Nature of Business

Bay National Corporation 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. 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, obtaining the approval of the Federal Deposit Insurance Corporation to insure its deposit accounts and meeting certain other regulatory requirements.

The principal business of the Company is to make loans and other investments and to accept time and demand deposits. The Company's primary market areas are Baltimore and Salisbury, Maryland, although the Company's business development efforts generate business outside of these areas. The Company offers a broad range of banking products, including a full line of business and personal savings and checking accounts, money market demand accounts, certificates of deposit and other banking services. The Company funds a variety of loan types including commercial and residential real estate loans, commercial term loans and lines of credit, consumer loans and letters of credit. The Company's customers are primarily individuals and small businesses.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company has included cash and due from banks, and federal funds sold and other overnight investments as cash and cash equivalents for the purpose of reporting cash flows.

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BAY NATIONAL CORPORATION
Notes to Consolidated Financial Statements
For the years ended December 31, 2004, 2003 and 2002

Investments Available-for-Sale and Other Equity Securities

Marketable equity securities and debt securities, not classified as held-to-maturity or trading, are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses based on the difference between amortized cost and fair value reported as accumulated other comprehensive income, a separate component of stockholders' equity, net of deferred tax. Realized gains and losses, using the specific identification method, are included as a separate component of non-interest income. Related interest and dividends are included in interest income. Declines in the fair value of individual available-for-sale securities below their cost, that are other than temporary, result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or the fact that management would not have the intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Other equity securities represented by Federal Reserve Bank and Federal Home Loan Bank of Atlanta stock are considered restricted as to marketability.

Loans Held for Sale

The Company engages in sales of residential mortgage loans originated by the Bank and by a third party. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of the loan originated by the Bank are recorded as a component of non-interest income in the accompanying consolidated statements of operations. No gains or losses are realized on the sale of loans originated by third parties. The Company's current practice is to sell loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing at either December 31, 2004 or December 31, 2003. The Company earns interest on the outstanding balances of all loans that are held for sale.

Loans

Loans are stated at the principal amount outstanding net of any deferred fees and direct costs. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Fees charged and costs capitalized for originating certain loans are amortized on the interest method over the term of the loan.

Loans are considered impaired when, based on current information, it is improbable that the Company will collect all principal and interest payments according to contractual terms. Generally, loans are considered impaired once principal and interest payments are 90 days past due and they are placed on non-accrual. Management also considers the financial condition of the borrower, cash flows of the loan and the value of the related collateral. Impaired loans do not include large groups of smaller balance homogeneous credits such as residential real estate, consumer installment loans and commercial leases, which are evaluated collectively for impairment. Loans specifically reviewed for impairment are not considered impaired during

periods of "minimal delay" in payment (usually ninety days or less) provided eventual collection of all amounts due is expected. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, the Company may measure impairment based on a loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. The Company recognizes interest income on impaired loans on a cash basis if the borrower demonstrates the ability to meet the contractual obligation and collateral is sufficient. If there is doubt regarding the borrower's ability to make payments, or if the collateral is not sufficient, payments received are accounted for as a reduction in principal.

Allowance for Credit Losses

The allowance for credit losses is established through a provision for credit losses charged to expense. Loans are charged against the allowance for credit losses when management believes that the collectibility of the principal is unlikely. The allowance, based on evaluations of the collectibility of loans, is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions and trends that may affect the borrowers' ability to pay.

The allowance for credit losses represents an estimation done pursuant to either Statement of Financial Accounting Standards ("SFAS") No. 5 "Accounting for Contingencies" or SFAS No. 114 "Accounting by Creditors for Impairment of a Loan." The Company uses a loan grading system where 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 nonspecific reserve. The nonspecific 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. The adequacy of the allowance is determined through careful and continuous evaluation of the credit portfolio and involves consideration of a number of factors to establish a prudent level. Determination of the allowance is inherently subjective and requires significant estimates, including estimated losses on pools of homogeneous loans based on historical loss experience and consideration of current economic trends, which may be susceptible to significant change.

While management believes it has established the allowance for credit losses in accordance with generally accepted accounting principles and has taken into account the views of its regulators and the current economic environment, there can be no assurance that in the future the Company's regulators or the economic environment will not require further increases in the allowance.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method. Premises and equipment are depreciated over the useful lives of the assets, except for leasehold improvements which are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Useful lives range from: five to ten years

for furniture, fixtures and equipment; and three to five years for software, hardware and data handling equipment. Leasehold improvements are amortized over the term of the respective lease plus the first optional renewal period, if applicable. Maintenance and repairs are charged to expense as incurred, while improvements, which extend the useful life, are capitalized and depreciated over the estimated remaining life of the asset.

Long-lived depreciable assets are evaluated periodically for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of a long-lived asset are less than its carrying value. In that event, the Company recognizes a loss for the difference between the carrying amount and the estimated fair value of the asset based on a quoted market price, if applicable, or a discounted cash flow analysis.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets;

and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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. Compensation expense for stock option awards is disclosed as a pro forma income adjustment, ratably recognized over the vesting period, based on the fair value of the stock on the date of grant under SFAS No. 123 and SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure."

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants during the year ended December 31:

	2002
Dividend yield	-
Expected volatility	20.00%
Risk-free interest rate	4.17%
Expected lives (in years)	8

No compensation expenses related to the Company's stock option plan was recorded during the years ended December 31, 2004, 2003 and 2002. The following table illustrates the effect on net income (loss) and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the years ending December 31:

	2004	2003
Net income (loss), as reported	$ 802,264	$ 7,581
Less pro forma stock-based compensation expense determined under the fair value method, net of related tax effects	(92,474)	(84,163
Pro forma net income (loss)	$ 709,790	$ (76,582
Net income (loss) per share:		
Basic - as reported	$ .43	$ .00
Diluted - as reported	.41	.00
Basic - pro forma	$ .38	$ (.05
Diluted - pro forma	.37	(.05

Advertising Costs

Advertising costs are generally expensed as incurred.

Income Taxes

The Company uses the liability method of 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 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.

Earnings Per Share

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, including any potential dilutive common shares outstanding such as options and warrants. For the year ended December 31, 2003 there were 56,250 shares excluded from the diluted net income per share computation because the exercise price exceeded the average market price and therefore, their effect would be anti-dilutive.

The Company's common stock equivalents were not considered in the computation of diluted earnings per share for the year ended December 31, 2002 because the result would have been anti-dilutive.

New Accounting Standards

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which covers guarantees such as standby letters of credit, performance guarantees, and direct or indirect guarantees of the indebtedness of others, but not guarantees of funding. FIN 45 requires a guarantor to recognize, at the inception of a guarantee, a liability in an amount equal to the fair value of the obligation undertaken in issuing the guarantee, and requires disclosure about the maximum potential payments that might be required, as well as the collateral or other recourse obtainable. The recognition and measurement provisions of FIN 45 were effective on a prospective basis after December 31, 2002, and its adoption by the Company on January 1, 2003 has not had a significant effect on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("Interpretation No. 46"), which explains identification of variable interest entities and the assessment of whether to consolidate these entities. Interpretation No. 46 requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among the involved parties. The provisions of Interpretation No. 46 effect all financial statements issued after January 1, 2003.

In December 2003, the FASB reissued FIN 46 with certain modifications and clarifications. Application of this guidance was effective for interests in certain VIEs commonly referred to as special-purpose entities (SPEs) as of December 31, 2003. Application for all other types of entities was required as of March 31, 2004, unless previously applied. The Company has no significant variable interests in any entities which would require disclosure or consolidation.

In April 2003, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. There was no material impact on the Company's financial condition or results of operations upon adoption of this Statement.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both a liability and equity. It requires that an issuer classify certain financial instruments as a liability, although the financial instrument may previously have been classified as equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. There was no material impact on the Company's financial condition or results of operations upon adoption of this Statement.

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." SOP 03-3

requires acquired loans, including debt securities, to be recorded at the amount of the purchaser's initial investment and prohibits carrying over valuation allowances from the seller for those individually-evaluated loans that have evidence of deterioration in credit quality since origination, and it is probable all contractual cash flows on the loan will be unable to be collected. SOP 03-3 also requires the excess of all undiscounted cash flows expected to be collected at acquisition over the purchaser's initial investment to be recognized as interest income on a level-yield basis over the life of the loan. Subsequent increases in cash flows expected to be collected are recognized prospectively through an adjustment of the loan's yield over its remaining life, while subsequent decreases are recognized as impairment. Loans carried at fair value, mortgage loans held for sale, and loans to borrowers in good standing under revolving credit agreements are excluded from the scope of SOP 03-3. The guidance is effective for loans acquired in fiscal years beginning after December 15, 2004 and is not expected to have a material impact on financial condition, results of operations, or liquidity.

In March 2004, the FASB Emerging Issues Task Force (EITF) released Issue 03-01, "Meaning of Other Than Temporary Impairment", which addressed other-than-temporary impairment for certain debt and equity investments. The recognition and measurement requirements of Issue 03-01, and other disclosure requirements not already implemented, were effective for periods beginning after June 15, 2004. In September 2004, the FASB staff issued FASB Staff Position (FSP) EITF 03-1-1, which delayed the effective date for certain measurement and recognition guidance contained in Issue 03-1. The FSP requires the application of pre-existing other-than-temporary guidance during the period of delay until a final consensus is reached. Management does not anticipate the issuance of the final consensus will have a material impact on financial condition, the results of operations, or liquidity.

In December 2004, the FASB revised SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123R establishes accounting requirements for share-based compensation to employees and carries forward prior guidance on accounting for awards to non-employees. The provisions of this statement will become effective January 1, 2006 for non-accelerated filers for all equity awards granted after the effective date. SFAS 123R requires an entity to recognize compensation expense based on an estimate of the number of awards expected to actually vest, exclusive of awards expected to be forfeited. The adoption of this standard is not expected to have a material effect on financial condition, the results of operations, or liquidity.

In December 2004, the FASB issued SFAS 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29", Accounting for Nonmonetary Transactions. This statement amends the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged and more broadly provides for exceptions regarding exchanges of nonmonetary assets that do not have commercial substance. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this standard is not expected to have a material impact on financial condition, results of operations, or liquidity.

2. INVESTMENT SECURITIES

Investments available-for-sale

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2004 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Treasury securities	$ 1,544,496	$ -	$ -
Total investments available-for-sale	$ 1,544,496	$ -	$ -

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2004 by contractual maturity are shown below.

	Amortized Cost
Due in one year or less	$ 1,544,496
Total investments available-for-sale	$ 1,544,496

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2003 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Treasury securities	$ 1,547,798	$ -	$ -
Total investments available-for-sale	$ 1,547,798	$ -	$ -

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2003 by contractual maturity are shown below.

	Amortized Cost
Due in one year or less	$ 1,547,798
Total investments available-for-sale	$ 1,547,798

There were no sales of investments available-for-sale during 2004, 2003 or 2002.

At December 31, 2004 and 2003, investments available-for-sale with a carrying value of $1,381,000 and $1,222,000, respectively, were pledged as collateral for certain short-term borrowings.

Other equity securities

At December 31, the Company's investment in other equity securities consisted of:

	2004	2003
Federal Reserve Bank stock	$ 312,690	$ 312,690
Federal Home Loan Bank stock	243,400	168,400
Total investments in other equity securities	$ 556,090	$ 481,090

3. LOANS AND ALLOWANCE FOR CREDIT LOSSES

Major loan categories at December 31 are presented below:

	2004	2003
Real Estate - Home Equity Line of Credit	$ 24,548,506	$ 16,078,166
Real Estate - Construction	12,968,251	8,101,017
Real Estate - Mortgage	27,854,130	13,687,709
Commercial	73,836,994	61,868,002
Consumer	2,205,556	1,657,081
Total Loans	141,413,437	101,391,975
Less: Allowance for credit losses	(1,810,000)	(1,266,500)
Net Loans	$ 139,603,437	$ 100,125,475

Activity in the allowance for credit losses for the year ended December 31, 2004, 2003 and 2002 is shown below:

	2004	2003	2002
Balance at beginning of year	$ 1,266,500	$ 851,500	$ 447,000
Provision for credit losses	559,596	415,000	404,500
Loan charge-offs	(17,356)	-	-
Loan recoveries	1,260	-	-
Net charge-offs	(16,096)	-	-
Balance at end of year	$ 1,810,000	$ 1,266,500	$ 851,500

Other than one non-accrual loan of $4,087 as of December 31, 2003, there were no loans that were considered impaired under SFAS No. 114 as of December 31, 2004, 2003 and 2002 and for the years then ended.

Notes to Consolidated Financial Statements
For the years ended December 31, 2004, 2003 and 2002

4. PREMISES AND EQUIPMENT

Premises and equipment at December 31 include the following:

		2004
Furniture and equipment	$	404,26
Computer hardware and software		511,36
Leasehold improvements		338,15
		1,253,79
Less accumulated depreciation		(660,21
Net premises and equipment	$	593,58

The Company rents office space in three locations under four non-cancelable lease arrangements accounted for as operating leases. The initial lease periods are from one to five years and provide for one or more one to five-year renewal options. The two leases for the Baltimore location provide for percentage annual rent escalations. One of the leases for the Salisbury location requires that the lessee pay certain operating expenses applicable to the leased space.

Rent expense applicable to operating leases, for the periods ended December 31, was as follows:

		2004		2003
Minimum rentals	$	241,097	$	202,72
Less: Sublease rentals		(12,930)		(23,84
Net rent expense	$	228,167	$	178,87

At December 31, 2004, future minimum lease payments under non-cancelable operating leases having an initial term in excess of one year are as follows:

Years ending December 31:		
2005	$	290,684
2006		303,429
2007		311,707
2008		320,233
2009		319,849

Total minimum lease payments	$	1,545,902

Total minimum future rental payments have not been reduced by $46,218 of sublease rentals expected to be received in 2005 and 2006 under a non-cancelable sublease expiring in December 2006.

BAY NATIONAL CORPORATION
Notes to Consolidated Financial Statements
For the years ended December 31, 2004, 2003 and 2002

5. DEPOSITS

Certificates of deposit in amounts of $100,000 or more and their remaining maturities at December 31 are as follows:

	2004	2003
Three months or less	$ 4,285,752	$ 4,258,011
Over three months through six months	3,553,729	3,069,247
Over six months through twelve months	3,351,703	2,897,570
Over twelve months	10,745,359	5,226,650
Total	$ 21,936,543	$ 15,451,478

Interest expense on deposits, for the years ended December 31, is as follows:

	2004	2003
Interest-bearing transaction	$ 293,076	$ 206,69
Savings and money market	244,628	195,82
Time, $100,000 or more	531,287	444,88
Other time	1,369,896	1,077,64
Total interest on deposits	$ 2,438,887	$ 1,925,04

6. BORROWINGS

Information relating to short-term borrowings, as of December 31, 2004 and 2003, is as follows:

2004	20

	Amount	Rate	Amount
As of year end	$ 1,381,000	2.00%	$ 1,222,000
Average for the year	$ 1,475,148	1.24%	$ 1,172,658
Maximum month end balance	$ 1,550,000		$ 1,550,000

The Company pledges U.S. Government Treasury Securities, based upon their market values, as collateral for 100% of the principal and accrued interest of its short-term borrowings.

In the first quarter of 2004, the Company received commitments for a total of $7.0 million of borrowing availability under unsecured federal funds lines of credit with three separate financial institutions. The Company also has approximately $10 million of borrowing capacity with the Federal Home Loan Bank of Atlanta as of December 31, 2004. These borrowing facilities will be used, as necessary, to supplement short-term liquidity needs.

Information relating to note payable as of December 31, 2004 and 2003 is as follows:

	2004		20
	Amount	Rate	Amount
As of year end	$ 1,250,000	5.25%	$ -
Average for the year	$ 129,098	4.88%	$ -
Maximum month end balance	$ 1,250,000		$ -

Note payable consists of $1,250,000 borrowed under a $5 million, three-year unsecured non-revolving credit facility executed on September 28, 2004 with another financial institution. Borrowings under the credit facility will be used to provide regulatory capital to the Bank. The loan bears interest at the prime rate.

7. ISSUANCE OF COMMON STOCK

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. Net proceeds after offering costs were $4,449,261.

On August 31, 1999, the Board of Directors of the Company authorized the issuance on September 10, 1999, to each stockholder of record of the Company on August 31, 1999, a warrant to purchase one share of common stock at $10 per share for every two shares that the stockholder purchased in the organizational offering. As a result, the Company issued warrants to purchase 56,250 shares. The warrants were issued in recognition of the financial and organizational risk undertaken by the purchasers in the organizational offering. The warrants became exercisable on April 30, 2001 and were exercisable in whole or in part until November 16, 2004. During the second half of 2004, 55,000 of these warrants were exercised resulting in the issuance of 55,000 shares of common stock and the receipt of $550,000 of additional capital.

8. STOCK OPTIONS

The Company's 2001 Stock Option Plan ("Option Plan") provides for the granting of incentive and non-qualifying stock options to the Company's directors and to selected employees on a periodic basis at the discretion of the Board of Directors. The Option Plan authorizes the issuance of up to 200,000 shares of common stock, has a term of ten years, and is administered by the Compensation Committee of the Board of Directors. The Compensation Committee consists of at least two non-employee directors appointed by the Board of Directors. In general, the options have an exercise price, which may not be less than 100% of the fair market value on the date of the grant, must be exercised within eight years and vest over a period of six years.

The following is a summary of changes in shares under options for the years ended December 31, 2004, 2003 and 2002:

		Number of Shares
Balance, January 1, 2002	$	141,533
Granted		16,815
Cancelled		(9,523)
Exercised		-
Balance, December 31, 2002		148,825
Granted		-
Cancelled		(919)
Exercised		-
Balance, December 31, 2003		147,906
Granted		-
Cancelled		(414)

Exercised		-
Balance, December 31, 2004		147,492
Weighted average fair value of options granted during 2002	$	3.05

The following table summarizes information about options outstanding at December 31, 2004:

Range of Exercise Price	Options Outstanding			Option
Price	Number	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number
$ 7.58	130,677	5	$ 7.58	69,721
$ 8.37	16,815	6	8.37	1,875
	147,492			

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For the years ended December 31, 2004, 2003 and 2002

8. RETIREMENT PLAN

The Company has a 401(k) profit sharing plan covering substantially all full-time employees. The plan requires the Company to match 25% of employee contributions of up to 3% of compensation as defined under the plan. The Company has also elected to make a safe harbor contribution to the plan on behalf of all eligible employees, as defined under the plan. The safe harbor contribution is equal to 3% of compensation as defined under the plan. The plan permits additional contributions at the discretion of management. Expenses under this plan totaled $77,180, $67,388 and $58,447 for the years ended December 31, 2004, 2003 and 2002, respectively.

9. INCOME TAXES

Federal and state income tax expense (benefit) consists of the following for the periods ended December 31:

	2004	2003
Current federal income tax	$ -	$ -
Current state income tax	-	-
Deferred federal income tax expense (benefit)	-	-
Deferred state income tax expense (benefit)	-	-
Total income tax expense (benefit)	$ -	$ -

The following table is a summary of the tax effect of temporary differences that give rise to a significant portion of deferred tax assets:

Deferred tax assets:	2004
Net operating loss carryforwards	$ 955,000
Other	18,000
Allowance for credit losses	525,000
Total deferred tax assets	1,498,000
Less valuation allowance	(1,381,000)
Deferred tax assets, net of valuation allowance	117,000
Deferred tax liabilities:	
Depreciation and amortization	(114,000)
Deferred loan costs, net	(3,000)
Net deferred tax assets (liabilities)	$ -

No income tax benefit or deferred tax asset is reflected in the financial statements. Deferred tax assets are recognized for future deductible temporary differences and tax loss carryforwards if their realization is "more likely than not".

At December 31, 2004, the Company had approximately $2.5 million in tax loss carryforwards, which expire between 2019 and 2022. Realization depends on generating sufficient taxable income before the expiration of the loss carryforward periods. The amount of loss carryforward available for any one year may be limited if the Company is subject to the alternative minimum tax.

10. RELATED PARTY TRANSACTIONS

Certain directors and executive officers have loan transactions with the Company. Such loans were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outsiders. The following schedule summarizes changes in amounts of loans outstanding, both direct and indirect, to these persons during 2004 and 2003.

	2004	2003
Balance at beginning of period	$ 4,672,104	$ 4,972,128
Additions	12,385,135	7,969,736
Repayments	(11,229,144)	(8,269,760)
Balance at December 31	$ 5,828,095	$ 4,672,104

An individual, who is a director of the Company, owns an office building which is leased to the Company. The lease term commenced September 1, 1999 for a term of five years and contains renewal options for three additional five-year terms. Rent expense under this agreement was $25,004 for the year ended December 31, 2004 and $23,756 for each of the periods ended December 31, 2003 and 2002, respectively. Management believes that the terms of the foregoing lease are no more and no less favorable to the Company than those which could have been received from unaffiliated parties.

An individual, who became a director of the Company in 2003, is an executive officer for the company which owns an office building in which the Company has leased space under two separate operating leases. The leases were effectively combined during 2004 and extended to February 28, 2010. Bay National Corporation has the right to extend the leases for one additional five year term, to February 28, 2015. Rent expense under these leases was $202,945, $170,099 and $163,556 for the periods ended December 31, 2004, 2003 and 2002, respectively. Management believes that the terms of the foregoing leases are no more and no less favorable to the Company than those which could have been received from unaffiliated parties.

11. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments may include commitments to extend credit, standby letters of credit and purchase commitments. The Company uses these financial instruments to meet the financing needs of its customers. Financial instruments involve, to varying degrees, elements of credit, interest rate and liquidity risk. These do not represent unusual risks and management does not anticipate any losses which would have a material effect on the accompanying financial statements.

Outstanding loan commitments and lines and letters of credit at December 31 are as follows:

	2004	2003

	----	----
Loan commitments	$ 9,867,893	$ 11,458,333
Unused lines of credit	40,423,986	32,234,145
Standby letters of credit	1,578,379	2,167,501

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. The Company generally requires collateral to support financial instruments with credit risk on the same basis as it does for on-balance sheet instruments. The collateral is based on management's credit evaluation of the counter party. 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 commitment amount does not necessarily represent future cash requirements. Each customer's credit-worthiness is evaluated on a case-by-case basis.

Standby letters of credit are conditional commitments issued 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 loan facilities to customers.

12. REGULATORY MATTERS

As of December 31, 2004, the Company was required to maintain a weekly average of $958,000 of non-interest-bearing deposits with the Federal Reserve Bank. As of December 31, 2003, the Company was required to maintain a weekly average of $543,000 of non-interest-bearing deposits with the Federal Reserve Bank. The average weekly balance maintained with the Federal Reserve Bank for the weekly period ended December 31, 2004 was $1,511,000. The average weekly balance maintained with the Federal Reserve Bank for the weekly period ended December 31, 2003 was $598,000. The actual balances maintained with the Federal Reserve Bank at December 31, 2004 and 2003 were $1,217,580 and $428,616, respectively.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2004, that the Bank met all capital adequacy requirements to which it is subject.

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-

BAY NATIONAL CORPORATION
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For the years ended December 31, 2004, 2003 and 2002

based, Tier I risk-based and Tier I leverage ratios. There are no conditions or events that management believes would prevent the Bank from continuing to be categorized as well capitalized.

The Bank's actual capital amounts and ratios as of December 31, 2004 and 2003 are presented in the following table:

December 31, 2004

	Actual Amount	Actual Ratio	For Capital Adequacy Purpose Amount	For Capital Adequacy Purpose Ratio	
Total Capital (to Risk Weighted Assets):	$ 16,242,797	10.32%	$ 12,592,000	8.00%	$ 15
Tier I Capital (to Risk Weighted Assets):	14,432,797	9.17%	6,296,000	4.00%	9
Tier I Capital (to Average Assets):	14,432,797	8.98%	4,821,000	3.00%	8

December 31, 2003

	Actual Amount	Actual Ratio	For Capital Adequacy Purpose Amount	For Capital Adequacy Purpose Ratio	
Total Capital (to Risk Weighted Assets):	$ 11,729,127	10.16%	$ 9,238,000	8.00%	$ 11
Tier I Capital (to Risk Weighted Assets):	10,462,627	9.09%	4,619,000	4.00%	6
Tier I Capital (to Average Assets):	10,462,627	8.93%	3,516,000	3.00%	5

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 which exceed the Bank's net profits for the current year, plus it's 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 December 31, 2004.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company discloses fair value information about financial instruments, for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Financial instruments have been defined broadly to encompass 99.3% of the Company's assets and 99.7% of its liabilities. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price, if one exists.

Quoted market prices, where available, are shown as estimates of fair market values. Because no quoted market prices are available for a significant part of the Company's financial instruments, the fair

values of such instruments have been derived based on the amount and timing of future cash flows and estimated discount rates.

Present value techniques used in estimating the fair value of many of the Company's financial instruments are significantly affected by the assumptions used. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate cash settlement of the instrument. Additionally, the accompanying estimates of fair values are only representative of the fair values of the individual financial assets and liabilities and should not be considered an indication of the fair value of the Company.

The estimated fair values of the Company's financial instruments at December 31 are as follows:

	2004		
(In thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount
Financial Assets			
Cash and temporary investments (1)	$ 27,725,114	$ 27,725,114	$ 18,983,93
Investments available-for-sale	1,544,496	1,544,496	1,547,79
Other equity securities	556,090	556,090	481,09
Loans, net of allowances	139,603,437	139,652,670	100,125,47
Accrued interest receivable and other assets (2)	591,844	591,844	380,08
Financial Liabilities			
Deposits	$ 153,927,042	$ 153,676,261	$ 108,530,90
Short-term borrowings	1,381,000	1,381,000	1,222,00
Note payable	1,250,000	1,250,000	-
Accrued interest payable and other liabilities (2)	222,602	222,602	130,85

(1) Temporary investments include federal funds sold and overnight investments, and loans held for sale.

(2) Only financial instruments as defined in Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments," are included in other assets

and other liabilities.

The following methods and assumptions were used to estimate the fair value of each category of financial instruments for which it is practicable to estimate that value:

Cash and due from banks, federal funds sold and overnight investments. The carrying amount approximated the fair value.

Loans held for sale. The fair value of residential mortgage loans held for sale was derived from secondary market quotations for similar instruments.

Investment Securities. The fair value for U.S. Treasury securities was based upon quoted market bids.

Other equity securities. The fair value of Federal Reserve Bank and Federal Home Loan Bank of Atlanta stock is not readily determinable since these stocks are restricted as to marketability.

Loans. The fair value was estimated by computing the discounted value of estimated cash flows, adjusted for potential credit losses, for pools of loans having similar characteristics. The discount rate was based upon the current loan origination rate for a similar loan. Non-performing loans have an assumed interest rate of 0%.

Accrued interest receivable. The carrying amount approximated the fair value of accrued interest, considering the short-term nature of the receivable and its expected collection.

Other assets. The carrying amount approximated the fair value.

Deposit liabilities. The fair value of demand, money market savings and regular savings deposits, which have no stated maturity, were considered equal to their carrying amount, representing the amount payable on demand. These estimated fair values do not include the intangible value of core deposit relationships, which comprise a significant portion of the Bank's deposit base. Management believes that the Bank's core deposit relationships provide a relatively stable, low-cost funding source that has a substantial intangible value separate from the value of the deposit balances.

The fair value of time deposits was based upon the discounted value of contractual cash flows at current rates for deposits of similar remaining maturity.

Short-term borrowings. The carrying amount approximated the fair value of repurchase agreements due to their variable interest rates.

Note payable. The carrying amount approximated the fair value of the note payable due to their variable interest rates.

Other liabilities. The carrying amount approximated the fair value of accrued interest payable, accrued dividends and premiums payable, considering their short-term nature and expected payment.

Off-balance sheet instruments. The Company charges fees for commitments to extend credit. Interest rates on loans, for which these commitments are extended, are normally committed for periods of less than one month. Fees charged on standby letters of credit and other financial guarantees are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused. It is impractical to assign any fair value to these commitments.

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BAY NATIONAL CORPORATION
Notes to Consolidated Financial Statements
For the years ended December 31, 2004, 2003 and 2002

14. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for Bay National Corporation (Parent Only) is as follows:

CONDENSED BALANCE SHEETS

December 31, 2004 and 2003

	2004
ASSETS	
Cash and cash equivalents	$ 104,769
Due from subsidiary	137,500
Investment in subsidiary	14,432,797
Total Assets	$ 14,675,066
LIABILITIES	
Accrued expenses and other liabilities	$ 6,302
Note payable	1,250,000
Total Liabilities	1,256,302
STOCKHOLDERS' EQUITY	
Common stock - $.01 par value, authorized: 9,000,000 shares authorized, 1,917,710 and 1,862,710 issued and outstanding as of December 31, 2004 and 2003, respectively:	19,177
Additional paid in capital	17,400,284
Accumulated Deficit	(4,000,697)

Total Stockholders' Equity	13,418,764	
Total Liabilities and Stockholders' Equity	$ 14,675,066	$

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BAY NATIONAL CORPORATION
CONDENSED STATEMENTS OF OPERATIONS

For the years ended December 31, 2004, 2003 and 2002

	2004	2003
Interest and dividends on investment securities	$ 2,231	$ 5,14
Interest expense	6,302	-
Net interest income (expense)	(4,071)	5,14
Non-interest expense	1,335	3,21
Income (loss) before income taxes and equity in undistributed losses of subsidiary	(5,406)	1,92
Income tax expense (benefit)	-	-
Income (loss) before equity in undistributed income (losses) of subsidiary	(5,406)	1,92
Equity in undistributed income (losses) of subsidiary	807,670	5,65
Net Income (Loss)	$ 802,264	$ 7,58

CONDENSED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2004, 2003 and 2002

	2004	2003
Cash Flows From Operating Activities		
Net Income (Loss)	$ 802,264	$ 7,58
Adjustments to reconcile net income (loss) to net cash (used) provided by operating activities:		
Equity in undistributed (income) loss of subsidiary	(807,670)	(5,65
Net decrease (increase) in other assets	812,686	(699,45
Net increase (decrease) in other liabilities	6,302	(250,29
Net cash (used) provided by operating activities	813,582	(947,81

Cash Flows From Investing Activities		
Investment in subsidiary	(3,162,500)	(3,500,00
Net cash used by investing activities	(3,162,500)	(3,500,00
Cash Flows From Financing Activities		
Net proceeds from note payable	1,250,000	-
Issuance of common stock	550,000	4,449,26
Net cash provided by financing activities	1,800,000	4,449,26
Net increase (decrease) in cash and cash equivalents	(548,918)	1,44
Cash and cash equivalents at beginning of year	653,687	652,24
Cash and cash equivalents at end of year	$ 104,769	$ 653,68

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Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There has been no occurrence requiring a response to this Item.

Item 8A. Controls and Procedures

As of the end of the period covered by this annual report on Form 10-KSB, Bay National Corporation's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness 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 other procedures that are designed to ensure that information required to be disclosed by Bay National Corporation in the reports that it files or submits 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, there were no changes in Bay National Corporation's internal controls over financial reporting (as defined in Rule 13a-15 or Rule 15d-15 under the Securities Act of 1934, as amended) during the quarter ended December 31, 2004, that have materially affected, or are reasonably likely to materially affect, Bay National Corporation's internal control over financial reporting.

Item 8B. Other Information

On December 7, 2004, the Compensation Committee of the Board of Directors of Bay National Bank increased, effective January 1, 2005, Hugh Mohler's annual base compensation from $164,000 to $200,000 and Mark Semanie's annual base compensation from $150,000 to $165,000

On December 7, 2004, the Compensation Committee of the Board of Directors of Bay National Bank authorized a $50,000 discretionary bonus to Mr. Mohler, and a $40,000 discretionary bonus to Mr. Semanie. These bonuses were paid on January 21, 2005.

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PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

Directors, Executive Officers, Promoters and Control Persons

The directors of Bay National Corporation, their ages, the years in which their terms expire and the year in which they became directors are as follows:

Name	Age	Term to Expire (1)	Direc
Hugh W. Mohler	59	2006 Annual Meeting	Jun
Carroll A. Bodie	59	2005 Annual Meeting	Jun
Charles E. Bounds	86	2005 Annual Meeting	Jun
Gary T. Gill	52	2005 Annual Meeting	Janu
John R. Lerch	60	2005 Annual Meeting	Jun
Donald G. McClure, Jr.	61	2006 Annual Meeting	Apr
Robert L. Moore	51	2006 Annual Meeting	Febru
James P. O'Conor	76	2005 Annual Meeting	Jul
H. Victor Rieger, Jr.	67	2006 Annual Meeting	Jun
Margaret Knott Riehl	71	2006 Annual Meeting	Jun
William B. Rinnier	63	2007 Annual Meeting	Augu
Edwin A. Rommel, III	55	2007 Annual Meeting	Jun
Henry H. Stansbury	65	2007 Annual Meeting	Jun
Kenneth H. Trout	56	2007 Annual Meeting	Octo
Eugene M. Waldron, Jr.	61	2007 Annual Meeting	Jun
Carl A.J. Wright	50	2005 Annual Meeting	Mar

(1) All of the directors with terms to expire in 2005 have been nominated to serve on the Board of Directors for an additional three (3) year term. Elections for these directors will take place at the 2005 Annual Meeting of Stockholders to be held on May 24, 2005.

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Biographical information concerning the directors is set forth below.

Hugh W. Mohler serves as chairman, president, and chief executive officer. He has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Mohler has 36 years experience in the financial services industry, holding positions in executive management, commercial lending and business development. From 1977 to 1999, Mr. Mohler was affiliated with Mercantile Bankshares Corporation, which is headquartered in Baltimore, Maryland, most recently serving as executive vice president with responsibility for 20 community banks in a three-state area. For 17 years, from 1977 to 1994, he was president of Mercantile's Salisbury, Maryland-based affiliate, Peninsula Bank, the largest financial institution on Maryland's Eastern Shore. Earlier he was a vice president in commercial lending at First National Bank of Maryland.

A native of Baltimore, Mr. Mohler earned his undergraduate degree in economics from Loyola College of Maryland and his master of business administration degree from the University of Baltimore. He is a past president of the board of trustees of Associated Catholic Charities, Inc. in the Roman Catholic Archdiocese of Baltimore. In the past, Mr. Mohler has served as a trustee of Loyola Blakefield, Goucher College and the Independent College Fund of Maryland. Mr. Mohler serves on the Board of Sponsors of the Sellinger School of Business at Loyola College of Maryland and the Board of Governors of The Maryland Club. In 2004, he was appointed by Governor Robert L. Ehrlich, Jr. to the Maryland Economic Development Commission. He also serves on the President's Advisory Council of Villa Julie College.

Mr. Mohler's prior civic experiences include serving as chairman of the Greater Salisbury Committee, chairman of the Salisbury School, and chairman of the Governor's Lower Shore Economic Task Force. He also served on the boards of Peninsula Regional Medical Center, Maryland Chamber of Commerce, Salisbury-Wicomico Economic Development Committee and the Somerset County Economic Development Committee. Mr. Mohler also served as president of the Maryland Bankers Association and on several committees of the American Bankers Association.

Carroll A. Bodie has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Bodie is vice president and general counsel of Noxell Corporation, a Hunt Valley, Maryland-based subsidiary of Procter & Gamble Company for which he also serves as associate general counsel. Mr. Bodie has served in that capacity since 1987. Prior to joining Noxell, Mr. Bodie spent more than two decades in the brewing industry, his most recent position being with the Miller Brewing Company subsidiary of Philip Morris Companies, Inc.

A Baltimore native, Mr. Bodie holds an undergraduate degree in marketing from the University of Baltimore and earned his law degree from the University of Baltimore School of Law. Admitted to practice before numerous courts, including those in the State of Maryland and the United States Supreme Court, he is a member of the Baltimore County, Maryland Bar Association, the American Bar Association and the American Corporate Counsel Association. Mr. Bodie is immediate past chairman of the board of trustees of Loyola Blakefield and a Trustee at the College of Notre Dame of Maryland. He is a past director and board chairman for the YMCA of Central Maryland and a past board member of the Independent College Fund.

Charles E. Bounds has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Bounds is a retired executive who served from 1944 to 1969 as director of purchases and inventory for Symington Wayne Corporation, an international conglomerate headquartered in Salisbury, Maryland, which operated businesses in the United States and seven foreign countries. From 1969 to 1999, he was a vice president-investments for Morgan Stanley Dean Witter, working in the Salisbury, Maryland office of the investment banking firm.

A native of Salisbury, Maryland, Mr. Bounds is past chairman of the Salvation Army Boys Club in Salisbury, Maryland, and headed the Salisbury, Maryland Salvation Army administrative board. He has also chaired fund raising efforts for the Boy Scouts of America, Delmarva District. Mr. Bounds was an original member of the Ward Foundation, which is a Salisbury, Maryland based non-profit organization, which operates The Ward Museum of Wildfowl Art. Mr. Bounds is an alumnus of Beacom College.

Gary T. Gill has been a director of Bay National Corporation and Bay National Bank since January 2003. Mr. Gill is president and chief executive officer of the MacKenzie Companies, a Baltimore-based full-service commercial real estate firm comprising Mackenzie Commercial Real Estate Services, LLC, Mackenzie Management Corporation, MacKenzie Services Corporation, MacKenzie Contracting Company, LLC, and MacKenzie Drywall Construction. Mr. Gill joined MacKenzie in 1977 and has served in his capacity as president since 1985. Mr. Gill serves also as executive vice president of MacKenzie Properties, Inc., the managing partner of over 35 partnerships of income-producing commercial properties.

A native of Towson, Maryland, Mr. Gill received his Bachelor of Arts degree in Business Administration in 1974 from Towson University. Mr. Gill currently serves on the Baltimore County Economic Advisory Board, Towson University Stadium Committee, USLacrosse Foundation Board, and chairs the Lax 4 Baltimore Committee for the NCAA National Men's Lacrosse Championships.

John R. Lerch has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Since January 1999, Mr. Lerch has been self-employed as a private investor trading as the Chesapeake Venture Group. From 1973 to January 1999, Mr. Lerch was president of Chesapeake Insurance-The Harris Riggin Agency, an independent insurance agency based in Salisbury, Maryland. Mr. Lerch began his business career in the securities industry, serving as a stockbroker at firms in Washington, D.C. and Salisbury, Maryland. Mr. Lerch is a past director of the Independent Insurance Agents of Maryland.

Mr. Lerch is an alumnus of Dickinson College of Carlisle, Pennsylvania. He served as an officer in the U.S. Army and holds a Bronze Star from his service in Vietnam. He is a director of Barr International, Inc., a regional medium and heavy truck sales and service organization. He is a past director of Peninsula Bank, a subsidiary of Baltimore-based Mercantile Bankshares Corporation. He is a past director and vice-chairman of the Greater Salisbury Committee, past trustee of the Peninsula Regional Medical Center in Salisbury, past president of Salisbury-Wicomico Economic Development Corporation and past president and campaign chairman of the United Way of the Lower Eastern Shore. He also has served as a director for the Mid-Delmarva Family YMCA and was a former chairman and a current trustee for The Ward Foundation.

Donald G. McClure, Jr. has been a director of Bay National Corporation and Bay National Bank since April 2000. Mr. McClure is a principal in the McClure Group, Inc, a Baltimore-based private equity investment firm originated in 1979. He is the former Chairman and Co-Chief Executive of Americom Wireless Services, Inc., which merged with a Fortune 200 company in 2000.

Mr. McClure is Chairman of the board of trustees of Loyola Blakefield and serves on several private company boards as well as devoting substantial time to various civic, charitable and educational organizations here and in other states.

Robert L. Moore has been a director of Bay National Corporation since February 2001 and Bay National Bank since June 2001. Mr. Moore is a certified public accountant. He received his CPA designation twenty-five years ago, and is the owner and founder of the Salisbury, Maryland accounting firm of Moore & Company, P.A. His professional concentration is income tax and all facets of business consulting.

Mr. Moore received his Bachelor of Science degree from the University of Virginia in 1976. Currently, he serves as Chairman of the Trustees of the Wicomico County Pension System, a board member of Salisbury-Wicomico Economic Development Corporation, a board member of the Greater Salisbury Committee, and a member of the Salisbury Area Chamber of Commerce.

Mr. Moore is a past president of the Eastern Shore Chapter of the Maryland Association of CPAs. He served as Chairman of the Administrative Board of Asbury United Methodist Church. In addition, Mr. Moore served on the Board of Directors of the Bank of Fruitland, Maple Shade Residential Homes, Inc., and the Holly Foundation. He was also a member of the Executive Committee and Board of Directors of the Green Hill Yacht & Country Club and a member and officer of the Salisbury Jaycees.

James P. O'Conor has been a director of Bay National Corporation and Bay National Bank since July 2004. Mr. O'Conor is the general partner of O'Conor Enterprises, a real estate investment and consulting company , and he has served in that capacity since 2002. Mr. O'Conor co-founded the Maryland real estate brokerage firm of O'Conor & Flynn in 1961. In 1984, that firm merged with another large Maryland real estate brokerage firm, creating O'Conor, Piper & Flynn. Mr. O'Conor served as its Chairman and CEO. In 1998, O'Connor, Piper & Flynn was sold to NRT. At the time of the sale, O'Conor, Piper & Flynn was the sixth largest residential real estate brokerage company in the United States.

Mr. O'Conor currently serves on the Board of Directors of the University of Maryland Medical System, the Baltimore Symphony Orchestra, Sheppard & Enoch Pratt Hospital, Loyola College, Towson University and is Chairman of Maryland General Hospital.

H. Victor Rieger, Jr. has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Rieger retired from Signet Banking Corporation, successor to Union Trust Company of Maryland, in December 1997 after nearly four decades of service. Mr. Rieger served in numerous capacities for Signet, including regional executive vice president of international banking and as part of Signet's Maryland commercial banking group. Mr. Rieger has extensive experience in commercial relationship banking, credit administration and loan policy.

An alumnus of Johns Hopkins University, Mr. Rieger is a graduate of the Stonier School of Banking at Rutgers University. He is past president and a current trustee of Family and Children's Services of Central Maryland, past treasurer and board member of the National Flag Day Foundation and a past vice-president and director of the Baltimore Junior Association of Commerce. He is a former member of the loan committee for the Minority Small Business Investment Company and a past advisory board member of the U.S. Small Business Administration. Mr. Rieger also is past president of the Chesapeake Chapter of Robert Morris Associates.

Margaret K. Riehl has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mrs. Riehl is a retired nurse and civic volunteer. She is currently a trustee of the Marion I. and Henry J. Knott Foundation, a Baltimore, Maryland-based philanthropic organization and has served in that capacity from 1978 to 1985 and again from 1993 to present. She serves as

a trustee of St. Mary's Seminary & University, also in Baltimore. Mrs. Riehl is a former president of the board of trustees of Baltimore's Associated Catholic Charities, Inc., and a former trustee of the Community Foundation of Baltimore, Mercy Medical Center, the Institute of Notre Dame and St. Paul's School for Girls. A Baltimore native, Mrs. Riehl is an alumna of the Mercy Hospital School of Nursing.

William B. Rinnier has been a director of Bay National Corporation since August 1999 and a director of Bay National Bank since April 2000. Mr. Rinnier is the owner and president of Rinnier Development Company, a Salisbury, Maryland based real estate development company, which specializes in the development and sale or management of resort condominiums, multi-family apartments, and commercial and industrial buildings. He joined Rinnier Development Company nearly three decades ago after his honorable discharge from the U.S. Navy.

A native of Salisbury, Maryland, Mr. Rinnier earned a degree in aerospace engineering from the Georgia Institute of Technology and attended the Graduate School of Business at the University of Virginia. He is a board member of the Greater Salisbury Committee and is past president of the Salisbury-Wicomico Economic Development Corporation and the Coastal Board of Realtors.

Edwin A. Rommel III has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Rommel is a certified public accountant that, since 1974, has been a partner in the Salisbury, Maryland, accounting firm of Twilley, Rommel & Stephens, P.A. Mr. Rommel has been certified as a valuation analyst and accredited in business evaluation by the American Institute of Certified Public Accountants.

A Baltimore native, Mr. Rommel earned his undergraduate degree from Loyola College of Maryland. Mr. Rommel is Chairman of the Maryland Association of Certified Public Accountants, and is a member of the governing board of the American Institute of Certified Public Accountants. Mr. Rommel is a current director of the Greater Salisbury Committee and past president of the Salisbury Area Chamber of Commerce. He serves as a director of the Maryland Association of Certified Public Accountants and an officer of its Eastern Shore Chapter. Mr. Rommel is past president of the St. Francis de Sales Board of Trustees and past member of the Wicomico County Democratic Central Committee.

Henry H. Stansbury has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Since 1975, Mr. Stansbury has been the chief executive officer of Agency Services, Inc., an independently owned premium finance company. Since 1989, Mr. Stansbury has been the chief executive officer of Agency Insurance Company of Maryland, Inc., a privately owned multi-line property/casualty insurance company. Mr. Stansbury is a past president of the Maryland Association of Premium Finance Companies and is a past president of the National Association of Premium Finance Companies.

Mr. Stansbury is a vice president and trustee of the Maryland Historical Society and a trustee of the Ward Museum of Wildfowl Art. He served as director and chairman of the museum committee for the Lacrosse Hall of Fame at the Johns Hopkins University and is vice president and a trustee of the St. Paul's School for Boys. He is also past president of ReVisions, Inc., a nonprofit organization that serves the mentally ill. Mr. Stansbury is a graduate of Leadership Maryland and a director of Leadership Baltimore County. He is the author of two books; LLOYD J. TYLER: FOLK ARTIST AND DECOY MAKER and IRA HUDSON AND FAMILY, CHINCOTEAGUE CARVERS. He is also a contributing writer for Decoy Magazine. Mr. Stansbury is an alumnus of the University of Maryland and holds a master of business administration degree from George Washington University.

Kenneth H. Trout has been a director of Bay National Corporation since October 1999 and a director of Bay National Bank since April 2000. Since January 1999, Mr. Trout has served as the president and chief executive officer of Rosemore, Inc., a Baltimore-based privately held investment company primarily engaged in the business of oil and gas exploration and production. He also serves as a director of Rosemore Holdings, Inc., Rosemore Calvert, Inc., Tema Oil and Gas Company and Gateway Gathering and Marketing Company, which are all subsidiaries of Rosemore, Inc. He is also a director of KCI Technologies, Inc. From 1970 to November 1997, Mr. Trout was employed by Signet Banking Corporation. During his last five years of tenure with Signet, he served as senior executive vice president-commercial banking and as president and chief executive officer of Signet Bank-Maryland. Mr. Trout was retired from December 1997 to December 1998.

A Bridgeton, New Jersey native, Mr. Trout received his undergraduate degree in economics and business administration from Methodist College in North Carolina. He is vice chairman of the Board of Trustees of The College of Notre Dame of Maryland.

Eugene M. Waldron, Jr. has been a director of Bay National Corporation since June 1999 and a director of Bay National Bank since April 2000. Mr. Waldron is a Chartered Financial Analyst and since September 1998 has been a senior vice president in the Washington, D.C., office of Capital Guardian Trust Company, an employee-owned firm based in Los Angeles dedicated to institutional investment management. From March 1994 to August 1998, Mr. Waldron was employed by Loomis, Sayles & Company, an investment management firm. Mr. Waldron's more than three decades of investment experience include employment at CS First Boston Asset Management, Fidelity Management Trust Company, T. Rowe Price Associates and Ferris, Baker, Watts & Company.

An alumnus of Mt. St. Mary's College, Emmitsburg, Maryland, Mr. Waldron earned his master of business administration degree at the Bernard M. Baruch College of the City University of New York. A native of Annapolis, Maryland, he is a member of the Mt. St. Mary's Board of Trustees and the Newton, Massachusetts Country Day School of the Sacred Heart's Endowment Committee.

Carl A.J. Wright has been a director of Bay National Corporation and Bay National Bank since March 2003. Mr. Wright is the senior vice president of Spherion (formerly Interim Financial Solutions), an executive search and staffing firm specializing in finance, human resources and information systems, and he has served in that capacity since 1998. Mr. Wright operated the Baltimore office of A.J. Burton from 1980 until its sale to Spherion in 1998. Mr. Wright served in the auditing and tax departments of Ernst & Young from 1976 to 1980.

Along with his corporate responsibilities, he is an involved community member and active in professional, civic and political organizations.

Mr. Wright is an alumnus of Loyola College and Loyola Blakefield and has served on boards and committees of both institutions. He is past president of the Baltimore Junior Association of Commerce and serves on Maryland Governor Robert Ehrlich's Strategic and Finance Committees. He was appointed as the chairman of the Maryland Stadium Authority in 2003. In addition, he is an active supporter of the Catholic Charities and Maryland Business for Responsive Government.

Other than Mr. Mohler and Mr. Waldron who are first cousins, there are no family relationships between any director or executive officer and any other director or executive officer of Bay National Corporation.

The one executive officer and significant employee of Bay National Corporation and Bay National Bank that does not serve on the Board of Directors of Bay National Corporation is Mark A. Semanie.

Mr. Semanie, age 41, serves as Executive Vice President and Chief Financial Officer, Treasurer and Secretary of Bay National Corporation and Executive Vice President and Chief Financial Officer, Chief Compliance Officer, Treasurer and Secretary of Bay National Bank. Mr. Semanie is a Certified Public Accountant. Mr. Semanie worked in the insurance industry for over seven years. From July 1996 to October 2000, he served as Executive Vice President and Chief Financial Officer for Agency Holding Company of Maryland, Inc., parent company of Baltimore-based Agency Services, Inc., an insurance premium finance company, and Agency Insurance Company of Maryland, Inc., a multi-line property/casualty insurance company. From March 1993 to July 1996, he was associated with USF&G Corporation where he served in various capacities, including Manager of SEC and External Reporting. From August 1985 to March 1993, Mr. Semanie worked in the Boston and Baltimore offices of the international accounting firm of KPMG LLP. He last served as a Senior Manager in the Audit practice with the firm. His background includes experience in financial planning and reporting, backroom operations, human resources and regulatory compliance.

A native of Connecticut, Mr. Semanie earned a Bachelor of Science degree in accounting from Bentley College. He currently serves on the Board of Directors of Agency Insurance Company of Maryland, Inc. He also serves as a director of the Baltimore Child Abuse Center and as Chairman of its Finance Committee. He is a member of the American Institute of Certified Public Accountants, the Maryland Association of Certified Public Accountants, the American Institute of Chartered Property Casualty Underwriters, and Financial Executives International.

Bay National Corporation's charter and bylaws provide that Bay National Corporation shall have at least three (3) directors, and that the number of directors may be increased or decreased by the Board of Directors. As of March 25, 2005, the number of directors has been fixed at 16 with all positions filled. Pursuant to Bay National Corporation's charter and bylaws, the Board of Directors is divided into three classes, with each class serving a three-year term, and the term of one class expiring each year. A director may only be removed by the affirmative vote of at least 80% of the votes entitled to be cast on the matter and only for cause.

Bay National Corporation's officers are appointed by the Board of

Directors and hold office at the will of the board or as otherwise provided in an employment agreement between an officer and Bay National Corporation.

As Bay National Corporation is the sole stockholder of Bay National Bank, each director of Bay National Bank is elected by the Board of Directors of Bay National Corporation. Directors of Bay National Bank serve for a term of one year and are elected each year at Bay National Bank's annual meeting of stockholders. Bay National Bank's officers are appointed by its Board of Directors and hold office at the will of the board.

Bay National Corporation has established an advisory board of directors, which is comprised of professionals and business persons, who provide advice to Bay National Corporation's and Bay National Bank's Board of Directors and who promote the interests of Bay National Corporation and Bay National Bank. An advisory board of directors is not required by any Maryland or federal law or regulation and advisory directors are not subject to regulatory approval or supervision. The advisory directors do not have the power to vote on any matter considered by the Board of Directors and they serve at the pleasure of the board.

Audit Committee Matters

Bay National Corporation has a standing Audit Committee. The Audit Committee currently has four members: Carroll A. Bodie, Chairman, William B. Rinnier, Henry H. Stansbury and Kenneth H. Trout. As of the date of this report, each of the members of the Audit Committee is "independent" under rules promulgated by the Securities and Exchange Commission. The Audit Committee's functions and responsibilities are described in a written charter that was adopted by Bay National Corporation's Board of Directors.

Pursuant to Securities and Exchange Commission regulations, Bay National Corporation is required to disclose in this annual report whether one or more members of the audit committee are "audit committee financial experts" and the names of those members. If Bay National Corporation does not have an audit committee financial expert on the audit committee, it is required to explain why that is the case.

The Securities and Exchange Commission has defined an "audit committee financial expert" as a person who has the following attributes:

- An understanding of generally accepted accounting principles and financial statements;

- The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;

- Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the financial statements, or experience actively supervising one or more persons engaged in such activities;

- An understanding of internal controls and procedures for financial reporting; and

o An understanding of audit committee functions.

Bay National Corporation's Board of Directors determined that none of the members of the audit committee meet this definition and, accordingly, the audit committee does not have an "audit committee financial expert." In its proposing release regarding financial experts on audit committees, the Securities and Exchange Commission indicated that a "primary benefit of having a financial expert serving on a company's audit committee is that the person, with his or her enhanced level of financial sophistication or expertise, can serve as a resource for the audit committee as a whole in carrying out its functions."

The Board of Directors believes that the audit committee, as it is presently constituted, is able to carry out its functions fully and in the best interests of stockholders notwithstanding the lack of an audit committee financial expert. In that regard, the Board of Directors believes that the combined knowledge and experience of the committee's four members, as described under the heading "Directors, Executive Officers, Promoters and Control Persons," serve as a valuable resource to that committee. In light of the foregoing, the Board of Directors has no current plans to add a new director to the audit committee who would qualify as an audit committee financial expert.

Compliance with Section 16(a) of the Exchange Act

The Company did not have a class of equity securities registered pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), at any time during the Company's fiscal year ended December 31, 2004. Accordingly, there is no requirement upon the Company's officers, directors and 10% or greater shareholders to file any reports required pursuant to Section 16(a) of the Exchange Act.

Code of Ethics

Bay National Corporation's Board of Directors has adopted a code of ethics that applies to its principal executive officer, principal accounting officer or controller and persons performing similar functions. That Code of Ethics for Senior Financial Officers has been posted on Bay National Bank's internet website at www.baynational.com. A copy of the Code of Ethics for Senior Financial Officers is also included as an exhibit to this annual report.

Item 10. Executive Compensation

Director Compensation

Except for discretionary grants of options to purchase shares of common stock as described below and discretionary payments based on special circumstances, the directors of Bay National Corporation and Bay National Bank were not compensated for their attendance at regularly scheduled or special board meetings or for other services prior to July 2004.

In July 2004, Bay National Bank began paying directors who are not officers or employees of Bay National Corporation or Bay National Bank (e.g., all directors other than Mr. Mohler) ("Qualified Directors") $200 for each attended regularly scheduled meeting and each special meeting of the Board of Directors of Bay National Bank, and $150 for each attended regularly scheduled meeting and each special meeting of a committee of the Board of Directors of Bay National Bank. In addition, the chair of the Executive Committee and the chair of the Audit Committee of the Board of Directors of Bay National Bank received an additional $100 for each attended regularly scheduled meeting and each special meeting. During 2004, Bay National Bank paid (or accrued the payment of) $23,250 for these meeting fees.

During 2004, all Qualified Directors of Bay National Bank were also entitled to reimbursement for their reasonable travel costs related to their attendance at board and committee meetings, and all directors of Bay National Corporation and Bay National Bank are reimbursed for reasonable expenses incurred on behalf of Bay National Corporation and Bay National Bank. During 2004, Bay National Corporation and Bay National Bank did not reimburse any travel costs or expenses.

In December 2004, the Compensation Committee of the Board of Directors of Bay National Bank authorized a special payment of $20,000 to Mr. H. Victor Rieger, Jr., a director of Bay National Corporation and Bay National Bank, in recognition of Mr. Rieger's outstanding service as a key member of Bay National Bank's Executive Committee. Since 2001, Bay National Bank has made annual special payments to Mr. Rieger in recognition of his outstanding service.

Bay National Corporation does not pay cash remuneration to its directors. It is expected that unless and until Bay National Corporation becomes actively involved in additional businesses other than owning all the capital stock of Bay National Bank, no separate cash compensation will be paid to the directors of Bay

National Corporation in addition to that paid to them by Bay National Bank in their capacities as directors of Bay National Bank. However, Bay National Corporation may determine in the future that such separate cash compensation is appropriate.

On January 25, 2005, the Board of Directors of Bay National Corporation and Bay National Bank adopted a formal Director Compensation Policy. The Director Compensation Policy provides for compensation for attendance at meetings and reimbursement of expenses in substantially the same manner as that paid from July 2004 to December 2004 except that directors of Bay National Bank will receive $300 for attended meetings of the Board of Directors instead of $200. The Director Compensation Policy also provides that the Board of Directors or the compensation committee of the Board of Directors of Bay National Bank may authorize discretionary payments to Qualified Directors as a result of outstanding service by the Qualified Director. Furthermore, the Director Compensation Policy provides that the policy may be changed from time to time. A copy of the Director Compensation Policy is included as an exhibit to this annual report.

In November 2001, Bay National Corporation granted each of its then directors options to purchase 3,000 shares of its common stock at $7.58 per share, the then fair market value. A total of 39,000 options were issued. The options vest in four (4) equal installments with the first 25% installment vesting on the third anniversary of the individual director's appointment to Bay National Corporation's Board of Directors. The remaining 25% installments vest on the fourth, fifth, and sixth anniversary of the individual director's appointment to the Board of Directors. As of December 31, 2004, options to purchase 27,000 shares were exercisable. The options expire on November 19, 2009 and none have been exercised.

Executive Compensation

Summary Compensation Table

The following table sets forth the compensation paid by Bay National Corporation and Bay National Bank to the Chief Executive Officer of Bay National Corporation and Bay National Bank and to any other executive officer of Bay National Corporation and Bay National Bank who received compensation in excess of $100,000 during 2004.

Summary Compensation Table

		Annual Compensation			Long Term Compensation		
					Awards		Pay
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Restricted Stock Award(s) ($)	Securities Underlying Options/ SARs (#)	LTIP Payo (
Hugh W. Mohler President and Chief Executive Officer (1)							
	2004	$170,308	$ 30,000	$ 7,500	-	-	
	2003	164,000	-	-	-	-	
	2002	164,000	-	-	-	-	
Mark A. Semanie Executive Vice President and CFO (2)	2004	$155,192	$ 30,000	-	-	-	
	2003	$135,000	$ 30,000	-	-	-	
	2002	$135,000	$ 30,000	-	-	-	

(1) Other compensation includes $7,003, $6,150 and $5,533 of contributions to the Company's 401(k) retirement plan for 2004, 2003 and 2002, respectively, and $651, $648 and $499 of term life insurance premiums paid by the Bank on Mr. Mohler's behalf for 2004, 2003 and 2002, respectively. Other annual compensation for 2004 includes $7,500 which represents the difference between the fair market value of 5,000 shares of common stock purchased upon the exercise of warrants and the $10 per share exercise price of the warrants. The aggregate market value of the stock purchased was $57,500 as of the exercise date of September 16, 2004, based on a sales price of $11.50 per share of Common Stock, which is the sales price at which shares of Common Stock were last sold in over the counter trading on August 31, 2004. The summary of Mr. Mohler's 2004 compensation does not include a bonus of $50,000 approved by the Compensation Committee of the Board of Directors on December 7, 2004 and paid on January 21, 2005.

(2) Other compensation includes $6,651, $5,962 and $5,947 of contributions to the Company's 401(k) retirement plan for 2004, 2003 and 2002, respectively, and $868, $864 and $891 of term life insurance premiums paid by the Bank on Mr. Semanie's behalf for 2004, 2003 and 2002, respectively. The summary of Mr. Semanie's 2004 compensation does not include a bonus of $40,000 approved by the Compensation Committee of the Board of Directors on December 7, 2004 and paid on January 21, 2005.

Aggregate Options Table

The following table sets forth information on the aggregate number of shares of common stock underlying unexercised options held as of December 31, 2004 by Mr. Mohler and Mr. Semanie and the aggregate dollar value of in-the-money unexercised options held as of December 31, 2004 by Mr. Mohler and Mr. Semanie.

Name	Number of Securities Underlying Unexercised Options at December 31, 2004		Value of Unexercised in-the-Money Options at December 31, 2004	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Hugh W. Mohler	18,630	18,631	$ 105,632	$ 105,638
Mark A. Semanie	9,315	9,315	52,816	52,816

The exercise price of these options is $7.58 per share. The market value of the common stock was $13.25 per share, which is the sales price at which shares of common stock were last sold in over the counter trading on December 20, 2004.

Employment Arrangements

Bay National Bank has entered into a written employment agreement with Mr. Mohler dated September 14, 1999, which became effective upon the opening of Bay National Bank on May 12, 2000. Under this agreement, Mr. Mohler serves as the president of Bay National Bank at an initial annual base salary of $154,000, subject to annual review. The Compensation Committee of the Board of Directors of the Bank provided Mr. Mohler with base salary increases of $10,000 beginning with the 2002 calendar year and $36,000 beginning with the 2005 calendar year. Accordingly, Mr. Mohler's current base salary is $200,000. Also, the Compensation Committee of the Board of Directors of the Bank approved discretionary bonuses to Mr. Mohler of $30,000 and $50,000 in December 2003 and 2004, respectively (the agreement is silent with respect to the payment of bonuses to Mr. Mohler). These bonuses were paid in February 2004 and January 2005, respectively.

The agreement had an initial term of three years, automatically renewable for one-year terms unless written notice is provided by either party 90 days before expiration of a term. Written notice was not provided by either party 90 days before the expiration of the term which was set to expire on September 13, 2004 and, accordingly the new term is set to expire on September 13, 2005. It is anticipated that the term set to expire in September 2005 will automatically renew to September 2006.

Bay National Bank may terminate the employment agreement without cause upon 30 days' prior written notice and may terminate the employment agreement for cause at any time without prior notice. Mr. Mohler may terminate his employment agreement at any time upon 30 days' prior written notice. In the event Mr. Mohler is terminated without cause, he will continue to receive salary payments for the earlier of six months from the date of termination or until he has found comparable employment. Mr. Mohler is required to use his best efforts to obtain comparable employment. In the event Bay National Bank elects to terminate the employment agreement at the expiration of a term, Bay National Bank must pay Mr. Mohler his then base salary for three months.

Pursuant to the agreement, if Mr. Mohler is employed by Bay National Bank on the date of a "change of control," he is entitled to a payment of 290% of his "base amount" (as that term is defined in Section 280G(b)(3) of the Internal Revenue Code) from Bay National Bank. In general, the employment

agreement defines "change of control" as: (i) the acquisition by any person of beneficial ownership of forty percent (40%) or more of the outstanding shares of common stock of Bay National Bank or Bay National Corporation; (ii) the election of a majority of the members of the Board of Directors who were not approved or nominated by then incumbent board; or (iii) the approval by the stockholders of Bay National Bank or Bay National Corporation of: (a) a reorganization, merger or consolidation of Bay National Bank or Bay National Corporation, subject to certain exceptions; (b) a liquidation or dissolution of Bay National Bank or Bay National Corporation; or (c) the sale or other disposition of all or substantially all of the assets of Bay National Bank or Bay National Corporation.

If the change of control severance payment were required to be paid in 2005, Mr. Mohler would receive approximately $580,000.

In the employment agreement, Mr. Mohler agrees that for a period of six (6) months after employment with Bay National Bank or any affiliate, he will not, directly or indirectly, own, operate or otherwise be associated with, any financial institution which is located in the Bank's market area. Mr. Mohler also agrees that for a period of one (1) year after employment with Bay National Bank or any affiliate, he will not (i) solicit any person or entity which at the time of his termination was, or within one (1) year prior thereto had been, a customer of Bay National Bank or any of its affiliates or (ii) solicit the employment of any person who was employed by Bay National Bank or any of its affiliates on a full or part time basis at the time of his termination of employment, unless such person (a) was involuntarily discharged by Bay National Bank or the affiliate or (b) voluntarily terminated his relationship with Bay National Bank or the affiliate prior to Mr. Mohler's termination of employment.

Bay National Bank has purchased "key man" life insurance on Mr. Mohler.

Bay National Bank has agreed to employ Mr. Semanie on an at will basis at a rate of pay of $165,000 as of January 1, 2005. Mr. Semanie is also eligible for incentive bonuses at the discretion of the Compensation Committee of the Board of Directors, and is entitled to all benefits available to full time employees of Bay National Bank. Mr. Semanie is not a party to a written agreement with Bay National Bank.

The Compensation Committee of the Board of Directors of the Bank approved discretionary bonuses to Mr. Semanie of $30,000 in December 2001, 2002 and 2003 and $40,000 in December 2004, respectively. These bonuses were paid in the subsequent calendar year.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Securities Authorized For Issuance Under Equity Compensation Plans

The following table sets forth certain information as of December 31, 2004, with respect to compensation plans under which equity securities of Bay National Corporation are authorized for issuance.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options and warrants (a)	Weighted-average exercise price of outstanding options and warrants (b)	N s
Equity compensation plans approved by security holders	147,492	$ 7.67	
Equity compensation plans not approved by security holders	-		
Total	147,492	$ 7.67	

Security Ownership

The following table sets forth the beneficial ownership of Bay National Corporation's common stock as of March 25, 2005 by its directors, executive officers named in the Summary Compensation Table in Item 10 above, directors and officers as a group and persons believed by management to beneficially own more than five percent (5%) of the common stock. The table includes warrants and options beneficially owned by these persons. Unless otherwise noted below, management believes that each person named in the table has the sole voting and sole investment power with respect to each of the shares of common stock reported as beneficially owned by such person.

Name and Address of Beneficial Owner (16)	Number of Shares (16)	Percentage of Class
	18,250	.90%
Carroll A. Bodie (1)		
4005 Greenway		
Baltimore, MD 21218		
Charles E. Bounds (2)		
1707 Upper Millstone Lane		
Salisbury, MD 21801	7,130	.35%
Citizens, Inc.		
P.O. Box 1550		
Butler, PA 16003	163,624	8.11%
Gary T. Gill		
6 Brierleigh Court		
Lutherville, Maryland 21093	5,949	.29%
John R. Lerch (3)		
618 Indian Lane		
Salisbury, MD 21801	45,250	2.42%
Donald G. McClure, Jr. (4)		
24 Dockside Lane		
Key Largo, FL 33037	16,250	.81%
Hugh W. Mohler (5)		
23 Buchanan Road		
Baltimore, MD 21212	83,995	4.16%
Robert L. Moore (6)		
10 79th #403		
Ocean City, MD 21842	9,000	.45%
James P. O'Conor		
2 Fieldspring court		
Lutherville, MD 21093	5,000	.25%

H. Victor Rieger, Jr. (7)		
1015 Ivy Hill Road		
Cockeysville, MD 21030	28,250	1.40%
Margaret K. Riehl (8)		
7A Devon Hill Road		
Baltimore, MD 21210	24,750	1.23%
William B. Rinnier (9)		
616 Manor Drive		
Salisbury, MD 21801	14,750	.73%
Edwin A. Rommel, III (10)		
5281 Silver Run Lane		
Salisbury, MD 21801	32,750	1.62%

Mark A. Semanie (11) 1200 Corinthian Court Bel Air, MD 21014	10,995	.55%
Henry H. Stansbury (12) 6200 Foxhall Farm Road Catonsville, MD 21228	41,050	2.04%
Kenneth H. Trout (13) 804 Hillstead Drive Lutherville, MD 21093	4,250	.21%
Eugene M. Waldron, Jr. (14) 5309 Woodlawn Avenue Chevy Chase, MD 20815	42,250	2.09%
Carl A.J. Wright 8609 Marburg Manor Drive Lutherville, MD 21093	14,000	.69%
All directors and executive officers as a group: Seventeen persons	403,869	20.01%

(1) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005.

(2) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005.

(3) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005. Includes 6,000 shares held by LFI partnership, of which Mr. Lerch is a general partner; and 3,000 shares held by Mr. Lerch's spouse. Mr. Lerch disclaims beneficial ownership as to the shares held by his spouse.

(4) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in April 2006. Includes 9,000 shares held in trust for the benefit of Mr. McClure's children for which Mr. McClure is a co-trustee.

(5) Includes 30,195 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 10,066 shares issuable upon the exercise of options that are exercisable starting in June 2005. Includes 1,000 shares held by Mr. Mohler's spouse. Mr. Mohler disclaims beneficial ownership as to the shares held by his spouse.

(6) Includes 1,500 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 1,500 shares issuable upon the exercise of options that are exercisable starting in February 2006.

(7) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable

upon the exercise of options that are exercisable starting in June 2005. Includes 1,000 shares held by Mr. Rieger's spouse. Mr. Rieger disclaims beneficial ownership as to the shares held by his spouse.

(8) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005. Includes 1,000 shares held by Mrs. Riehl's spouse. Mrs. Riehl disclaims beneficial ownership as to the shares held by her spouse.

(9) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in August 2005. Includes 3,000 shares held by Mr. Rinnier's spouse, and 2,000 shares held by Mr. Rinnier's children. Mr. Rinnier disclaims beneficial ownership as to the shares held by his spouse and his children.

(10) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005.

(11) Includes 9,315 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 9,315 shares issuable upon the exercise of options that are exercisable starting in October 2005.

(12) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005. Includes 12,500 shares held by Mr. Stansbury's spouse. Mr. Stansbury disclaims beneficial ownership as to the shares held by his spouse.

(13) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in October 2005.

(14) Includes 2,250 shares issuable upon the exercise of options that are exercisable within 60 days of March 25, 2005. Excludes 750 shares issuable upon the exercise of options that are exercisable starting in June 2005. Includes 3,000 shares held by Mr. Waldron's children. Mr. Waldron disclaims beneficial ownership as to the shares held by his children.

(15) All of the named individuals, other than Mr. Semanie, are directors of Bay National Corporation. Mr. Mohler is a director and executive officer of Bay National Corporation.

The number of shares beneficially owned includes shares of common stock subject to held by the named persons that are exercisable as of, or within 60 days of, March 25, 2005. Such shares are deemed outstanding for the purpose of computing the percentage ownership of the person holding the options or warrants, but are not deemed outstanding for the purpose of computing the percentage ownership of any other person.

In November 2001, Bay National Corporation granted each of its then directors, including Mr. Mohler, options to purchase 3,000 shares of Bay National Corporation common stock at $7.58 per share, the then fair market value. A total of 39,000 options were issued. The options vest in four (4) equal installments with the first 25% installment vesting on the third anniversary of the individual director's appointment to the Board of Directors of Bay National Corporation. The remaining 25% installments vest on the fourth, fifth and sixth anniversary of the individual director's appointment to the Board of Directors of Bay National Corporation. A total of 28,500 of these options to purchase shares were exercisable as of, or within 60 days of March 25, 2005. The options expire on November 19, 2009 and none have been exercised.

In November 2001, Mr. Mohler was granted options to purchase 37,261 shares of Bay National Corporation common stock, and Mr. Semanie was granted options to purchase 18,630 shares of Bay National Corporation common stock. The options vest in four (4) equal installments with the first 25% installment vesting on the third anniversary of the officer's date of employment with Bay National Bank. The remaining 25% installments vest on the fourth, fifth and sixth anniversary of the individual officer's date of employment with Bay National Bank. A total of 37,260 of these options to purchase shares were exercisable as of, or within 60 days of, March 25, 2005. The options expire on November 19, 2009. They are exercisable at $7.58 per share. None have been exercised.

Item 12. Certain Relationships and Related Transactions

Prior to Bay National Corporation's initial public offering, the organizers of Bay National Corporation and Bay National Bank and certain other investors purchased an aggregate of 112,500 shares of Bay National Corporation's common stock at a purchase price of $10.00 per share. The primary purpose of this "organizational offering" was to provide Bay National Corporation and Bay National Bank with the capital necessary to fund some of the initial organizational and prepaid operating expenses.

In recognition of the financial and organizational risk undertaken by the purchasers in the organizational offering, on September 10, 1999, the purchasers in the organizational offering received, for no additional consideration, a warrant to purchase one share of common stock at $10.00 per share for every two

shares that they purchased in the organizational offering. As a result, Bay National Corporation issued warrants to purchase an aggregate of 56,250 shares of common stock to the purchasers in the organizational offering.

The warrants became exercisable on April 30, 2001 and were exercisable in whole or in part until November 16, 2004. Prior to expiration on November 16, 2004, 55,000 of the warrants were exercised. The remaining 1,250 warrants expired. Bay National Corporation received an aggregate of $550,000 from the exercise of the warrants.

Lucy Mohler, the spouse of Hugh W. Mohler, serves as Bay National Corporation's and Bay National Bank's Vice President of Marketing and Investor Relations. Ms. Mohler earned an aggregate compensation of $64,371 plus benefits valued at $2,932 during 2003 and aggregate compensation of $72,308, plus benefits valued at $3,239, during 2004 from Bay National Bank.

Matthew Waldron and Bradford Wright, the sons of directors Eugene Waldron and Carl A.J. Wright, respectively, became employees of Bay National Bank during 2004. Neither of them earned aggregate compensation in excess of $60,000 during 2004.

Director John R. Lerch owns a 100% interest in the property being leased for Bay National Bank's Salisbury, Maryland branch office. This lease, which became effective as of September 1, 1999, was for a term of five years with Bay National Corporation having the option to extend the term for three five-year renewal terms. During the initial lease term, Bay National Corporation paid monthly rent of approximately $1,980, plus all real estate taxes and utilities. Bay National Corporation exercised its option to extend this lease and it will now terminate on August 31, 2009, unless extended. During the new lease term, Bay National Corporation will pay monthly rent of approximately $2,292, plus all real estate taxes and utilities. Pursuant to this lease, Bay National Corporation has a right of first refusal to purchase the building in the event the landlord receives a bona fide offer to sell. Bay National Corporation paid Mr. Lerch $23,756 during 2003 and $25,004 during 2004.

At the time of entering into the lease in 1999, Bay National Corporation believed that the lease rate was at fair market value, based, in part, on an evaluation of the lease terms by William E. Martin of ERA Martin Associates, a Salisbury-based real estate brokerage firm. Bay National Corporation engaged Mr. Martin to review the lease terms for the purpose of determining whether the terms were consistent with the lease terms for similar properties in the downtown Salisbury area. Although Bay National Corporation did not have an independent third party reevaluate the lease terms in connection with the renewal, management believes that the terms of the lease are at least as favorable as could be obtained from an independent third party.

Director Gary T. Gill is president and chief executive officer of the MacKenzie Companies, which owns the property being leased for Bay National Bank's Lutherville, Maryland corporate and branch offices. Bay National Corporation is a party to two leases with this landlord dated July 16, 1999. These leases were amended during February and October 2004 to add additional space and extended in October 2004 to February 28, 2010. Bay National Corporation has the right to extend the leases for one additional five year term, to February 28, 2015. The amendments also effectively combined both leases.

As of December 31, 2004, Bay National Corporation was leasing 1,712 square feet on the first floor of the building and 6,206 square feet on the third floor of the building, and was paying $19,425 in monthly rent,

which includes Bay National Corporation's share of taxes and building operating costs. Bay National Corporation paid the landlord $170,099 during 2003 and $202,945 during 2004.

The leases were originally entered into well in advance of Mr. Gill's appointment to the Board of Directors in January 2003. Although Bay National Corporation did not have an independent third party reevaluate the lease terms in connection with the renewal, management believes that the terms of the lease are at least as favorable as could be obtained from an independent third party.

Some of Bay National Bank's directors and officers and the business and professional organizations with which they are associated have banking transactions with Bay National Bank in the ordinary course of business. It is Bay National Bank's policy that any loans and loan commitments will be made in accordance with applicable laws and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of comparable credit standing. Loans to directors and officers must comply with Bay National Bank's lending policies and statutory lending limits; directors with a personal interest in any loan application will be excluded from considering any such loan application.

The officers and directors of Bay National Corporation and Bay National Bank have loans due to Bay National Bank in the amount of $5,828,095 at December 31, 2004 and $4,672,104 at December 31, 2003. All loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unaffiliated third parties and do not involve more than the normal risk of repayment or present other unfavorable features.

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Item 13. Exhibits

The following exhibits are filed with or incorporated by reference into this report.

Exhibit No.	Description of Exhibit
3.1*	Articles of Incorporation of Bay National Corporation
3.2*	Bylaws of Bay National Corporation
4.1*	Rights of Holders of Common Stock (as contained in Exhibit 3.1)
4.2*	Form of Common Stock Certificate
10.1	Employment Agreement between Bay National Bank and Hugh W. Mohler
10.2	Terms of December 2005 Amendment to Employment Agreement between Bay National Bank and Hugh W. Mohler
10.3	Terms of Employment Relationship between Bay National Bank and Mark A. Semanie
10.4**	Bay National Corporation Stock Option Plan
10.5**	Form of Incentive Stock Option Agreement for Stock Option Plan
10.6#	Bay National Corporation and Bay National Bank Director Compensation Policy
10.7*	Office Lease Agreement dated July 16, 1999 between Bay National Corporation and Joppa Green II Limited Partnership
10.8*	Office Lease Agreement dated July 16, 1999 between Bay National Corporation and Joppa Green II Limited Partnership
10.9##	Amendment to Lease Agreement dated February 12, 2004 between Bay National Corporation and Joppa Green II Limited Partnership

10.10##	Amendment to Lease Agreement dated October 5, 2004 between Bay National Corporation and Joppa Green II Limited Partnership
10.11##	Amendment to Lease Agreement dated January 3, 2005 between Bay National Corporation and Joppa Green II Limited Partnership
10.12##	Amendment to Lease Agreement dated March 7, 2005 between Bay National Corporation and Joppa Green II Limited Partnership
10.13*	Lease Agreement dated September 16, 1999 between Bay National Corporation and John R. Lerch and Thomas C. Thompson
14@	Code of Ethics for Senior Financial Officers
21.1	Subsidiaries of Bay National Corporation
23.1	Consent of Stegman & Company
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The exhibits which are denominated with an asterisk (*) were previously filed by Bay National Corporation as a part of, and are hereby incorporated by reference from, Bay National Corporation's Registration Statement on Form SB-2, as amended, under the Securities Act of 1933, Registration Number 333-87781.

The exhibit which are denominated by two asterisks (**) were previously filed by Bay National Corporation as a part of, and is hereby incorporated by reference from, Bay National Corporation's Registration Statement on Form S-8, as amended, under the Securities Act of 1933, Registration Number 333-69428.

The exhibit which is denominated by the at sign (@) was previously filed by Bay National Corporation as a part of, and is hereby incorporated by reference from, Bay National Corporation's Annual Report on Form 10-KSB, as amended, filed on March 30, 2004.

The exhibit which is denominated by the number sign (#) was previously filed by Bay National Corporation as a part of, and is hereby incorporated by reference from, Bay National Corporation's Current Report on Form 8-K filed on January 26, 2005.

The exhibit which is denominated by two number signs (##) was previously filed by Bay National Corporation as a part of, and is hereby incorporated by reference from, Bay National Corporation's Current Report on Form 8-K filed on March 11, 2005.

Note: Exhibits 10.1 through 10.6 relate to management contracts or compensatory plans or arrangements.

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Item 14. Principal Accountant Fees and Services.

Audit and Non-Audit Fees

The following table presents fees for professional audit services rendered by Stegman & Company for the audit of Bay National Corporation's annual consolidated financial statements for the years ended December 31, 2004 and December 31, 2003 and fees billed for other services rendered by Stegman & Company during those periods.

	Years Ended December 31	
	2004	2003
Audit Fees (1)	$ 37,669	$ 34,151
Audit Related Fees (2)	-	-
Tax Fees (3)	4,000	4,000
All Other Fees (4)	-	-
Total	$ 41,669	$ 38,151

(1) Audit Fees consist of fees billed for professional services rendered for the audit of the Company's consolidated annual financial statements and review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by Stegman & Company in connection with statutory and regulatory filings or engagements.

(2) Audit-Related Fees would normally consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements and are not reported under "Audit Fees."

(3) Tax Fees consist of fees billed for professional services rendered for federal and state tax compliance, tax advice and tax planning.

(4) All Other Fees would normally consist of fees for services other than the services reported above.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of Independent Auditor

Before the accountant is engaged by Bay National Corporation or Bay National Bank to render any audit or non-audit services, the engagement is approved by Bay National Corporation's audit committee.

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SIGNATURES

In accordance with Section 13 or 15(d) 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: March 25, 2005

By: /s/ Hugh W. Mohler

Hugh W. Mohler, President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Position	Date
/s/ Hugh W. Mohler Hugh W. Mohler	Director and President (Principal Executive Officer)	Marc
/s/ Mark A. Semanie. Mark A. Semanie	Executive Vice President and CFO (Principal Accounting and Financial Officer)	Marc
/s/Carroll A. Bodie. Carroll A. Bodie	Director	Marc
/s/ Charles E. Bounds Charles E. Bounds	Director	Marc
/s/ Gary T. Gill Gary T. Gill	Director	Marc
/s/ John R. Lerch John R. Lerch	Director	Marc
/s/ Donald G. McClure, Jr.	Director	
/s/ Robert L. Moore Robert L. Moore	Director	Marc
/s/ James P. O'Conor James P. O'Conor	Director	Marc
/s/ H. Victor Rieger, Jr. H. Victor Rieger, Jr.	Director	Marc

/s/________________________________ Margaret Knott Riehl	Director	
/s/ William B. Rinnier ---------------------- William B. Rinnier	Director	Marc
/s/ Edwin A. Rommel --------------------- Edwin A. Rommel, III	Director	Marc
/s/ Henry H. Stansbury ---------------------- Henry H. Stansbury	Director	Marc
/s/ Kenneth H. Trout -------------------- Kenneth H. Trout	Director	Marc
/s/________________________________ Eugene M. Waldron, Jr.	Director	
/s/ Carl A. J. Wright --------------------- Carl A.J. Wright	Director	Marc

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SUPPLEMENTAL INFORMATION TO BE FURNISHED WITH REPORTS FILED PURSUANT TO SECTION 15(D) OF THE EXCHANGE ACT BY NON-REPORTING ISSUERS

Subsequent to the date of this filing, Bay National Corporation intends to provide proxy materials and an annual report to its security holders in connection with its annual meeting of security holders. A copy of such proxy materials and annual report will be furnished to the Securities and Exchange Commission for its information and Bay National Corporation understands that such materials will not be considered to be filed or subject to the liabilities of Section 18 of the Exchange Act.

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