AMES NATIONAL CORP
Form 10-Q
August 08, 2007

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 SECURITIESEXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission File Number 0-32637

AMES NATIONAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

IOWA	**42-1039071**
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification Number)

405 FIFTH STREET
AMES, IOWA 50010
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

NOT APPLICABLE
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

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

COMMON STOCK, $2.00 PAR VALUE	**9,429,580**
(Class)	(Shares Outstanding at August 1, 2007)

1

AMES NATIONAL CORPORATION

INDEX

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
(unaudited)

ASSETS	**June 30, 2007**	**December 31, 2006**
Cash and due from banks	$ 19,255,762	$ 16,510,082
Federal funds sold	-	13,100,000
Interest bearing deposits in financial institutions	1,010,523	1,544,306
Securities available-for-sale	351,099,722	354,571,864
Loans receivable, net	441,320,062	429,122,541
Loans held for sale	2,094,327	525,999
Bank premises and equipment, net	13,761,917	12,617,741
Accrued income receivable	7,712,138	7,871,365
Deferred income taxes	690,829	-
Other assets	3,105,341	2,989,090
Total assets	$ 840,050,621	$ 838,852,988
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$ 71,606,140	$ 77,638,264
NOW accounts	154,583,055	158,584,115
Savings and money market	160,263,988	159,401,753
Time, $100,000 and over	106,054,915	102,230,631
Other time	178,147,623	182,501,710
Total deposits	670,655,721	680,356,473
Federal funds purchased and securities sold under agreements to repurchase	49,425,759	34,727,897
Other short-term borrowings	1,286,770	1,470,116
FHLB term advances	2,000,000	2,000,000
Dividends payable	2,545,987	2,450,503
Deferred income taxes	-	1,187,948
Accrued expenses and other liabilities	4,064,406	3,736,739
Total liabilities	729,978,643	725,929,676
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; 9,429,580 and 9,425,013 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	18,859,160	18,850,026
Additional paid-in capital	22,588,691	22,498,904
Retained earnings	66,114,331	65,856,627
Accumulated other comprehensive income, net unrealized gain on securities available-for-sale	2,509,796	5,717,755

Total stockholders' equity	110,071,978	112,923,312
Total liabilities and stockholders' equity	$ 840,050,621	$ 838,852,988

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income
(unaudited)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Interest and dividend income:				
Loans	$ 7,864,594	$ 7,357,897	$ 15,437,801	$ 14,559,841
Securities				
Taxable	2,322,316	2,127,842	4,659,405	4,168,073
Tax-exempt	1,189,988	1,040,194	2,384,314	2,076,557
Federal funds sold	149,213	92,691	179,390	103,994
Dividends	383,982	359,005	774,550	698,779
Total interest income	11,910,093	10,977,629	23,435,460	21,607,244
Interest expense:				
Deposits	5,483,677	4,968,077	10,808,882	9,404,262
Other borrowed funds	522,757	257,605	1,014,917	600,224
Total interest expense	6,006,434	5,225,682	11,823,799	10,004,486
Net interest income	5,903,659	5,751,947	11,611,661	11,602,758
Provision (credit) for loan losses	143,877	(302,854)	153,605	(273,230)
Net interest income after provision (credit) for loan losses	5,759,782	6,054,801	11,458,056	11,875,988
Non-interest income:				
Trust department income	721,320	389,676	1,104,665	753,078
Service fees	474,593	497,729	903,207	905,051
Securities gains, net	452,554	270,830	906,077	515,308
Gain on sale of loans held for sale	195,004	172,521	298,105	283,987
Merchant and ATM fees	144,611	133,160	282,285	276,220
Gain on foreclosure of real estate	—	—	—	471,469
Other	142,783	134,651	284,661	286,193
Total non-interest income	2,130,865	1,598,567	3,778,999	3,491,306
Non-interest expense:				
Salaries and employee benefits	2,563,314	2,372,072	5,063,267	4,787,278
Data processing	557,915	582,175	1,108,357	1,082,277
Occupancy expenses	300,084	287,920	621,488	597,879
Other operating expenses	731,223	715,330	1,434,372	1,384,961
Total non-interest expense	4,152,536	3,957,497	8,227,484	7,852,395

Income before income taxes	3,738,111	3,695,871	7,009,571	7,514,899
Income tax expense	910,680	931,053	1,661,126	1,837,714
Net income	$ 2,827,431	$ 2,764,818	$ 5,348,445	$ 5,677,185
Basic and diluted earnings per share	$ 0.30	$ 0.29	$ 0.57	$ 0.60
Declared dividends per share	$ 0.27	$ 0.26	$ 0.54	$ 0.52
Comprehensive income (loss)	$ (54,376)	$ 688,961	$ 2,140,486	$ 2,799,602

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cashflows
(unaudited)

	Six Months Ended June 30,	
	2007	**2006**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 5,348,445	$ 5,677,185
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	153,605	(273,230)
Amortization and accretion	(97,359)	115,521
Depreciation	495,565	477,208
Provision for deferred taxes	5,264	151,694
Securities gains, net	(906,077)	(515,308)
Gain on foreclosure of real estate	—	(471,469)
Change in assets and liabilities:		
Increase in loans held for sale	(1,568,328)	(399,389)
Decrease in accrued income receivable	159,227	66,722
Increase in other assets	(116,251)	(231,553)
Increase in accrued expenses and other liabilities	327,667	1,831,774
Net cash provided by operating activities	3,801,758	6,429,155
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(37,789,276)	(30,273,695)
Proceeds from sale of securities available-for-sale	4,383,029	3,765,005
Proceeds from maturities and calls of securities available-for-sale	32,789,825	21,891,088
Net decrease in interest bearing deposits in financial institutions	533,783	1,610,394
Net decrease (increase) in federal funds sold	13,100,000	(10,850,000)
Net decrease (increase) in loans	(12,351,126)	11,042,775
Purchase of bank premises and equipment	(1,639,741)	(1,004,012)
Net cash used in investing activities	(973,506)	(3,818,445)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	(9,700,752)	4,109,298
Increase in federal funds purchased and securities sold under agreements to repurchase	14,697,862	1,327,947
Decrease in other borrowings, net	(183,346)	(2,831,173)
Dividends paid	(4,995,257)	(4,803,828)
Proceeds from issuance of common stock	98,921	127,013
Net cash used in financing activities	(82,572)	(2,070,743)
Net increase in cash and cash equivalents	2,745,680	539,967
CASH AND DUE FROM BANKS		
Beginning	16,510,082	18,092,139

Ending	$ 19,255,762	$ 18,632,106
Cash payments for:		
Interest	$ 12,207,048	$ 9,230,172
Income taxes	1,567,209	1,867,780

5

Index

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

1. Significant Accounting Policies

The consolidated financial statements for the three and six month periods ended June 30, 2007 and 2006 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's 10-K. The consolidated condensed financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the “Banks”). All significant intercompany balances and transactions have been eliminated in consolidation.

2. Dividends

On May 10, 2007, the Company declared a cash dividend on its common stock, payable on August 15, 2007 to stockholders of record as of August 1, 2007, equal to $0.27 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended June 30, 2007 and 2006 were 9,425,767 and 9,420,218, respectively. The weighted average outstanding shares for the six months ended June 30, 2007 and 2006 were 9,425,391 and 9,419,747, respectively.

4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company’s off-balance sheet arrangements have occurred since December 31, 2006.

5. New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in its tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective in fiscal years beginning after December 15, 2006. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption, with the cumulative effect adjustment reported as an adjustment to the opening balance of retained earnings. The Company adopted FIN 48 as of January 1, 2007, and the adoption had no significant impact of the consolidated financial statements.

Index

The following are disclosures made pursuant to the initial adoption of FIN 48:

- Accounting policy regarding classification of interest and penalties:

The Company has adopted the policy of classifying interest and penalties as income tax expense.

- Unrecognized tax benefits as of date of adoption:

The Company had no significant unrecognized tax benefits as of January 1, 2007 and, likewise, no significant unrecognized tax benefits that, if recognized, would affect the effective tax rate.

- Total interest and penalties recognized:

The Company had recorded no accrued interest or penalties as of the date of adoption.

- Uncertainty on tax position:

The Company had no positions for which it deemed that it is reasonably possible that the total amounts of the unrecognized tax benefit will significantly increase or decrease within the 12 months of the date of adoption.

- Open tax years:

The tax years that remain subject to examination by major tax jurisdictions currently are:

Federal 2004 - 2006
State of Iowa 2004 - 2006

On February 15, 2007, FASB issued Statement of Financial Accounting Standards No. 159, the Fair Value Option for Financial Assets and Financial Liabilities, a standard that provides companies with an option to report selected financial assets and liabilities at fair value. The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new statement does not eliminate disclosure requirements included in other accounting standards.

This statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided, among other things, that the entity makes that choice in the first 120 days of that fiscal year.

The Company will not early adopt the standard, rather it will adopt the standard effective January 1, 2008. The Company has not determined the impact that the standard might have on its consolidated financial statements.

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

Overview

Ames National Corporation is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa. The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Randall-Story State Bank (Randall-Story Bank) and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

Index

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and trust services. The Banks also offer investment services through a third-party broker dealer. The Company employs twelve individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 183 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cashflow are: (i) interest and fees earned on loans made by the Banks; (ii) securities gains and dividends on equity investments held by the Company and the Banks; (iii) service charges on deposit accounts maintained at the Banks; (iv) interest on fixed income investments held by the Banks; and (v) fees on trust services provided by those Banks exercising trust powers. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs associated with maintaining the Bank's loan and deposit functions; and (iv) occupancy expenses for maintaining the Banks' facilities. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company earned net income of $2,827,000, or $0.30 per share for the three months ended June 30, 2007, compared to net income of $2,765,000, or $0.29 per share, for the three months ended June 30, 2006, an increase of 2%. The improvement in earnings can be attributed to higher net interest income of $152,000, a one-time increase in trust revenues of $275,000, and higher securities gains of $182,000. Tempering these improvements in income was higher quarterly provisions for loan losses of $144,000 in 2007 compared to a negative provision of $303,000 recorded in 2006. In addition, salaries and employee benefits costs were higher primarily as the result of staffing First National Bank's new office in Ankeny, Iowa.

For the six month period ending June 30, 2007, the Company earned net income of $5,348,000, or $0.57 per share, a 6% decrease from net income of $5,677,000, or $0.60 per share, earned a year ago. The decline in income can be attributed to increased loan loss provision expense and higher salary and employee benefit expense. In addition, the prior year's results were aided by income resulting from the reduction in the allowance for loan losses of $273,000 and a gain on the foreclosure of real estate of $471,000. Higher trust revenues and security gains had a favorable impact on earnings for the six months ended June 30, 2007 compared to the same period a year ago.

The following management discussion and analysis will provide a summary review of important items relating to:

- Challenges
- Key Performance Indicators and Industry Results
- Income Statement Review
- Balance Sheet Review
- Asset Quality and Credit Risk Management
- Liquidity and Capital Resources
- Forward-Looking Statements and Business Risks

Index

Challenges

Management has identified certain challenges that may negatively impact the Company's revenues in the future and is attempting to position the Company to best respond to those challenges.

- Short-term interest rates have increased significantly since June of 2004 while longer term rates (10 to 20 years) are relatively unchanged since 2004. This movement in short-term rates has caused the yield curve to be flatter or slightly inverted since June 30, 2006. Banks have historically earned higher levels of net interest income by investing in intermediate and longer term loans and investments at higher yields and paying lower deposit expense rates on shorter maturity deposits. If the yield curve remains flat or inverted for the remainder of 2007, the Company's net interest margin may continue to compress.

- If interest rates continue to rise, maintaining net interest income revenues presents a challenge to the Company in 2007. Continued increases in interest rates may negatively impact the Company's net interest margin particularly if existing trends of interest expense increases more quickly than interest income continue. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense will increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

- The Company's market in central Iowa has numerous banks, credit unions, and investment and insurance companies competing for similar business opportunities. This competitive environment will continue to put downward pressure on the Banks' net interest margins and thus affect profitability. Strategic planning efforts at the Company and Banks continue to focus on capitalizing on the Banks' strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.

- A potential challenge to the Company's earnings would be poor performance in the Company's equity portfolio, thereby reducing the historical level of realized security gains. The Company, on an unconsolidated basis, invests capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks totaling $23 million as of June 30, 2007. The Company focuses on stocks that have historically paid dividends that may lessen the negative effects of a bear market.

Index

Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 8,650 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

Selected Indicators for the Company and the Industry

	June 30, 2007		March 31, 2007		Years Ended December 31,			
	3 Months Ended	6 Months Ended	3 Months Ended		2006		2005	
	Company	Company	Company	Industry*	Company	Industry	Company	Industry
Return on assets	1.33%	1.27%	1.21%	1.21%	1.34%	1.28%	1.40%	1.28%
Return on equity	10.09%	9.54%	9.00%	11.44%	9.99%	12.34%	10.57%	12.46%
Net interest margin	3.31%	3.28%	3.27%	3.32%	3.29%	3.31%	3.56%	3.49%
Efficiency ratio	51.68%	53.46%	55.40%	57.56%	52.27%	56.79%	49.09%	57.24%
Capital ratio	13.19%	13.28%	13.40%	8.23%	13.38%	8.23%	13.21%	8.25%

*Latest available data

Key performances indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.33% and 1.35%, respectively, for the three month periods ending June 30, 2007 and 2006. The ratio declined in 2007 from the previous year as the result of increased provision expense and higher non- interest expense primarily associated with the second quarter 2007 opening of the Ankeny office of First National Bank.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's annualized return on equity ratio is below that of the industry primarily as a result of the higher level of capital the Company maintains for future growth and acquisitions. The Company's return on average equity was 10.09% and 10.22%, respectively for the three month periods ending June 30, 2007 and 2006.

Index

- Net Interest Margin

The net interest margin for the three months ended June 30, 2007 was 3.31% compared to 3.29% for the three months ended June 30, 2006. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings. The Company's net interest margin improved slightly when compared to June 30, 2006 and is in line with the industry average for 2006. Management expects the flat yield curve and the competitive nature of the Company's market environment to put downward pressure on the Company's margin for the remainder of 2007.

- Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio compares favorably to the industry's average and was 51.68% and 53.84% for the three months ended June 30, 2007 and 2006, respectively.

- Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio is significantly higher than the industry average.

Industry Results

The FDIC Quarterly Banking Profile reported the following results for the first quarter of 2007:

Higher credit expenses at large institutions and narrower net interest margins at smaller institutions exerted downward pressure on earnings of FDIC-insured institutions in the first quarter of 2007. The industry reported total net income of $36.0 billion in the quarter, the fourth-highest quarterly amount ever, but it was $912 million (2.5%) less than the earnings posted in the first quarter of 2006. This is the largest year-over-year decline in quarterly earnings since the first quarter of 2001. A significant part of the decrease was attributable to a change in the way that earnings were reported in the aftermath of a large corporate restructuring, but lower operating results at a number of institutions also contributed to the earnings drop. Evidence of pressure on earnings was widespread, as a majority of institutions (50.3%) reported lower quarterly net income. Narrower net interest margins had a negative effect on earnings of smaller banks and thrifts, while higher expenses for bad loans were more significant for large banks. More than two out of every three institutions, 67.9%, reported lower net interest margins than a year ago, but only 36.6% of all institutions reported higher provisions for loan losses. Among institutions with more than $10 billion in assets, 73 percent raised their loss provisions. The average ROA for the quarter was 1.21 percent, down from 1.34 percent in the first quarter of 2006, as 59 percent of all institutions saw their quarterly ROAs decline. This is the lowest first-quarter ROA for the industry since 2001.

Index

Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the three month periods ended June 30, 2007 and 2006:

Critical Accounting Policies

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company's audited consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" contained in the Company's 10-K. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified its most critical accounting policy to be that related to the allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs.

Index

AVERAGE BALANCES AND INTEREST RATES

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

AVERAGE BALANCE SHEETS AND INTEREST RATES

Three Months Ended June 30,

	2007			2006		
ASSETS (dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-earning assets						