AUBURN NATIONAL BANCORPORATION INC
Form 10-Q
May 15, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended March 31, 2008

¨ Transition report pursuant to Section 13 or 15(d) of the Exchange Act
For the transition period ______ to ______

Commission File Number: 0-26486

Auburn National Bancorporation, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**63-0885779**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

100 N. Gay Street

Auburn, Alabama 36830

(334) 821-9200

(Address and telephone number of principal executive offices)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x (Do not check if a smaller reporting company) Smaller reporting company ¨

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

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

Class	Outstanding at April 30, 2008
Common Stock, $0.01 par value per share	3,680,809 shares

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except share data)	March 31, 2008	December 31, 2007
Assets:		
Cash and due from banks	$ 16,614	$ 13,312
Federal funds sold	23,071	50
Interest bearing bank deposits	101	136
Cash and cash equivalents	39,786	13,498
Securities available-for-sale	322,843	318,373
Loans held for sale	3,731	2,978
Loans, net of unearned income	331,083	322,411
Allowance for loan losses	(4,074)	(4,105)
Loans, net	327,009	318,306
Premises and equipment, net	6,350	6,423
Bank-owned life insurance	14,947	14,825
Other assets	14,240	14,256
Total assets	$ 728,906	$ 688,659
Liabilities:		
Deposits:		
Noninterest-bearing	$ 74,236	$ 70,241
Interest-bearing	463,207	422,344
Total deposits	537,443	492,585
Federal funds purchased and securities sold under agreements to repurchase	7,471	24,247
Long-term debt	123,381	115,386
Accrued expenses and other liabilities	4,319	3,423
Total liabilities	672,614	635,641
Stockholders equity:		
Preferred stock of $.01 par value; authorized 200,000 shares; issued shares - none		
Common stock of $.01 par value; authorized 8,500,000 shares; issued 3,957,135 shares	39	39
Additional paid-in capital	3,748	3,748
Retained earnings	56,532	55,362
Accumulated other comprehensive income (loss), net	1,707	(397)
Less treasury stock, at cost - 275,326 shares for March 31, 2008 and December 31, 2007, respectively	(5,734)	(5,734)

Total stockholders equity	56,292	53,018
Total liabilities and stockholders equity	$ 728,906	$ 688,659

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(Unaudited)

(Dollars in thousands, except share and per share data)	Three Months Ended March 31 2008	2007
Interest income:		
Loans, including fees	$ 6,019	$ 5,695
Securities	3,913	3,517
Federal funds sold and interest bearing bank deposits	24	95
Total interest income	9,956	9,307
Interest expense:		
Deposits	4,069	4,120
Short-term borrowings	96	197
Long-term debt	1,253	1,035
Total interest expense	5,418	5,352
Net interest income	4,538	3,955
Provision for loan losses	60	3
Net interest income after provision for loan losses	4,478	3,952
Noninterest income:		
Service charges on deposit accounts	311	328
Servicing fees	79	89
Gain on sale of loans held for sale	174	176
Bank-owned life insurance	122	141
Securities gains, net	43	11
Other	427	443
Total noninterest income	1,156	1,188
Noninterest expense:		
Salaries and benefits	1,853	1,735
Net occupancy and equipment	306	294
Professional fees	158	134
Other	832	740
Total noninterest expense	3,149	2,903
Earnings before income taxes	2,485	2,237
Income tax expense	634	559
Net earnings	$ 1,851	$ 1,678
Net earnings per share:		
Basic and diluted	$ 0.50	$ 0.45

Weighted average shares outstanding:		
Basic and diluted	3,681,809	3,739,803

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders Equity and Comprehensive Income

(Unaudited)

(Dollars in thousands, except share and per share data)	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Total
Balance, December 31, 2006	3,957,135	$ 39	$ 3,748	$ 51,087	$ (2,335)	$ (4,121)	$ 48,418
Comprehensive income:							
Net earnings				1,678			1,678
Other comprehensive income due to change in net unrealized gain (loss) on securities available-for-sale					879		879
Total comprehensive income				1,678	879		2,557
Cash dividends paid ($0.175 per share)				(653)			(653)
Stock repurchases (8,084 shares)						(233)	(233)
Balance, March 31, 2007	3,957,135	$ 39	$ 3,748	$ 52,112	$ (1,456)	$ (4,354)	$ 50,089
Balance, December 31, 2007	3,957,135	$ 39	$ 3,748	$ 55,362	$ (397)	$ (5,734)	$ 53,018
Comprehensive income:							
Net earnings				1,851			1,851
Other comprehensive income due to change in net unrealized gain (loss) on securities available-for-sale					2,104		2,104
Total comprehensive income				1,851	2,104		3,955
Cash dividends paid ($0.185 per share)				(681)			(681)
Balance, March 31, 2008	3,957,135	$ 39	$ 3,748	$ 56,532	$ 1,707	$ (5,734)	$ 56,292

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Three Months Ended March 31 2008	2007
Cash flows from operating activities:		
Net earnings	$ 1,851	$ 1,678
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	60	3
Depreciation and amortization	90	100
Premium amortization and discount accretion, net	(23)	54
Net (gain) loss on securities available for sale transactions	(43)	602
Net gain on sale of loans held for sale	(174)	(176)
Gain on sale of privately-held stock investments		(613)
Loans originated for sale	(24,805)	(24,780)
Proceeds from sale of loans	24,226	23,594
Increase in cash surrender value of bank owned life insurance	(122)	(141)
Net decrease (increase) in other assets	64	(694)
Net (decrease) increase in accrued expenses and other liabilities	(242)	606
Net cash provided by operating activities	882	233
Cash flows from investing activities:		
Proceeds from maturities of securities held- to- maturity		25
Proceeds from sales of securities available-for-sale	14,532	16,014
Proceeds from maturities of securities available-for-sale	29,386	12,842
Purchase of securities available-for-sale	(44,815)	(23,456)
Net increase in loans	(9,086)	(778)
Net purchases of premises and equipment	(7)	(137)
Proceeds from sale of privately-held stock investment		1,146
Net cash (used in) provided by investing activities	(9,990)	5,656
Cash flows from financing activities:		
Net increase (decrease) in noninterest-bearing deposits	3,995	(1,001)
Net increase in interest-bearing deposits	40,863	24,571
Net decrease in federal funds purchased and securities sold under agreements to repurchase	(16,776)	(7,453)
Proceeds from issuance of long-term debt	8,000	
Net decrease in other short-term borrowings		(10,000)
Repayments or retirement of long-term debt	(5)	(5)
Purchase of treasury stock		(233)
Dividends paid	(681)	(653)
Net cash provided by financing activities	35,396	5,226
Net change in cash and cash equivalents	26,288	11,115
Cash and cash equivalents at beginning of period	13,498	17,026
Cash and cash equivalents at end of period	$ 39,786	$ 28,141

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 5,123	$ 5,365
Income taxes	110	523
Supplemental disclosure of non-cash transactions:		
Real estate acquired through foreclosure	323	

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements

NOTE 1: BASIS OF PRESENTATION

General

Auburn National Bancorporation, Inc. (the Company) provides a full range of banking services to individual and corporate customers in Lee County, Alabama and surrounding counties through its subsidiary, AuburnBank (the Bank). The Company does not have any segments other than banking that are considered material.

The unaudited condensed consolidated financial statements in this report have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include, in the opinion of management, all adjustments necessary to present a fair statement of the financial position and the results of operations for all periods presented. All such adjustments are of a normal recurring nature. The results of operations as of and for the three months ended March 31, 2008, are not necessarily indicative of the results of operations that the Company and its subsidiaries may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company s annual report on Form 10-K for the year ended December 31, 2007.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no effect on the Company s previously reported net earnings or total stockholders equity.

NOTE 2: BASIC AND DILUTED EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the three months ended March 31, 2008 and 2007, respectively. Diluted net earnings per share reflect the potential dilution that could occur if the Company s potential common stock was issued. At March 31, 2008 and 2007, respectively, the Company had no options issued or outstanding.

A reconciliation of the numerator and denominator of the basic earnings per share computation to the diluted earnings per share computation for the three months ended March 31, 2008 and 2007, respectively, is presented below.

	Three Months Ended March 31	
(Dollars in thousands, except share and per share data)	**2008**	**2007**
Basic:		
Net earnings	$ 1,851	$ 1,678
Average common shares outstanding	3,681,809	3,739,803
Earnings per share	$ 0.50	$ 0.45
Diluted:		
Net earnings	$ 1,851	$ 1,678
Average common shares outstanding	3,681,809	3,739,803
Dilutive effect of options issued		
Average diluted shares outstanding	3,681,809	3,739,803
Earnings per share	$ 0.50	$ 0.45

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NOTE 3: COMPREHENSIVE INCOME

Comprehensive income is defined as the change in equity from all transactions other than those with stockholders, and it includes net earnings and other comprehensive income (loss). Comprehensive income for the three months ended March 31, 2008 and 2007 is presented below.

(In thousands)	**Three Months Ended March 31 2008**	**2007**
Comprehensive income:		
Net earnings	$ 1,851	$ 1,678
Other comprehensive income:		
Change in net unrealized gain (loss) on securities available-for-sale	2,104	879
Total comprehensive income	$ 3,955	$ 2,557

NOTE 4: SECURITIES

The fair value and amortized cost for securities available-for-sale at March 31, 2008, by contractual maturity are presented below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without prepayment penalties.

	March 31, 2008							
(Dollars in thousands)	**1 year or less**	**1 to 5 years**	**5 to 10 years**	**After 10 years**	**Fair Value**	**Gross Unrealized Gains**	**Losses**	**Amortized cost**
Available-for-sale:								
U.S. government agencies, excluding mortgage-backed securities	$ 1,002	3,055	27,859	60,209	92,125	2,047		90,078
State and political subdivisions	436	70	13,076	49,835	63,417	793	430	63,054
Corporate securities		2,528	1,011	9,717	13,256	38	121	13,339
Collateralized mortgage obligations			2,178	9,551	11,729	23	107	11,813
Mortgage-backed securities		13,609	21,588	107,119	142,316	1,060	459	141,715
Total available-for-sale	$ 1,438	19,262	65,712	236,431	322,843	3,961	1,117	319,999
Weighted average yield:								
U.S. government agencies, excluding mortgage-backed securities	3.77%	5.25%	5.25%	5.46%	5.37%			
State and political subdivisions	3.62%	7.64%	6.03%	6.06%	6.04%			
Corporate securities		6.75%	6.01%	6.59%	6.57%			
Collateralized mortgage obligations			3.98%	5.03%	4.83%			
Mortgage-backed securities		3.86%	3.75%	4.99%	4.69%			
Total available-for-sale	3.72%	4.47%	4.88%	5.40%	5.23%			

Securities with an aggregate fair value of $228.9 million and $193.7 million at March 31, 2008 and December 31, 2007, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, structured securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, and for other purposes required or permitted by law.

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Yields related to tax-exempt securities are stated on a fully tax-equivalent basis using an income tax rate of 34%.

On a quarterly basis, the Company makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired. The Company considers many factors including the severity and duration of the impairment; the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value; recent events specific to the issuer or industry; external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss in securities gains (losses).

Gross unrealized losses on securities at March 31, 2008 were primarily attributable to interest rate changes. The Company has reviewed these securities and does not consider them other-than-temporarily impaired.

Gross gains realized on the sale of securities available-for-sale for the three months ended March 31, 2008 were $43 thousand. Gross losses realized on the sale of securities available-for-sale for the three months ended March 31, 2007 were $602 thousand.

The fair value and amortized cost for securities available-for-sale at December 31, 2007, by contractual maturity are presented below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without prepayment penalties.

	December 31, 2007							
						Gross Unrealized		
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gains	Losses	Amortized cost
Available-for-sale:								
U.S. government agencies, excluding mortgage-backed securities	$ 6,475	20,100	27,314	54,372	108,261	951	54	107,364
State and political subdivisions	433	69	11,762	46,551	58,815	560	320	58,575
Corporate securities		2,528	1,011	9,320	12,859	56	118	12,921
Collateralized mortgage obligations			2,304	9,916	12,220	33	189	12,376
Mortgage-backed securities		12,942	20,588	92,688	126,218	189	1,770	127,799
Total available-for-sale	$ 6,908	35,639	62,979	212,847	318,373	1,789	2,451	319,035
Weighted average yield:								
U.S. government agencies, excluging mortgage-backed securities	3.74%	4.49%	5.26%	5.69%	5.24%			
State and political subdivisions	3.62%	7.64%	6.04%	6.10%	6.07%			
Corporate securities		6.75%	6.01%	6.72%	6.67%			
Collateralized mortgage obligations			4.04%	4.97%	4.79%			
Mortgage-backed securities		3.95%	3.67%	4.99%	4.67%			
Total available-for-sale	3.73%	4.46%	4.85%	5.49%	5.21%			

NOTE 5: INCOME TAXES

As of March 31, 2008 and December 31, 2007, the Company had no unrecognized tax benefits related to federal or state income tax matters.

As of March 31, 2008 and December 31, 2007, the Company has accrued no interest and no penalties related to uncertain tax positions. It is the Company s policy to recognize interest and penalties related to income tax matters in income tax expense.

The Company and its subsidiaries file a consolidated U.S. federal income tax return. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2004 through 2007. The Company is currently open to audit by the state of Alabama for the years ended December 31, 2003, through 2007, although certain matters have been closed.

NOTE 6: FAIR VALUE DISCLOSURES

The Company adopted the provisions of Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), effective January 1, 2008. Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on quoted prices for similar assets or liabilities in active markets, valuations based on quoted prices for similar assets or liabilities in markets that are not active or valuations based on inputs other than quoted prices for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The Company s assets recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS No. 157. At March 31, 2008 the Company had no liabilities recorded at fair value on a recurring basis. In addition, at March 31, 2008 the Company had no assets where the fair value measurement required the use of significant unobservable inputs or Level 3 inputs.

The fair value hierarchy as of March 31, 2008 for the Company s assets measured at fair value on a recurring basis is presented on the following page.

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Assets Measured at Fair Value on a Recurring Basis

(Dollars in thousands)	Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At March 31, 2008:				
Securities available-for-sale	$ 322,843		322,843	

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is designed to provide a better understanding of various factors related to the results of operations and financial condition of the Auburn National Bancorporation, Inc. (the Company) and its wholly-owned subsidiary, AuburnBank (the Bank). This discussion is intended to supplement and highlight information contained in the accompanying unaudited consolidated financial statements for the three months ended March 31, 2008 and March 31, 2007.

Certain of the statements made herein under the caption MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, and elsewhere, including information incorporated herein by reference to other documents, are forward-looking statements within the meaning of, and subject to the protections of Section 27A of the Securities Act of 1933, as amended, (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act).

Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions, and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as may, will, anticipate, assume, should, desired, indicate, would, belie contemplate, expect, seek, estimate, evaluate, continue, plan, point to, project, predict, could, intend, target, potenti and expressions of the future. These forward-looking statements may not be realized due to a variety of factors, including, without limitation:

- future economic, business and market conditions; domestic and foreign;
- government monetary and fiscal policies;
- legislative and regulatory changes, including changes in banking, securities and tax laws and regulations, and their application by governmental authorities;
- changes in accounting policies, rules and practices;
- the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities and interest sensitive assets and liabilities;
- credit risks of borrowers;
- changes in the prices, values, sales volumes and liquidity of residential and commercial real estate, as well as securities;
- the failure of assumptions underlying the establishment of reserves for possible loan losses and other estimates;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment, and insurance services;

the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of effecting such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;

changes in the availability and cost of credit and capital in the financial markets;

changes in the prices, values, sales volumes and liquidity of residential and commercial real estate, as well as securities;

changes in accounting policies, rules and practices;

changes in technology or products may be more difficult or costly, or less effective, than anticipated;

the effects of war or other conflicts, acts of terrorism or other events that may affect general economic conditions and economic confidence; and

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other factors and information in this report and other filings that we make with the SEC under the Exchange Act, including our annual report on Form 10-K for the year ended December 31, 2007 and subsequent quarterly and current reports. See Part II, Item 1A, RISK FACTORS.

All written or oral forward-looking statements that are made by or attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

Business

Auburn National Bancorporation, Inc. (the Company) is a one-bank holding company established in 1984, and incorporated under the laws of the State of Delaware. AuburnBank (the Bank), the Company s principal subsidiary, is an Alabama state-chartered bank that is a member of the Federal Reserve System and has operated continuously since 1907. Both the Company and the Bank are headquartered in Auburn, Alabama. The Bank conducts its business in East Alabama, including Lee County and surrounding areas. The Bank operates full-service branches in Auburn, Opelika, Hurtsboro and Notasulga, Alabama. In-store branches are located in the Auburn and Opelika Kroger stores, as well as Wal-Mart SuperCenter stores in Auburn, Opelika and Phenix City, Alabama. Mortgage loan offices are located in Phenix City, Valley, and Mountain Brook, Alabama.

Summary of Results of Operations ***(In thousands, except per share amounts)***	**Three Months Ended March 31** **2008**	 **2007**
Net interest income (GAAP)	$ 4,538	$ 3,955
Tax-equivalent adjustment	321	268
Net interest income	4,859	4,223
Noninterest income	1,156	1,188
Total revenue	6,015	5,411
Provision for loan losses	60	3
Noninterest expense	3,149	2,903
Income tax expense	634	559
Tax-equivalent adjustment	321	268
Net earnings	1,851	1,678
Basic and diluted earnings per share	$ 0.50	$ 0.45

Financial Summary

The Company s first quarter 2008 net earnings were $1.9 million, an increase of 10% from the same period of 2007, and basic and diluted earnings per share were up 11% to $0.50.

In the first quarter of 2008, total revenue (on a tax-equivalent basis) was approximately $6.0 million, an increase of 11% from the first quarter of 2007. Net interest income (on a tax-equivalent basis) was approximately $4.9 million for the first quarter of 2008, an increase of 15% from the first quarter of 2007, reflecting growth in the loan portfolio.

Credit quality continues to be strong, with an annualized net charge-offs ratio of 0.11%. Nonperforming assets increased to 1.53% of total loans at March 31, 2008, however, the increase was primarily due to one loan participation in the amount of $4.5 million that was placed on nonaccrual in the first quarter of 2008. Excluding the effects of this loan participation, nonperforming assets were only 0.18% of total loans. Management is closely monitoring this loan participation, which is secured by a completed Gulf Coast condominium project. Management currently believes the level of the allowance for loan losses is adequate to absorb inherent losses in the loan portfolio, including this loan participation. The provision for loan losses increased $57 thousand in the

first quarter of 2008 compared with the first quarter of 2007. This increase is primarily due to net charge-offs of $91 thousand in the first quarter of 2008, compared to a net recovery of $76 thousand in the first quarter of 2007.

Average loans and loans held for sale increased 16.9% in the first quarter of 2008 from the first quarter of 2007 to $332.7 million. Average total securities increased 6.8% in the first quarter of 2008 from the first quarter of 2007 to $318.3 million. Average total deposits increased 7.3% in the first quarter of 2008 from the first quarter of 2007 to $511.4 million.

Noninterest expense increased 8% in the first quarter of 2008 from the first quarter of 2007, largely reflecting increases in salaries and benefits expense and other noninterest expense.

In the first quarter of 2008, the Company paid cash dividends of $681 thousand, or $ 0.185 per share, and our dividend payout ratio was 37.00%. The Company s balance sheet remains strong and well capitalized under regulatory guidelines with a tier 1 capital ratio of 14.64% and a leverage ratio of 8.82% at March 31, 2008.

Critical Accounting Policies

The accounting and financial policies of the Company conform to U.S. generally accepted accounting principles and to general practices within the banking industry. The allowance for loan losses is an accounting policy applied by the Company which is deemed critical. Critical accounting policies are defined as policies which are important to the portrayal of the Company s financial condition and results of operations, and that require management s most difficult, subjective or complex judgments. These estimates and judgments involve significant uncertainties, and are susceptible to change. If different conditions exist or occur- depending upon the magnitude of the changes; then our actual financial condition and financial results could differ significantly. For a more detailed discussion on these critical accounting policies, see CRITICAL ACCOUNTING POLICIES on pages 25 26 of the Company s annual report on Form 10-K for the year ended December 31, 2007.

Average Balance Sheet and Interest Rates

	Three Months Ended March 31			
	2008		2007	
(Dollars in thousands)	Average Balance	Yield/ Rate	Average Balance	Yield/ Rate
Loans and loans held for sale	$ 332,741	7.28%	$ 284,541	8.12%
Securities - taxable	259,046	5.11%	247,561	4.91%
Securities - tax-exempt	59,247	6.41%	50,573	6.34%
Total securities	318,293	5.35%	298,134	5.15%
Federal funds sold	2,513	2.40%	7,095	4.97%
Interest bearing bank deposits	758	4.78%	946	3.43%
Total interest-earning assets	654,305	6.32%	590,716	6.57%
Deposits:				
NOW	65,478	2.46%	61,308	2.49%
Savings and money market	127,208	2.29%	143,498	3.99%
Certificates of deposits less than $100,000	90,937	5.34%	84,191	5.14%
Certificates of deposits and other time deposits of $100,000 or more	157,737	4.43%	117,466	4.37%
Total interest-bearing deposits	441,360	3.71%	406,463	4.11%
Short-term borrowings	13,541	2.85%	15,592	5.12%
Long-term debt	116,581	4.32%	90,530	4.64%
Total interest-bearing liabilities	571,482	3.81%	512,585	4.23%
Net interest income and margin	$ 4,859	2.99%	$ 4,223	2.90%

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RESULTS OF OPERATIONS

Net Interest Income and Margin

Tax-equivalent net interest income increased 15% in the first quarter of 2008 from the first quarter of 2007, reflecting growth in the loan portfolio. Net interest margin increased 9 basis points to 2.99%.

The tax-equivalent yield on total interest earning assets decreased 25 basis points in the first quarter of 2008 from the first quarter of 2007, to 6.32%. This decrease was driven by an 84 basis point decrease in the yield on loans and loans held for sale to 7.28% offset by a 20 basis point increase in the tax-equivalent yield on total securities to 5.35%.

The cost of total interest-bearing liabilities decreased 42 basis points in the first quarter of 2008 from the first quarter of 2007, to 3.81%. This decrease was driven by a 40 basis point decrease in the cost of total interest-bearing deposits to 3.71%, a 227 basis point decrease in the cost of short-term borrowings to 2.85% and a 32 basis point increase in the cost of long-term debt to 4.32%. The average federal funds rate during the first quarter of 2008 was 208 basis points lower than the average for the same period in 2007.

Noninterest Income	**Three Months Ended March 31**	
(Dollars in thousands)	**2008**	**2007**
Service charges on deposit accounts	$ 311	$ 328
Servicing fees	79	89
Gain on sale of loans held for sale	174	176
Bank-owned life insurance	122	141
Securities gains (losses), net	43	11
Other	427	443
Total noninterest income	$ 1,156	$ 1,188

The major components of noninterest income are service charges on deposit accounts, servicing fees, gain on sale of loans held for sale, income from bank-owned life insurance, securities gains, net, and other noninterest income.

Noninterest income decreased 3% or $32 thousand in the first quarter of 2008 compared to the same period in 2007. Overall, there were no material changes in the first quarter of 2008 compared to the same period in 2007 among the major components of noninterest income.

Noninterest Expense	**Three Months Ended March 31**	
(In thousands)	**2008**	**2007**
Salaries and benefits	$ 1,853	$ 1,735
Net occupancy and equipment	306	294
Professional fees	158	134
Other	832	740
Total noninterest expense	$ 3,149	$ 2,903

The major components of noninterest expense are salaries and benefits, net occupancy and equipment, professional fees, and other noninterest expense.

Noninterest expense increased 8%, or $246 thousand, in the first quarter of 2008 from the first quarter of 2007. This increase was primarily related to increases of $118 thousand in salaries and benefits expense and $92

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thousand in other noninterest expense. The increase in salaries and benefits expense is primarily due to the hiring of new personnel and normal increases in salaries and benefits costs. The increase in other noninterest expense is a result of various factors, including increases in assessments charged under the new FDIC deposit assessment rules.

Income Tax Expense

Income tax expense increased $75 thousand in the first quarter of 2008 from the first quarter of 2007. The Company s effective tax rate for the first quarter of 2008 was 25.51%, compared to 24.99% for the first quarter of 2007. The increase in income tax expense was primarily due to an increase in the earnings before taxes.

BALANCE SHEET ANALYSIS

Securities

Securities available-for-sale were $322.8 million and $318.4 million as of March 31, 2008 and December 31, 2007, respectively. Unrealized net gains on securities available-for-sale were $2.8 million at March 31, 2008 compared to unrealized net losses of $0.7 million at December 31, 2007. Increases in the fair value of securities available-for-sale from December 31, 2007 were primarily driven by decreases in interest rates.

The average yield earned on total securities was 5.35% in the first quarter of 2008 and 5.15% in the first quarter of 2007. The increase in the average yield is due to an increase in the average balance of tax-exempt municipal bonds. These bonds typically have longer maturities and offer above-market yields.

Loans	**2008**		**2007**		
	First	**Fourth**	**Third**	**Second**	**First**
(In thousands)	**Quarter**	**Quarter**	**Quarter**	**Quarter**	**Quarter**
Commercial, financial and agricultural	$ 66,272	62,478	56,986	54,923	50,740
Leases - commercial	459	486	513	646	713
Real estate - construction:					
Commercial	8,706	7,901	10,282	9,096	5,137
Residential	9,574	11,370	13,420	12,611	10,067
Real estate - mortgage:					
Commercial	165,402	161,703	157,072	151,591	144,671
Residential	68,643	67,246	66,957	63,121	61,707
Consumer installment	12,317	11,539	11,892	11,619	10,121
Total loans	331,373	322,723	317,122	303,607	283,156
Less: Unearned Income	(290)	(312)	(327)	(326)	(319)
Loans, net of unearned income	$ 331,083	322,411	316,795	303,281	282,837

Total loans, net of unearned income, were $331.1 million as of March 31, 2008, an increase of $8.7 million, or 3%, from $322.4 million at December 31, 2007. Growth in commercial, financial, and agricultural loans and commercial real estate mortgage loans were the primary drivers of the increase. As of March 31, 2008, commercial, financial, and agricultural loans and commercial real estate mortgage loans increased $3.8 million and $3.7 million, respectively, from December 31, 2007.

Three loan categories represented the majority of the loan portfolio as of March 31, 2008. Commercial real estate mortgage loans represented 50%, residential real estate mortgage loans represented 21% and commercial, financial and agricultural loans represented 20% of the Bank s total loans at March 31, 2008.

The average yield earned on loans and loans held for sale was 7.28% in the first quarter of 2008 and 8.12% in the first quarter of 2007.

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Allowance for Loan Losses

The Company maintains the allowance for loan losses at a level that management deems appropriate to adequately cover the probable losses in the loan portfolio. As of March 31, 2008 and December 31, 2007, the allowance for loan losses was $4.1 million, which management deemed to be adequate at each of the respective dates. The judgments and estimates associated with the determination of the allowance for loan losses are described under CRITICAL ACCOUNTING POLICIES on pages 25 26 of the Company s annual report on Form 10-K for the year ended December 31, 2007.

A summary of the changes in the allowance for loan losses during the first quarter of 2008 and the previous four quarters are presented below.

	2008	2007			
(In thousands)	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Balance at beginning of period	$ 4,105	4,074	4,104	4,123	4,044
Charge-offs	(139)	(95)	(36)	(119)	0
Recoveries	48	126	6	80	76
Net (charge-offs) recoveries	(91)	31	(30)	(39)	76
Provision for loan losses	60	0	0	20	3
Ending balance	$ 4,074	4,105	4,074	4,104	4,123

As noted in our critical accounting policies, management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management s evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect a borrower s ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indicators and other pertinent factors. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The ratio of our allowance for loan losses to total loans outstanding was 1.23% at March 31, 2008, compared to 1.27% at December 31, 2007. In the future, the allowance to total loans outstanding ratio will increase or decrease to the extent the factors that influence our quarterly allowance assessment in their entirety are believed to be weakening or improving, respectively.

Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management s evaluation, should be adequate to provide coverage for the probable losses on outstanding loans. The provision for loan losses amounted to $60 thousand and $3 thousand for the three months ended March 31, 2008 and 2007.

Based upon its evaluation of the loan portfolio, management believes the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at March 31, 2008. Increased charge-offs in the first quarter of 2008 compared to the first quarter of 2007 were the primary reasons for the increased provision expense.

Based upon its assessment of the loan portfolio, management adjusts the allowance for loan losses to an amount deemed appropriate to adequately cover probable losses in the loan portfolio. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management and are reviewed from time to time by

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regulators, they are necessarily approximate. There exist factors beyond our control, such as general economic conditions both locally and nationally, which may negatively impact, materially, the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

Nonperforming Assets

The specific economic and credit risks associated with our loan portfolio include, but are not limited to, a general downturn in the economy which could affect employment rates in our market areas, general real estate market deterioration, interest rate fluctuations, deteriorated or non-existent collateral, title defects, inaccurate appraisals, financial deterioration of borrowers, fraud, and violations of laws and regulations.

The Company discontinues the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At March 31, 2008, the Company had $4.6 million in loans on nonaccrual compared to $447 thousand at December 31, 2007. The increase was primarily due to one purchased loan participation in the amount of $4.5 million that was placed on nonaccrual in the first quarter of 2008.

At March 31, 2008 and December 31, 2007, respectively, the Company owned $421 thousand and $98 thousand in other real estate which we had acquired through foreclosure and otherwise from borrowers.

At March 31, 2008, the Company had no loans 90 days past due and still accruing interest compared to $4 thousand at December 31, 2007. At March 31, 2008 and at December 31, 2007, no loans were deemed to be restructured loans.

The table below provides information concerning nonperforming assets and certain asset quality ratios.

	2008	2007			
(In thousands)	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Nonaccrual loans	$ 4,631	447	392	7	230
Other nonperforming assets					
(primarily other real estate owned)	421	98			
Accruing loans 90 days or more past due		4	55		
Total nonperforming assets	$ 5,052	549	447	7	230
as a % of loans	1.53%	0.17	0.14	0.00	0.08

Potential problem assets, which are not included in nonperforming assets, amounted to $4.7 million, or 1.4% of total loans outstanding, net of unearned income at March 31, 2008, compared to $9.2 million, or 2.8% of total loans outstanding, net of unearned income at December 31, 2007. The decrease in potential problem assets is due to the $4.5 million loan participation previously mentioned being placed on nonaccrual in the first quarter of 2008. Potential problem assets represent those assets with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower s ability to comply with present repayment terms.

Deposits

Total deposits were $537.4 million and $492.6 million at March 31, 2008 and December 31, 2007, respectively. The increase of $44.8 million in total deposits from December 31, 2007 was largely due to increases in NOW accounts and CDs over $100,000, offset by decreases in money market accounts. NOW accounts increased $25.4, million or 47%, from

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December 31, 2007. CDs over $100,000 increased $29.6 million or 21% from December 31, 2007. These increases were primarily driven by increases in large commercial and public customer accounts. Money market accounts decreased $17.7 million or 15% from December 31, 2007. This decrease was primarily driven by customer preferences as decreases in market rates have lowered yields on these accounts.

The average rate paid on total interest-bearing deposits was 3.71% in the first quarter of 2008 and 4.11% in the first quarter of 2007.

Noninterest bearing deposits were 14% of total deposits as of March 31, 2008 and December 31, 2007, respectively.

Other Borrowings

Other borrowings consists of short-term borrowings and long-term debt. Short-term borrowings consist of federal funds purchased, securities sold under agreements to repurchase, and other short-term borrowings. The Bank had available federal fund lines totaling $44.0 million with none outstanding at March 31, 2008, compared to $44.0 million and $8.7 million outstanding at December 31, 2007. Securities sold under agreements to repurchase totaled $7.5 million at March 31, 2008, compared to $15.5 million at December 31, 2007.

The average rate paid on short-term borrowings was 2.85% in the first quarter of 2008 and 5.12% in the first quarter of 2007.

Long-term debt included FHLB borrowings with an original maturity greater than one year, structured securities sold under agreements to repurchase and junior subordinated debentures related to trust preferred securities. At March 31, 2008 and December 31, 2007, the Bank had $91.2 million and $83.2 million in long-term FHLB borrowings, respectively. At March 31, 2008 and December 31, 2007, the bank had $25.0 million in structured securities sold under agreements to repurchase, respectively. Structured securities sold under agreements to repurchase are term repurchase agreements with original maturities greater than one year. At March 31, 2008 and December 31, 2007, the Company had $7.2 million in junior subordinated debentures outstanding, respectively.

The average rate paid on long-term debt was 4.32% in the first quarter of 2008 and 4.64% in the first quarter of 2007.

CAPITAL ADEQUACY

The Company s consolidated stockholders equity was $56.3 million and $53.0 million as of March 31, 2008 and December 31, 2007, respectively. The increase from December 31, 2007 is primarily due to net earnings of $1.9 million and other comprehensive income due to the change in unrealized gains (losses) on securities available-for-sale of $2.1 million. These increases were partially offset by cash dividends paid of $681 thousand, or $0.185 per share.

The Company s Tier 1 leverage ratio was 8.82%, Tier 1 risk-based capital ratio was 14.64% and Total risk-based capital ratio was 15.60% at March 31, 2008. These ratios exceed the minimum regulatory capital percentages of 4.0% for Tier 1 leverage ratio, 4.0% for Tier 1 risk-based capital ratio and 8.0% for Total risk-based capital ratio. Based on current regulatory standards, the Company is classified as well capitalized.

MARKET AND LIQUIDITY RISK MANAGEMENT

Management s objective is to manage assets an