

AMES NATIONAL CORP
Form 10-K
March 15, 2007

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

FORM 10-K

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006. Commission File Number
0-32637.

AMES NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

IOWA
(State or other jurisdiction of incorporation or
organization)

42-1039071
(I.R.S. Employer Identification No.)

405 FIFTH STREET, AMES, IOWA
(Address of principal executive offices)

50010
(Zip Code)

(515) 232-6251
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: **NONE**

Securities registered pursuant to Section 12(g) of the Exchange Act:

COMMON STOCK, \$2.00 PAR VALUE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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-K or any amendment to this Form 10-K. x

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 ☐

Accelerated filer ☒ x

Non-accelerated filer ☐

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

As of June 30, 2006, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sale price for the registrant's common stock in the NASDAQ Capital Market, was \$195,454,346. Shares of common stock beneficially owned by each executive officer and director of the Company and by each person who beneficially owns 5% or more of the outstanding common stock have been excluded on the basis that such persons may be deemed to be an affiliate of the registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

The number of shares outstanding of the registrant's common stock on February 28, 2007, was 9,425,013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement, as filed with the Securities and Exchange Commission on March 16, 2007, are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1.

BUSINESS

General

Ames National Corporation (the "Company") is an Iowa corporation and bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company owns 100% of the stock of five banking subsidiaries consisting of two national banks and three state-chartered banks, as described below. All of the Company's operations are conducted in the State of Iowa and primarily within the central Iowa counties of Boone, Story and Marshall where the Company's banking subsidiaries are located. The Company does not engage in any material business activities apart from its ownership of its banking subsidiaries. The principal executive offices of the Company are located at 405 Fifth Street, Ames, Iowa 50010 and its telephone number is (515) 232-6251.

The Company was organized and incorporated on January 21, 1975 under the laws of the State of Iowa to serve as a holding company for its principal banking subsidiary, First National Bank, Ames, Iowa ("First National") located in Ames, Iowa. In 1983, the Company acquired the stock of the State Bank & Trust Co. ("State Bank") located in Nevada, Iowa; in 1991, the Company, through a newly-chartered state bank known as Boone Bank & Trust Co. ("Boone Bank"), acquired certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company located in Boone, Iowa; in 1995, the Company acquired the stock of the Randall-Story State Bank ("Randall-Story Bank") located in Story City, Iowa; and in 2002, the Company chartered and commenced operations of a new national banking organization, United Bank & Trust NA ("United Bank"), located in Marshalltown, Iowa. First National, State Bank, Boone Bank, Randall-Story Bank and United Bank are each operated as a wholly owned subsidiary of the Company. These five financial institutions are referred to in this Form 10-K collectively as the "Banks" and individually as a "Bank".

The principal sources of Company revenue are: (i) interest and fees earned on loans made by the Banks; (ii) service charges on deposit accounts maintained at the Banks; (iii) interest on fixed income investments held by the Banks; (iv) fees on trust services provided by those Banks exercising trust powers; and (v) securities gains and dividends on equity investments held by the Company and the Banks.

The Banks' lending activities consist primarily of short-term and medium-term commercial and residential real estate loans, agricultural and business operating loans and lines of credit, equipment loans, vehicle loans, personal loans and lines of credit, home improvement loans and secondary mortgage loan origination. The Banks also offer a variety of demand, savings and time deposits, cash management services, merchant credit card processing, safe deposit boxes, wire transfers, direct deposit of payroll and social security checks and automated teller machine access. Four of the five Banks also offer trust services.

The Company provides various services to the Banks which include, but are not limited to, management assistance, internal auditing services, human resources services and administration, compliance management, marketing assistance and coordination, loan review and assistance with respect to computer systems and procedures.

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Banking Subsidiaries

First National Bank, Ames, Iowa. First National is a nationally-chartered, commercial bank insured by the Federal Deposit Insurance Corporation (the "FDIC"). It was organized in 1903 and became a wholly owned subsidiary of the Company in 1975 through a bank holding company reorganization whereby the then shareholders of First National exchanged all of their First National stock for stock in the Company. First National provides full-service banking to businesses and residents within the Ames community and surrounding area. It provides a variety of products and services designed to meet the needs of the market it serves. It has an experienced staff of bank officers including many who have spent the majority of their banking careers with First National and who emphasize long-term customer relationships. First National conducts business out of three full-service offices and one super market location, all located in the city of Ames. A new full-service branch office is being built in Ankeny, Iowa and is expected to open in the second quarter of 2007.

As of December 31, 2006, First National had capital of \$41,284,000 and 88 full-time equivalent employees. Full-time equivalents represent the number of people a business would employ if all its employees were employed on a full-time basis. It is calculated by dividing the total number of hours worked by all full and part-time employees by the number of hours a full-time individual would work for a given period of time. First National had net income of \$5,938,000 in 2006, \$6,417,000 in 2005, and \$6,949,000 in 2004. Total assets as of December 31, 2006, 2005 and 2004 were \$423,517,000, \$413,412,000, and \$436,074,000, respectively.

State Bank & Trust Co., Nevada, Iowa. State Bank is an Iowa, state-chartered, FDIC insured commercial bank. State Bank was acquired by the Company in 1983 through a stock transaction whereby the then shareholders of State Bank exchanged all their State Bank stock for stock in the Company. State Bank was organized in 1939 and provides full-serve banking to businesses and residents within the Nevada area from its main Nevada location and two offices, one in McCallsburg, Iowa and the other in Colo, Iowa. It is strong in agricultural, commercial and residential real estate lending.

As of December 31, 2006, State Bank had capital of \$11,298,000 and 22 full-time equivalent employees. It had net income of \$1,310,000 in 2006, \$1,401,000 in 2005 and \$1,707,000 in 2004. Total assets as of December 31, 2006, 2005 and 2004 were \$114,266,000, \$112,626,000 and \$112,599,000, respectively.

Boone Bank & Trust Co., Boone, Iowa. Boone Bank is an Iowa, state-chartered, FDIC insured commercial bank. Boone Bank was organized in 1992 by the Company under a new state charter in connection with a purchase and assumption transaction whereby Boone Bank purchased certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company in exchange for a cash payment. It provides full service banking to businesses and residents within the Boone community and surrounding area. It is actively engaged in agricultural, consumer and commercial lending, including real estate, operating and equipment loans. It conducts business from its main office and a full service branch office, both located in Boone.

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As of December 31, 2006, Boone Bank had capital of \$12,490,000 and 26 full-time equivalent employees. It had net income of \$1,636,000 in 2006, \$1,849,000 in 2005 and \$2,059,000 in 2004. Total assets as of December 31, 2006, 2005 and 2004 were \$103,225,000, \$108,780,000 and \$112,578,000, respectively.

Randall-Story State Bank, Story City, Iowa. Randall-Story Bank is an Iowa, state-chartered, FDIC insured commercial bank. Randall-Story Bank was acquired by the Company in 1995 through a stock transaction whereby the then shareholders of Randall-Story Bank exchanged all their Randall-Story Bank stock for stock in the Company. Randall-Story Bank was organized in 1928 and provides full-service banking to Story City and the surrounding area. While its primary emphasis is in agricultural lending, Randall-Story Bank also provides the traditional lending services typically offered by community banks. The bank closed its office in Randall, Iowa in 2006 as the result of the community's declining population base.

As of December 31, 2006, Randall-Story Bank had capital of \$7,871,000 and 15 full-time equivalent employees. It had net income of \$902,000 in 2006, \$869,000 in 2005 and \$1,036,000 in 2004. Total assets as of December 31, 2006, 2005 and 2004 were \$73,777,000, \$70,371,000 and \$74,427,000, respectively.

United Bank & Trust NA, Marshalltown, Iowa. United Bank is a nationally-chartered, commercial bank insured by the FDIC. It was newly chartered in June of 2002 and offers a broad range of deposit and loan products, as well as Internet banking and trust services to customers located in the Marshalltown and surrounding Marshall County area.

As of December 31, 2006, United Bank had capital of \$7,581,000 and 21 full-time equivalent employees. United Bank had a loss of \$58,000 in 2006 and a profit in 2005 and 2004 of \$124,000 and \$105,000, respectively. Total assets as of December 31, 2006, 2005 and 2004 were \$95,619,000, \$94,684,000 and \$89,653,000, respectively.

Business Strategy and Operations

As a locally owned, multi-bank holding company, the Company emphasizes strong personal relationships to provide products and services that meet the needs of the Banks' customers. The Company seeks to achieve growth and maintain a strong return on equity. To accomplish these goals, the Banks focus on small to medium size businesses that traditionally wish to develop an exclusive relationship with a single bank. The Banks, individually and collectively, have the size to give the personal attention required by business owners, in addition to the credit expertise to help businesses meet their goals.

The Banks offer a full range of deposit services that are typically available in most financial institutions, including checking accounts, savings accounts and time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. One major goal in developing the Banks' product mix is to keep the product offerings as simple as possible, both in terms of the number of products and the features and benefits of the individual services. The transaction accounts and time certificates are tailored to each Bank's principal market area at rates competitive in that Bank's market. In addition, retirement accounts such as IRAs (Individual Retirement Accounts) are available. The FDIC insures all deposit accounts up to the maximum amount. The Banks solicit these accounts from small-to-medium sized businesses in their respective primary trade areas, and from individuals who live and/or work within these areas. No material portion of the Banks' deposits has been obtained from a single person or from a few persons. Therefore, the Company does not believe that the loss of the deposits of any person or of a few persons would have an adverse effect on the Banks' operations or erode their deposit base.

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Loans are provided to creditworthy borrowers regardless of their race, color, national origin, religion, sex, age, marital status, disability, receipt of public assistance or any other basis prohibited by law. The Banks intend to fulfill this commitment while maintaining prudent credit standards. In the course of fulfilling this obligation to meet the credit needs of the communities which they serve, the Banks give consideration to each credit application regardless of the fact that the applicant may reside in a low to moderate income neighborhood, and without regard to the geographic location of the residence, property or business within their market areas.

The Banks provide innovative, quality financial products, such as Internet banking and trust services that meet the banking needs of their customers and communities. The loan programs and acceptance of certain loans may vary from time-to-time depending on the funds available and regulations governing the banking industry. The Banks offer all basic types of credit to their local communities and surrounding rural areas, including commercial, agricultural and consumer loans. The types of loans within these categories are as follows:

Commercial Loans. Commercial loans are typically made to sole proprietors, partnerships, corporations and other business entities such as municipalities and individuals where the loan is to be used primarily for business purposes. These loans are typically secured by assets owned by the borrower and often times involve personal guarantees given by the owners of the business. The types of loans the Banks offer include:

- financing guaranteed under Small Business Administration programs
 - operating and working capital loans
 - loans to finance equipment and other capital purchases
 - commercial real estate loans
 - business lines of credit
 - term loans
 - loans to professionals
 - letters of credit

Agricultural Loans. The Banks, by nature of their location in central Iowa, are directly and indirectly involved in agriculture and agri-business lending. This includes short-term seasonal lending associated with cyclical crop and livestock production, intermediate term lending for machinery, equipment and breeding stock acquisition and long-term real estate lending. These loans are typically secured by the crops, livestock, equipment or real estate being financed. The basic tenet of the Banks' agricultural lending philosophy is a blending of strong, positive cash flow supported by an adequate collateral position, along with a demonstrated capacity to withstand short-term negative impact if necessary. Applicable governmental subsidies and affiliated programs are utilized if warranted to accomplish these parameters. Approximately 14% of the Banks' loans have been made for agricultural purposes. The Banks have not experienced a material adverse effect on their business as a result of defaults on agricultural loans and do not anticipate at the present time experiencing any such effect in the future.

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Consumer Loans. Consumer loans are typically available to finance home improvements and consumer purchases, such as automobiles, household furnishings, boats and education. These loans are made on both a secured and an unsecured basis. The following types of consumer loans are available:

- automobiles and trucks
- boats and recreational vehicles
- personal loans and lines of credit
- home equity lines of credit
- home improvement and rehabilitation loans
- consumer real estate loans

Other types of credit programs, such as loans to nonprofit organizations, to public entities, for community development and to other governmental offered programs also are available.

First National, Boone Bank, State Bank and United Bank offer trust services typically found in a commercial bank with trust powers, including the administration of estates, conservatorships, personal and corporate trusts and agency accounts. The Banks also provide farm management, investment and custodial services for individuals, businesses and non-profit organizations.

The Banks earn income from the origination of residential mortgages that are sold in the secondary real estate market without retaining the mortgage servicing rights.

The Banks offer traditional banking services, such as safe deposit boxes, wire transfers, direct deposit of payroll and social security checks, automated teller machine access and automatic drafts (ACH) for various accounts.

Credit Management

The Company strives to achieve sound credit risk management. In order to achieve this goal, the Company has established uniform credit policies and underwriting criteria for the Banks' loan portfolios. The Banks diversify in the types of loans offered and are subject to regular credit examinations, annual internal and external loan audits and annual review of large loans, as well as quarterly reviews of loans experiencing deterioration in credit quality. The Company attempts to identify potential problem loans early, charge off loans promptly and maintain an adequate allowance for loan losses. The Company has established credit guidelines for the Banks' lending portfolios which include guidelines relating to the more commonly requested loan types, as follows:

Commercial Real Estate Loans - Commercial real estate loans, including agricultural real estate loans, are normally based on loan to appraisal value ratios of 80% and secured by a first priority lien position. Loans are typically subject to interest rate adjustments no less frequently than 5 years from origination. Fully amortized monthly repayment terms normally do not exceed twenty years. Projections and cash flows that show ability to service debt within the amortization period are required. Property and casualty insurance is required to protect the Banks' collateral interests. Commercial and agricultural real estate loans represent approximately 45% of the loan portfolio. Major risk factors for commercial real estate loans, as well as the other loan types described below, include a geographic concentration in central Iowa; the dependence of the local economy upon several large governmental entities, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that is dependent on weather conditions and government programs.

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Commercial and Agricultural Operating Lines - These loans are made to businesses and farm operations with terms up to twelve months. The credit needs are generally seasonal with the source of repayment coming from the entity's normal business cycle. Cash flow reviews are completed to establish the ability to service the debt within the terms of the loan. A first priority lien on the general assets of the business normally secures these types of loans. Loan to value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s).

Commercial and Agricultural Term Loans – These loans are made to businesses and farm operations to finance equipment, breeding stock and other capital expenditures. Terms are generally the lesser of five years or the useful life of the asset. Term loans are normally secured by the asset being financed and are often additionally secured with the general assets of the business. Loan to value is generally 75% of the cost or value of the assets. Loans are normally guaranteed by the principal(s). Commercial and agricultural operating and term loans represent approximately 20% of the loan portfolio.

Residential First Mortgage Loans – Proceeds of these loans are used to buy or refinance the purchase of residential real estate with the loan secured by a first lien on the real estate. Most of the residential mortgage loans originated by the Banks (including servicing rights) are sold in the secondary mortgage market due to the higher interest rate risk inherent in the 15 and 30 year fixed rate terms consumers prefer. Loans that are originated and not sold in the secondary market generally have higher interest rates and have rate adjustment periods of no longer than seven years. The maximum amortization of first mortgage residential real estate loans is 30 years. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. Property insurance is required on all loans to protect the Banks' collateral position. Loans secured by one to four family residential properties represent approximately 23% of the loan portfolio.

Home Equity Term Loans – These loans are normally for the purpose of home improvement or other consumer purposes and are secured by a junior mortgage on residential real estate. Loan-to-value ratios normally do not exceed 90% of market value.

Home Equity Lines of Credit - The Banks offer a home equity line of credit with a maximum term of 60 months. These loans are secured by a junior mortgage on the residential real estate and normally do not exceed a loan-to-market value ratio of 90% with the interest adjusted quarterly.

Consumer Loans – Consumer loans are normally made to consumers under the following guidelines. Automobiles - loans on new and used automobiles generally will not exceed 80% and 75% of the value, respectively. Recreational vehicles and boats - 66% of the value. Mobile home - maximum term on these loans is 180 months with the loan-to-value ratio generally not exceeding 66%. Each of these loans is secured by a first priority lien on the assets and requires insurance to protect the Banks' collateral position. Unsecured - The term for unsecured loans generally does not exceed 12 months. Consumer and other loans represent approximately 7% of the loan portfolio.

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Employees

At December 31, 2006, the Banks had a total of 172 full-time equivalent employees and the Company had an additional 12 full-time employees. The Company and Banks provide their employees with a comprehensive program of benefits, including comprehensive medical and dental plans, long-term and short-term disability coverage, and a 401(k) profit sharing plan. Management considers its relations with employees to be satisfactory. Unions represent none of the employees.

Market Area

The Company operates five commercial banks with locations in Story, Boone and Marshall Counties in central Iowa.

First National is located in Ames, Iowa with a population of 50,731. The major employers are Iowa State University, Ames Laboratories, Iowa Department of Transportation, Mary Greeley Medical Center, National Veterinary Services Laboratory, Ames Community Schools, City of Ames, Barilla, Sauer-Danfoss and McFarland Clinic. First National's primary business includes providing retail banking services and business and consumer lending. First National has a minimum exposure to agricultural lending.

Boone Bank is located in Boone, Iowa with a population of 12,800. Boone is the county seat of Boone County. The major employers are Fareway Stores, Inc., Patterson Dental Supply Co., Union Pacific Railroad, and Communication Data Services. Boone Bank provides lending services to the agriculture, commercial and real estate markets.

State Bank is located in Nevada, Iowa with a population of 6,658. Nevada is the county seat of Story County. The major employers are Print Graphics, General Financial Supply, Central Iowa Printing, Burke Corporation and Almaco. State Bank provides various types of loans with a major agricultural presence. It provides a wide variety of banking services including trust, deposit, ATM, and merchant card processing.

Randall-Story Bank is located in Story City, Iowa with a population of 3,228. The major employers are Pella Corporation, Bethany Manor, American Packaging, Precision Machine and Record Printing. Located in a major agricultural area, it has a strong presence in this type of lending. As a full service commercial bank it provides a full line of products and services.

United Bank is located in Marshalltown, Iowa with a population of 26,123. The major employers are Swift & Co., Fisher Controls International, Lennox Industries and Marshalltown Medical & Surgical Center. The Bank offers a full line of loan, deposit, and trust services. Loan services include primarily commercial and consumer types of credit including operating lines, equipment loans, automobile financing and real estate loans.

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Competition

The geographic market area served by the Banks is highly competitive with respect to both loans and deposits. The Banks compete principally with other commercial banks, savings and loan associations, credit unions, mortgage companies, finance divisions of auto and farm equipment companies, agricultural suppliers and other financial service providers. Some of these competitors are local, while others are statewide or nationwide. The major commercial bank competitors include F & M Bank, U.S. Bank National Association and Wells Fargo Bank, each of which have a branch office or offices within the Banks' primary trade areas. Among the advantages such larger banks have are their ability to finance extensive advertising campaigns and to allocate their investment assets to geographic regions of higher yield and demand. These larger banking organizations have much higher legal lending limits than the Banks and thus are better able to finance large regional, national and global commercial customers.

In order to compete with the other financial institutions in their primary trade areas, the Banks use, to the fullest extent possible, the flexibility which is accorded by independent status. This includes an emphasis on specialized services, local promotional activity and personal contacts by the Banks' officers, directors and employees. In particular, the Banks compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services. The Banks compete for loans primarily by offering competitive interest rates, experienced lending personnel and quality products and services.

As of December 31, 2006, there were 26 FDIC insured institutions having approximately 65 offices or branch offices within Boone, Story and Marshall County, Iowa where the Banks' offices are located. First National, State Bank and Randall-Story Bank together have the largest percentage of deposits in Story County and Boone Bank has the highest percentage of deposits in Boone County.

The Banks also compete with the financial markets for funds. Yields on corporate and government debt securities and commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for funds with equity, money market, and insurance products offered by brokerage and insurance companies. This competitive trend will likely continue in the future.

The Company anticipates bank competition will continue to change materially over the next several years as more financial institutions, including the major regional and national banks, continue to consolidate. Credit unions, which are not subject to income taxes, have a significant competitive advantage and provide additional competition in the Company's local markets.

Supervision and Regulation

The following discussion generally refers to certain statutes and regulations affecting the banking industry. These references provide brief summaries and therefore do not purport to be complete and are qualified in their entirety by reference to those statutes and regulations. In addition, due to the numerous statutes and regulations that apply to and regulate the banking industry, many are not referenced below.

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USA Patriot Act. The USA Patriot Act was enacted in 2001 which, together with regulations issued pursuant to this act, substantially broadened previously existing anti-money laundering law and regulation, increased compliance, due diligence and reporting obligations for financial institutions, created new crimes and penalties and required federal banking agencies, in reviewing merger and other acquisition transactions, to consider the effectiveness of the parties in combating money laundering activities. The Act requires all financial institutions to establish certain anti-money laundering compliance and due diligence programs that are reasonably designed to detect and report instances of money laundering. The Company believes its compliance policies, procedures and controls satisfy the material requirements of the Patriot Act and regulations.

Sarbanes-Oxley Act. The Sarbanes-Oxley Act was enacted in 2002 to, among other things, increase corporate responsibility and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the federal securities laws. This act generally applies to all companies that are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The Act implements significant changes in the responsibilities of officers and directors of public companies and makes certain changes to the corporate reporting obligation of those companies and their external auditors. Among the requirements and prohibitions addressed by the act are certifications required by CEOs and CFOs of periodic reports filed with the SEC; accelerated reporting of stock transactions by directors, officers and large shareholders; prohibitions against personal loans from companies to directors and executive officers (except loans made in the ordinary course of business); requirements for public companies' audit committees; requirements for auditor independence; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and executive officers in the 12-month period following initial publication of any financial statements that later require restatement; various increased criminal penalties for violations of securities laws; and the creation of a public company accounting oversight board. Rules adopted by the SEC to implement various provisions of the act include CEO and CFO certifications related to fair presentation of financial statements and financial information in public filings, as well as management's evaluation of disclosure controls and procedures; disclosure of whether any audit committee members qualify as a "financial expert"; disclosures related to audit committee composition and auditor pre-approval policies; disclosure related to adoption of a written code of ethics; reconciling non-GAAP financial information with GAAP in public communications; disclosure of off-balance sheet transactions; and disclosure related to director independence and the director nomination process. The Company has adopted modifications to its corporate governance procedures to comply with the provisions of the act and regulations.

The Company and the Banks are subject to extensive federal and state regulation and supervision. Regulation and supervision of financial institutions is primarily intended to protect depositors and the FDIC rather than shareholders of the Company. The laws and regulations affecting banks and bank holding companies have changed significantly over recent years, particularly with the passage of the Financial Services Modernization Act. There is reason to expect that similar changes will continue in the future. Any change in applicable laws, regulations or regulatory policies may have a material effect on the business, operations and prospects of the Company. The Company is unable to predict the nature or the extent of the effects on its business and earnings that any fiscal or monetary policies or new federal or state legislation may have in the future.

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The Company

The Company is a bank holding company by virtue of its ownership of the Banks, and is registered as such with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), which subjects the Company and the Banks to supervision and examination by the Federal Reserve. Under the BHCA, the Company files with the Federal Reserve annual reports of its operations and such additional information as the Federal Reserve may require.

Source of Strength to the Banks. The Federal Reserve takes the position that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve's position that in serving as a source of strength to its subsidiary banks, bank holding companies should use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. It should also maintain the financial flexibility and capital raising capacity to obtain additional resources for providing assistance to its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both.

Federal Reserve Approval. Bank holding companies must obtain the approval of the Federal Reserve before they: (i) acquire direct or indirect ownership or control of any voting stock of any bank if, after such acquisition, they would own or control, directly or indirectly, more than 5% of the voting stock of such bank; (ii) merge or consolidate with another bank holding company; or (iii) acquire substantially all of the assets of any additional banks.

Non-Banking Activities. With certain exceptions, the BHCA also prohibits bank holding companies from acquiring direct or indirect ownership or control of voting stock in any company other than a bank or a bank holding company unless the Federal Reserve finds the company's business to be incidental to the business of banking. When making this determination, the Federal Reserve in part considers whether allowing a bank holding company to engage in those activities would offer advantages to the public that would outweigh possible adverse effects. A bank holding company may engage in permissible non-banking activities on a de novo basis, if the holding company meets certain criteria and notifies the Federal Reserve within ten (10) business days after the activity has commenced.

Under the Financial Services Modernization Act, eligible bank holding companies may elect (with the approval of the Federal Reserve) to become a "financial holding company." Financial holding companies are permitted to engage in certain financial activities through affiliates that had previously been prohibited activities for bank holding companies. Such financial activities include securities and insurance underwriting and merchant banking. At this time, the Company has not elected to become a financial holding company, but may choose to do so at some time in the future.

Control Transactions. The Change in Bank Control Act of 1978, as amended, requires a person or group of persons acquiring "control" of a bank holding company to provide the Federal Reserve with at least 60 days prior written notice of the proposed acquisition. Following receipt of this notice, the Federal Reserve has 60 days to issue a notice disapproving the proposed acquisition, but the Federal Reserve may extend this time period for up to another 30 days. An acquisition may be completed before the disapproval period expires if the Federal Reserve issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, would constitute the acquisition of control. In addition, any "company" would be required to obtain the approval of the Federal Reserve under the BHCA before acquiring 25% (or 5% if the "company" is a bank holding company) or more of the outstanding shares of the Company, or otherwise obtain control over the Company.

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Affiliate Transactions. The Company and the Banks are deemed affiliates within the meaning of the Federal Reserve Act, and transactions between affiliates are subject to certain restrictions. Generally, the Federal Reserve Act: (i) limits the extent to which the financial institution or its subsidiaries may engage in "covered transactions" with an affiliate; and (ii) requires all transactions with an affiliate, whether or not "covered transactions," to be on terms substantially the same, or at least as favorable to the institution or subsidiary, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar transactions.

State Law on Acquisitions. Iowa law permits bank holding companies to make acquisitions throughout the state. However, Iowa currently has a deposit concentration limit of 15% on the amount of deposits in the state that any one banking organization can control and continue to acquire banks or bank deposits (by acquisitions), which applies to all depository institutions doing business in Iowa.

Banking Subsidiaries

Applicable federal and state statutes and regulations governing a bank's operations relate, among other matters, to capital adequacy requirements, required reserves against deposits, investments, loans, legal lending limits, certain interest rates payable, mergers and consolidations, borrowings, issuance of securities, payment of dividends, establishment of branches and dealings with affiliated persons.

First National and United Bank are national banks subject to primary federal regulation and supervision by the Office of the Comptroller of the Currency (the "OCC"). The FDIC, as an insurer of the deposits, also has some limited regulatory authority over First National and United Bank. State Bank, Boone Bank and Randall-Story Bank are state banks subject to regulation and supervision by the Iowa Division of Banking. The three state Banks are also subject to regulation and examination by the FDIC, which insures their respective deposits to the maximum extent permitted by law. The federal laws that apply to the Banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for loans. The laws and regulations governing the Banks generally have been promulgated to protect depositors and the deposit insurance fund of the FDIC and not to protect stockholders of such institutions or their holding companies.

The OCC and FDIC each has authority to prohibit banks under their supervision from engaging in what it considers to be an unsafe and unsound practice in conducting their business. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires federal banking regulators to adopt regulations or guidelines in a number of areas to ensure bank safety and soundness, including internal controls, credit underwriting, asset growth, management compensation, ratios of classified assets to capital and earnings. FDICIA also contains provisions which are intended to change independent auditing requirements, restrict the activities of state-chartered insured banks, amend various consumer banking laws, limit the ability of "undercapitalized banks" to borrow from the Federal Reserve's discount window, require regulators to perform periodic on-site bank examinations and set standards for real estate lending.

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Borrowing Limitations. Each of the Banks is subject to limitations on the aggregate amount of loans that it can make to any one borrower, including related entities. Subject to numerous exceptions based on the type of loans and collateral, applicable statutes and regulations generally limit loans to one borrower of 15% of total equity and reserves. Each of the Banks is in compliance with applicable loans to one borrower requirements.

FDIC Insurance. Generally, customer deposit accounts in banks are insured by the FDIC for up to a maximum amount of \$100,000 for single accounts, \$250,000 for self-directed retirement accounts, \$100,000 for joint accounts, and \$100,000 for qualifying revocable trust accounts. The FDIC has adopted a risk-based insurance assessment system under which depository institutions contribute funds to the FDIC insurance fund based on their risk classification. The FDIC may terminate the deposit insurance of any insured depository institution if it determines after an administrative hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law.

Capital Adequacy Requirements. The Federal Reserve, the FDIC and the OCC (collectively, the "Agencies") have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and account for off-balance sheet items. Failure to achieve and maintain adequate capital levels may give rise to supervisory action through the issuance of a capital directive to ensure the maintenance of required capital levels. Each of the Banks is in compliance with applicable capital level requirements.

The current guidelines require all federally regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders' equity, qualifying perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles and the allowance for loan and lease losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term preferred stock, 45% of unrealized gain of equity securities and general reserve for loan and lease losses up to 1.25% of risk weighted assets. None of the Banks has received any notice indicating that it will be subject to higher capital requirements.

Under these guidelines, banks' assets are given risk weights of 0%, 20%, 50% or 100%. Most loans are assigned to the 100% risk category, except for first mortgage loans fully secured by residential property and, under certain circumstances, residential construction loans (both carry a 50% rating). Most investment securities are assigned to the 20% category, except for municipal or state revenue bonds (which have a 50% rating) and direct obligations of or obligations guaranteed by the United States Treasury or United States Government Agencies (which have a 0% rating).

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The Agencies have also implemented a leverage ratio, which is equal to Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk based guidelines. The principal objective of the leverage ratio is to limit the maximum degree to which a bank may leverage its equity capital base. The minimum required leverage ratio for top rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points. Any institution operating at or near the 3% level is expected to be a strong banking organization without any supervisory, financial or operational weaknesses or deficiencies. Any institutions experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

Prompt Corrective Action. Regulations adopted by the Agencies impose even more stringent capital requirements. The FDIC and other Agencies must take certain "prompt corrective action" when a bank fails to meet capital requirements. The regulations establish and define five capital levels: (i) "well-capitalized," (ii) "adequately capitalized," (iii) "undercapitalized," (iv) "significantly undercapitalized" and (v) "critically undercapitalized." Increasingly severe restrictions are imposed on the payment of dividends and management fees, asset growth and other aspects of the operations of institutions that fall below the category of being "adequately capitalized". Undercapitalized institutions are required to develop and implement capital plans acceptable to the appropriate federal regulatory agency. Such plans must require that any company that controls the undercapitalized institution must provide certain guarantees that the institution will comply with the plan until it is adequately capitalized. As of February 28, 2007, neither the Company nor any of the Banks were subject to any regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure. Furthermore, as of that same date, each of the Banks was categorized as "well capitalized" under regulatory prompt corrective action provisions.

Restrictions on Dividends. Dividends paid to the Company by the Banks is the major source of Company cash flow. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National Bank, as a national bank, generally may pay dividends, without obtaining the express approval of the Office of the Comptroller of the Currency, in amount up to its retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Randall-Story Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

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Reserves Against Deposits. The Federal Reserve requires all depository institutions to maintain reserves against their transaction accounts (primarily checking accounts) and non-personal time deposits. Generally, reserves of 3% must be maintained against total transaction accounts of \$45,800,000 or less (subject to an exemption not in excess of the first \$8,500,000 of transaction accounts). A reserve of \$1,374,000 plus 10% of amounts in excess of \$45,800,000 must be maintained in the event total transaction accounts exceed \$45,800,000. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy applicable liquidity requirements. Because required reserves must be maintained in the form of vault cash or a noninterest bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce the earning assets of the Banks.

Regulatory Developments

In 2000, the Financial Services Modernization Act was enacted which: (i) repealed historical restrictions on preventing banks from affiliating with securities firms; (ii) broadens the activities that may be conducted by national banks and banking subsidiaries of holding companies; and (iii) provides an enhanced framework for protecting the privacy of consumers' information. In addition, bank holding companies may be owned, controlled or acquired by any company engaged in financially related activities, as long as such company meets regulatory requirements. To the extent that this legislation permits banks to affiliate with financial services companies, the banking industry may experience further consolidation.

Regulatory Enforcement Authority

The enforcement powers available to federal and state banking regulators are substantial and include, among other things, the ability to assess civil monetary penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, enforcement actions must 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. Applicable law also requires public disclosure of final enforcement actions by the federal banking agencies.

National Monetary Policies

In addition to being affected by general economic conditions, the earnings and growth of the Banks are affected by the regulatory authorities' policies, including the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply, credit conditions and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government securities, changes in reserve requirements against bank deposits and the Federal Reserve Discount Rate, which is the rate charged member banks to borrow from the Federal Reserve Bank. These instruments are used in varying combinations to influence overall growth and distribution of credit, bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid on deposits.

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The monetary policies of the Federal Reserve have had a material impact on the operating results of commercial banks in the past and are expected to have a similar impact in the future. Also important in terms of effect on banks are controls on interest rates paid by banks on deposits and types of deposits that may be offered by banks. The Depository Institutions Deregulation Committee, created by Congress in 1980, phased out ceilings on the rate of interest that may be paid on deposits by commercial banks and savings and loan associations, with the result that the differentials between the maximum rates banks and savings and loans can pay on deposit accounts have been eliminated. The effect of deregulation of deposit interest rates has been to increase banks' cost of funds and to make banks more sensitive to fluctuation in market rates.

Availability of Information on Company Website

The Company files periodic reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The Company makes available on or through its website free of charge all periodic reports filed by the Company with the SEC, including any amendments to such reports, as soon as reasonably practicable after such reports have been electronically filed with the SEC. The address of the Company's website on the Internet is: www.amesnational.com.

The Company will provide a paper copy of these reports free of charge upon written or telephonic request directed to John P. Nelson, Vice President and Secretary, 405 Fifth Street, Ames, Iowa 50010 or (515) 232-6251 or by email request at info@amesnational.com. The information found on the Company's website is not part of this or any other report the Company files with the SEC.

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Executive Officers of Company and Banks

The following table sets forth summary information about the executive officers of the Company and certain executive officers of the Banks. Unless otherwise indicated, each executive officer has served in his current position for the past five years.

Name	Age	Position with the Company or Bank and Principal Occupation and Employment During the Past Five Years
Kevin G. Deardorff	52	Vice President & Technology Director of the Company.
Leo E. Herrick	65	President of United Bank commencing June, 2002. Previously, employed as Chairman of the Board and President of F&M Bank-Iowa, Marshalltown, Iowa.
Daniel L. Krieger	70	Chairman of the Company since 2003 and President of Company since 1997. Previously served as President of First National. Also serves as a Director of the Company, Chairman of the Board and Trust Officer of First National and Chairman of the Board of Boone Bank and United Bank.
Stephen C. McGill	52	President of State Bank since 2003. Previously served as Senior Vice President of State Bank.
John P. Nelson	40	Vice President, Secretary and Treasurer of Company. Also serves as Director of Randall-Story Bank and State Bank.
Thomas H. Pohlman	56	Named Chief Operating Officer of the Company in 2006 and also serves as President of First National since 1999.
Jeffrey K. Putzier	45	President of Boone Bank since 1999.
Harold E. Thompson	61	President of Randall Story Bank since 2003. Previously served as Executive Vice President of Randall-Story State Bank.
Terrill L. Wycoff	63	Executive Vice President of First National since 2000.

ITEM 1A.**RISK FACTORS**

Rising Interest Rates

The Company has experienced a decrease in net income from 2004 to 2006, primarily as a result of reductions in net interest income due to rising market interest rates that have caused interest expense to increase more quickly than interest income. Rising interest rates will again present a challenge to the Company in 2007. Continued increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily its 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.

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Concentration of Operations

The Company's operations are concentrated in central Iowa. As a result of this geographic concentration, the Company's results may correlate to the economic conditions in this area. Deterioration in economic conditions, particularly in the industries on which this area depends (including agriculture which, in turn, is dependent upon weather conditions and government support programs), may adversely affect the quality of the Company's loan portfolio and the demand for the Company's products and services, and accordingly, its results of operations.

Risks Associated with Loans

A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Company has underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying the Company's loan portfolio. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect results of operations.

Competition with Larger Financial Institutions

The banking and financial services business in the Company's market area continues to be a competitive field and is becoming more competitive as a result of:

- changes in regulations;
- changes in technology and product delivery systems; and
- the accelerating pace of consolidation among financial services providers.

It may be difficult to compete effectively in the Company's market, and results of operations could be adversely affected by the nature or pace of change in competition. The Company competes for loans, deposits and customers with various bank and non-bank financial services providers, many of which are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services.

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Trading Volume

The trading volume in the Company's common stock on the Nasdaq Capital Market is relatively limited compared to those of larger companies listed on the Nasdaq Capital Market, the Nasdaq Global Markets, the New York Stock Exchange or other consolidated reporting systems or stock exchanges. A change in the supply or demand for the Company's common stock may have a more significant impact on the price of the Company's stock than for more actively traded companies.

Technological Advances

The financial services industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. The Company's future success will depend, in part, on its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in the Company's operations. Many of our competitors have substantially greater resources than the Company to invest in technological improvements.

Government Regulations

Current and future legislation and the policies established by federal and state regulatory authorities will affect the Company's operations. The Company and its Banks are subject to extensive supervision of, and examination by, federal and state regulatory authorities which may limit the Company's growth and the return to our shareholders by restricting certain activities, such as:

- the payment of dividends to the Company's shareholders;
- the payment of dividends to the Company from the Banks;
- possible mergers with or acquisitions of or by other institutions;
- investment policies;
- loans and interest rates on loans;
- interest rates paid on deposits;
- expansion of branch offices; and/or
- the possibility to provide or expand securities or trust services.

The Company cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any changes may have on future business and earnings prospects. The cost of compliance with regulatory requirements may adversely affect the Company's net income.

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Equity Prices

A substandard performance in the Company's equity portfolio could lead to a reduction in the historical level of realized security gains, thereby negatively impacting the Company's earnings. The Company invests capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks with an estimated fair market value of approximately \$24 million as of December 31, 2006. The Company focuses on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market.

ITEM 1B.

UNRESOLVED STAFF COMMENTS

The Company has not received any written comments from the staff of the SEC regarding its periodic or current reports filed under the Exchange Act in 2006.

ITEM 2.

PROPERTIES

The Company's office is housed in the main office of First National located at 405 Fifth Street, Ames, Iowa and occupies approximately 3,357 square feet. A lease agreement between the Company and First National provides the Company will make available for use by First National an equal amount of interior space at the Company's building located at 2330 Lincoln Way in lieu of rental payments. The main office is owned by First National free of any mortgage and consists of approximately 45,000 square feet and includes a drive-through banking facility. In addition to its main office, First National conducts its business through two full-service offices, the University office and the North Grand office, and one super-market location, the Cub Food office. A new full-service office branch is being constructed in Ankeny, Iowa and will occupy approximately 14,000 square feet and is expected to be opened in the second quarter of 2007. The North Grand office is owned by First National free of any mortgage. The University office is located in a 16,000 square foot multi-tenant property owned by the Company. A 24-year lease agreement with the Company has been modified in 2002 to provide that an equal amount of interior space will be made available to the Company at First National's main office at 405 Fifth Street in lieu of rental payments. First National will continue to rent the drive-up facilities of approximately 1,850 square feet at this location for \$1,200 per month. The Cub Foods office is leased by First National under a 20 year lease with a five year initial term and three, five year renewal options. The current annual rental payment is \$21,000.

State Bank conducts its business from its main office located at 1025 Sixth Street, Nevada, Iowa and from two additional full-service offices located in McCallsburg and Colo, Iowa. All of these properties are owned by State Bank free of any mortgage.

Boone Bank conducts its business from its main office located at 716 Eighth Street, Boone, Iowa and from one additional full-service office also located in Boone, Iowa. All properties are owned by Boone Bank free of any mortgage.

Randall-Story Bank conducts its business from its main office located at 606 Broad Street, Story City, Iowa which is owned by Randall-Story Bank free of any mortgage.

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United Bank conducts its business from its main office located at 2101 South Center Street, Marshalltown, Iowa. The 5,200 square foot premise was constructed in 2002. In 2005, United Bank purchased a branch location at 29 S. Center Street in Marshalltown that is 1,972 square feet. Both properties are owned by United Bank free of any mortgage.

The property the Company owns is located at 2330 Lincoln Way, Ames, Iowa consisting of a multi tenant building of approximately 16,000 square feet. First National leases 5,422 square feet of this building to serve as its University Office. 4,131 square feet of the remaining space is currently leased to five tenants who occupy the space for business purposes; the remaining 3,536 square feet of rentable space is currently unoccupied. The Company owns a real estate property adjacent to 2330 Lincoln Way at 2318 Lincoln Way which consists of a single story commercial building with 2,400 square feet of leased space that is currently occupied by one tenant for business purposes.

ITEM 3. LEGAL PROCEEDINGS

The Banks are from time to time parties to various legal actions arising in the normal course of business. The Company believes that there is no threatened or pending proceeding against the Company or the Banks, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company or the Banks.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

There were no matters submitted to a vote of the shareholders of the Company during the fourth quarter of 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

On February 28, 2007, the Company had approximately 570 shareholders of record and an estimated 926 additional beneficial owners whose shares were held in nominee titles through brokerage or other accounts. The Company's common stock is traded on the NASDAQ Capital Market under the symbol "ATLO". Trading in the Company's common stock is, however, relatively limited.

The Board of Directors of the Company approved a stock repurchase program on November 8, 2006. The Company has a strong capital position and this program provides an opportunity to repurchase Company stock on the open market when it is deemed to be favorably priced for repurchase. The program authorizes the repurchase of up to 100,000 shares during the calendar year 2007, or approximately 1% of 9,425,013 shares of common stock presently outstanding. The repurchases will be made in open market transactions at the discretion of management using Company cash. The timing and actual number of shares purchased will depend on a variety of factors such as price, the Company's liquidity position and other market conditions. The program may be limited or discontinued at any time without notice. The Company did not repurchase any shares in 2006.

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Based on information provided to and gathered by the Company on an informal basis, the Company believes that the high and low sales price for the common stock on a per share basis during the last two years is as follows:

<u>2006</u>			<u>2005</u>		
Market Price			Market Price		
Quarter	High	Low	Quarter	High	Low
1 st	\$ 28.57	\$ 22.85	1 st	\$ 32.67	\$ 27.57
2 nd	\$ 26.00	\$ 19.75	2 nd	\$ 40.00	\$ 30.00
3 rd	\$ 22.75	\$ 21.41	3 rd	\$ 42.82	\$ 25.57
4 th	\$ 22.69	\$ 19.82	4 th	\$ 29.00	\$ 23.12

The Company declared aggregate annual cash dividends in 2006 and 2005 of \$9,801,000 and \$9,417,000, respectively, or \$1.04 per share in 2006 and \$1.00 per share in 2005. In February 2007, the Company declared an aggregate cash dividend of \$2,545,000 or \$.27 per share. Quarterly dividends declared during the last two years were as follows:

<u>2006</u>		<u>2005</u>	
Quarter	Cash dividends declared per share	Cash dividends declared per share	
1 st	\$ 0.26	\$ 0.25	
2 nd	0.26	0.25	
3 rd	0.26	0.25	
4 th	0.26	0.25	

The decision to declare any such cash dividends in the future and the amount thereof rests within the discretion of the Board of Directors of the Company and will be subject to, among other things, the future earnings, capital requirements and financial condition of the Company and certain regulatory restrictions imposed on the payment of dividends by the Banks. Such restrictions are discussed in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources and in Note 11 of the Company's financial statements included herein.

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The following performance graph provides information regarding cumulative, five-year total return on an indexed basis of the Company's Common Stock as compared with the NASDAQ Composite Index, the SNL Midwest OTC Bulletin Board Bank Index ("Midwest OTC Bank Index") and the SNL NASDAQ Bank Index prepared by SNL Financial L.C. of Charlottesville, Virginia. The Midwest OTC Bank Index reflects the performance of 135 bank holding companies operating principally in the Midwest as selected by SNL Financial. The SNL NASDAQ Bank Index is comprised of all 525 bank holding companies listed on the NASDAQ market throughout the United States. The indexes assume the investment of \$100 on December 31, 2001 in the Common Stock, the NASDAQ Composite Index, Midwest OTC Bank Index and the NASDAQ Bank Index with all dividends reinvested. The Company's stock price performance shown in the following graph is not indicative of future stock price performance.

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The following financial data of the Company for the five years ended December 31, 2002 through 2006 is derived from the Company's historical audited financial statements and related footnotes. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and the consolidated financial statements and related notes contained elsewhere in this Annual Report.

(dollars in thousands, except per share amounts)	Year Ended December 31				
	2006	2005	2004	2003	2002
STATEMENT OF INCOME DATA					
Interest income	\$ 44,296	\$ 41,306	\$ 37,354	\$ 35,314	\$ 36,270
Interest expense	21,306	15,933	10,564	10,339	11,663
Net interest income	22,990	25,373	26,790	24,975	24,607
Provision (credit) for loan losses	(183)	331	479	645	688
Net interest income after provision (credit) for loan losses	23,173	25,042	26,311	24,330	23,919
Noninterest income	6,674	5,613	5,269	6,435	5,135
Noninterest expense	15,504	15,210	14,935	14,819	13,276
Income before provision for income tax	14,343	15,445	16,645	15,946	15,778
Provision for income tax	3,399	3,836	4,255	4,321	4,438
Net Income	\$ 10,944	\$ 11,609	\$ 12,390	\$ 11,625	\$ 11,340
	2006	2005	2004	2003	2002
DIVIDENDS AND EARNINGS PER SHARE DATA					
Cash dividends declared	\$ 9,801	\$ 9,417	\$ 7,590	\$ 7,142	\$ 6,820
Cash dividends declared per share	\$ 1.04	\$ 1.00	\$ 0.81	\$ 0.76	\$ 0.73
Basic and diluted earnings per share	\$ 1.16	\$ 1.23	\$ 1.32	\$ 1.24	\$ 1.21
Weighted average shares outstanding	9,422,402	9,415,599	9,405,705	9,393,672	9,381,855
BALANCE SHEET DATA					
Total assets	\$ 838,853	\$ 819,384	\$ 839,753	\$ 752,786	\$ 677,229
Net loans	429,123	440,318	411,639	355,533	329,593
Deposits	680,356	668,342	658,176	619,549	550,622
Stockholders' equity	112,923	109,227	110,924	107,325	101,523
Equity to assets ratio	13.46%	13.33%	13.21%	14.26%	14.99%
FIVE YEAR FINANCIAL PERFORMANCE					
Net income	\$ 10,944	\$ 11,609	\$ 12,390	\$ 11,625	\$ 11,340
Average assets	818,450	831,198	793,076	726,945	635,816
Average stockholders' equity	109,508	109,802	108,004	104,141	98,282
Return on assets (net income divided by average assets)	1.34%	1.40%	1.56%	1.60%	1.78%
Return on equity (net income divided by average equity)	9.99%	10.57%	11.47%	11.16%	11.54%

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Net interest margin (net interest income divided by average earning assets)	3.29%	3.56%	3.97%	4.02%	4.51%
Efficiency ratio (noninterest expense divided by noninterest income plus net interest income)	52.27%	49.09%	46.59%	47.18%	44.64%
Dividend payout ratio (dividends per share divided by net income per share)	89.66%	81.30%	61.27%	61.46%	60.05%
Dividend yield (dividends per share divided by closing year-end market price)	4.95%	3.89%	3.01%	3.91%	4.69%
Equity to assets ratio (average equity divided by average assets)	13.38%	13.21%	13.62%	14.33%	15.46%

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**ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
7. OF OPERATIONS**

Overview

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

The Company does not engage in any material business activities apart from its ownership of the Banks and managing its own bond and equity portfolio. 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, marketing, audit, compliance, technology systems and the coordination of management activities, in addition to 172 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 prompt response times and 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 improve 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) service charges on deposit accounts maintained at the Banks; (iii) interest on fixed income investments held by the Banks; (iv) fees on trust services provided by those Banks exercising trust powers; and (v) securities gains and dividends on equity investments held by the Company and the Banks. 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 Banks' 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 deposit accounts 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 reported net income of \$10,944,000 for the year ended December 31, 2006 compared to \$11,609,000 and \$12,390,000 reported for the years ended December 31, 2005 and 2004, respectively. This represents a decrease of 5.7% when comparing 2006 and 2005, and a decrease of 6.3% when comparing 2005 and 2004. The decline in net income in 2006 and 2005 is primarily the result of lower net interest income which in turn, has resulted from higher market interest rates that have caused deposit interest expense to increase more quickly than interest income on earning assets. Earnings per share for 2006 were \$1.16 compared to \$1.23 in 2005 and \$1.32 in 2004. Four of the Company's five Banks had profitable operations during 2006. United Bank posted a loss of \$58,000 in 2006.

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The Company's return on average equity for 2006 was 9.99% compared to 10.57% and 11.47% in 2005 and 2004, respectively, and the return on average assets for 2006 was 1.34% compared to 1.40% in 2005 and 1.56% in 2004. Lower net interest income caused both the return on average equity and return on average assets to decline in 2006 and 2005 compared to the previous year.

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

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

Challenges

Management has identified certain challenges that may negatively impact the Company's revenues and profitability 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 flat or slightly inverted for most of 2006. Banks have historically earned higher levels of net interest income by investing in 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 in 2007, the Company's net interest margin may continue to compress.
- Rising interest rates will present a challenge to the Company in 2007. Continued increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. 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.

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·The Company's market in central Iowa has numerous banks, credit unions, 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 substandard performance in the Company's equity portfolio could lead to a reduction in the historical level of realized security gains, thereby negatively impacting the Company's earnings. The Company invests capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks with an estimated fair market value of approximately \$24 million as of December 31, 2006. The Company focuses on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market.

Key Performance Indicators

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 8,681 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

	Year Ended December 31,					
	2006		2005		2004	
	Company	Industry	Company	Industry	Company	Industry
Return on assets	1.34%	1.28%	1.40%	1.28%	1.56%	1.29%
Return on equity	9.99%	12.34%	10.57%	12.46%	11.47%	13.28%
Net interest margin	3.29%	3.31%	3.56%	3.49%	3.97%	3.53%
Efficiency ratio	52.27%	56.79%	49.09%	57.24%	46.59%	58.03%
Capital ratio	13.38%	8.23%	13.21%	8.25%	13.62%	8.12%

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Key performance 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 return on assets ratio is in line with that of the industry, however, this ratio has declined in 2006 as compared to 2005 and 2004 as the result of lower net interest income.

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 return on equity ratio is below that of the industry primarily as a result of lower net interest income in 2006 and the higher level of capital the Company maintains for future growth and acquisitions.

Net Interest Margin

The ratio is calculated by dividing net interest income by average earning assets. Earning assets consist primarily 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 deposit accounts and other borrowings. The Company's net interest margin is in line with peer bank averages but has fallen since 2005 as rising market interest rates have caused interest expense to increase more quickly than interest income.

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 average.

Capital Ratio

The 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 fourth quarter of 2006:

FDIC-insured institutions reported total net income of \$35.7 billion in the fourth quarter of 2006. This was the lowest quarterly earnings total in 2006, but it was still more than the industry has earned in any quarter prior to 2006. Fourth-quarter net income was \$3.0 billion (9.3%) more than insured institutions reported in the last quarter of 2005 when large losses in credit-card portfolios hurt industry earnings. Fourth-quarter results were affected by accounting adjustments triggered by a few large corporate restructurings that occurred during the quarter; these adjustments had the effect of reducing a number of reported income and expense items. If not for these adjustments, industry net income probably would have set a new quarterly record, thanks to large one-time gains at a few big institutions. However, core earnings would have still been below the levels of the previous three quarters in 2006.

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Net interest income was \$178 million (0.2%) higher in the fourth quarter than a year earlier. This is the smallest year-over-year increase in quarterly net interest income in three years. Without the accounting impact of corporate restructurings, the underlying growth rate would have been closer to 3.3%. Similarly, the industry reported total noninterest income for the quarter of \$56.1 billion, or \$677 million (1.2%) more than it reported for the fourth quarter of 2005. Adjusted for the effect of the restructurings, the increase in noninterest income would have been approximately 13.7%. Among items that were not affected by the restructurings, sales of securities and other assets yielded net gains of \$624 million in the fourth quarter, while extraordinary items contributed another \$2.1 billion to pretax earnings. This is the largest quarterly amount of extraordinary gains ever reported. Most of the gains came from the sale of retail branches and a trust operation between insured institutions. One negative factor in fourth-quarter results was higher expenses for bad loans. The fourth-quarter loan-loss provision of \$9.6 billion was \$923 million (10.6%) higher than in the fourth quarter of 2005, and was the largest quarterly loss provision for the industry in two and a half years. The average return on assets (ROA) for the fourth quarter was 1.21%, the same as in the fourth quarter of 2005. Year-over-year improvements in quarterly profitability were concentrated among the largest institutions. More than half of all institutions — 52.4% — reported lower ROAs in the fourth quarter compared to the fourth quarter of 2005. Three out of every four institutions reporting lower ROAs also reported lower net interest margins.

About two out of every three insured institutions (64.4%) saw their net interest margins decline between the third and fourth quarters of 2006. The industry's average margin declined from 3.38% to 3.20%, based on reported results. Excluding the accounting impact of corporate restructurings, the industry's fourth-quarter margin would have been closer to 3.30%. In an environment of relatively stable interest rates and an inverted yield curve, insured institutions' average funding costs rose more rapidly than their average asset yields. This development is especially problematic for smaller institutions. During 2006, insured institutions with assets less than \$1 billion obtained three-quarters of their net operating revenue (total noninterest income plus net interest income) from net interest income. Larger institutions obtained only 57.1% of their net operating revenue from net interest income.

Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the last three years.

Critical Accounting Policy

The discussion contained in this Item 7 and other disclosures included within this report are based 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.

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

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.

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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.

ASSETS

	2006			2005			2004		
	Average balance	Revenue	Yield	Average balance	Revenue	Yield	Average balance	Revenue	Yield
(dollars in thousands)									
Interest-earning assets									
Loans 1									
Commercial	\$ 70,581	\$ 5,490	7.78%	\$ 66,581	\$ 4,286	6.44%	\$ 48,775	\$ 2,548	5.22%
Agricultural	33,054	2,758	8.34%	29,772	2,143	7.20%	28,406	1,839	6.47%
Real estate	306,991	19,655	6.40%	310,438	18,912	6.09%	285,087	17,169	6.02%
Consumer and other	27,540	1,691	6.14%	29,206	1,638	5.61%	23,079	1,317	5.71%
Total loans (including fees)	\$ 438,166	\$ 29,594	6.75%	\$ 435,997	\$ 26,979	6.19%	\$ 385,347	\$ 22,873	5.94%
Investment securities									
Taxable	\$ 212,897	\$ 9,195	4.32%	\$ 216,785	\$ 8,823	4.07%	\$ 213,043	\$ 8,911	4.18%
Tax-exempt 2	123,427	7,913	6.41%	126,323	8,006	6.34%	127,048	8,125	6.40%
Total investment securities	\$ 336,324	\$ 17,108	5.09%	\$ 343,108	\$ 16,829	4.90%	\$ 340,091	\$ 17,036	5.01%
Interest bearing deposits with banks	\$ 4,114	\$ 139	3.38%	\$ 7,037	\$ 169	2.40%	\$ 8,713	\$ 130	1.49%
Federal funds sold	4,229	224	5.30%	4,833	131	2.71%	11,630	159	1.37%
Total Interest-earning assets	\$ 782,833	\$ 47,065	6.01%	\$ 790,975	\$ 44,108	5.58%	\$ 745,781	\$ 40,198	5.39%
Noninterest-earning assets									
Cash and due from banks	\$ 17,056			\$ 22,885			\$ 27,581		
Premises and equipment, net	11,005			9,229			8,517		
Other, less allowance for loan losses	7,556			8,109			11,197		
Total noninterest-earning	\$ 35,617			\$ 40,223			\$ 47,295		

assets

TOTAL ASSETS	\$ 818,450	\$ 831,198	\$ 793,076
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1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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Average Balances and Interest Rates(continued)

LIABILITIES AND STOCKHOLDERS' EQUITY

	Average balance	2006 Revenue/ expense	Yield/ rate	Average balance	2005 Revenue/ expense	Yield/ rate	Average balance	2004 Revenue/ expense	Yield/ rate
(dollars in thousands)									
Interest-bearing liabilities									
Deposits									
Savings, NOW accounts, and money markets	\$ 314,567	\$ 8,250	2.62%	\$ 323,334	\$ 5,757	1.78%	\$ 329,410	\$ 3,210	0.97%
Time deposits < \$100,000	182,241	7,071	3.88%	173,966	5,530	3.18%	173,581	4,974	2.87%
Time deposits > \$100,000	99,123	4,422	4.46%	90,687	3,095	3.41%	70,076	1,759	2.51%
Total deposits	\$ 595,931	\$ 19,743	3.31%	\$ 587,987	\$ 14,382	2.45%	\$ 573,067	\$ 9,943	1.74%
Other borrowed funds	36,388	1,563	4.30%	56,443	1,551	2.75%	38,211	620	1.62%
Total Interest-bearing liabilities	\$ 632,319	\$ 21,306	3.37%	\$ 644,430	\$ 15,933	2.47%	\$ 611,278	\$ 10,563	1.73%
Noninterest-bearing liabilities									
Demand deposits	\$ 70,095			\$ 69,577			\$ 65,785		
Other liabilities	6,528			7,389			8,009		
Stockholders' equity	\$ 109,508			\$ 109,802			\$ 108,004		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 818,450			\$ 831,198			\$ 793,076		
Net interest income		\$ 25,759	3.29%		\$ 28,177	3.56%		\$ 29,635	3.97%
Spread Analysis									
Interest income/average assets		\$ 47,065	5.75%		\$ 44,108	5.31%		\$ 40,198	5.07%
Interest expense/average assets		21,306	2.60%		15,931	1.92%		10,563	1.33%
Net interest income/average assets		25,759	3.15%		28,177	3.39%		29,635	3.74%

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Rate and Volume Analysis

The rate and volume analysis is used to determine how much of the change in interest income or expense is the result of a change in volume or a change in interest rate. For example, commercial loan interest income increased \$1,204,000 in 2006 compared to 2005. An increased volume of commercial loans added \$270,000 in income in 2006 and higher interest rates increased interest income in 2006 by \$934,000.

The following table sets forth, on a tax-equivalent basis, a summary of the changes in net interest income resulting from changes in volume and rates.

(dollars in thousands)	2006 Compared to 2005			2005 Compared to 2004		
	Volume	Rate	Total 1	Volume	Rate	Total
Interest income						
Loans						
Commercial	\$ 270	\$ 934	\$ 1,204	\$ 1,060	\$ 678	\$ 1,738
Agricultural	253	362	615	91	213	304
Real estate	(212)	955	743	1,541	202	1,743
Consumer and other	(97)	150	53	344	(23)	321
Total loans (including fees)	\$ 214	\$ 2,401	\$ 2,615	\$ 3,036	\$ 1,070	\$ 4,106
Investment securities						
Taxable	\$ (161)	\$ 533	\$ 372	\$ 152	\$ (240)	\$ (88)
Tax-exempt	(182)	89	(93)	(45)	(74)	(119)
Total investment securities	\$ (343)	\$ 622	279	\$ 107	\$ (314)	\$ (207)
Interest bearing deposits with						
banks	\$ (84)	\$ 53	\$ (31)	\$ (29)	\$ 68	\$ 39
Federal funds sold	(18)	112	94	(127)	99	(28)
Total Interest-earning assets	\$ (231)	\$ 3,188	\$ 2,957	\$ 2,987	\$ 923	\$ 3,910
Interest-bearing liabilities						
Deposits						
Savings, NOW accounts, and money markets	\$ (160)	\$ 2,653	\$ 2,493	\$ (60)	\$ 2,605	\$ 2,545
Time deposits < \$100,000	274	1,267	1,541	12	544	556
Time deposits > \$100,000	308	1,020	1,328	602	734	1,336
Total deposits	\$ 422	\$ 4,940	\$ 5,362	\$ 554	\$ 3,883	\$ 4,437
Other borrowed funds	(672)	683	11	378	553	931
Total Interest-bearing liabilities	\$ (250)	\$ 5,623	\$ 5,373	\$ 932	\$ 4,436	\$ 5,368
Net interest income/earning assets	\$ 19	\$ (2,435)	\$ (2,416)	\$ 2,055	\$ (3,513)	\$ (1,458)

1 The change in interest due to both volume and yield/rate has been allocated to change due to volume and change due to yield/rate in proportion to the absolute value of the change in each.

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Net Interest Income

The Company's largest component contributing to net income is net interest income, which is the difference between interest earned on earning assets (which are primarily loans and investments) and interest paid on interest bearing liabilities (which are primarily deposits accounts and other borrowings). The volume of and yields earned on earning assets and the volume of and the rates paid on interest bearing liabilities determine net interest income. Refer to the tables preceding this paragraph for additional detail. Interest earned and interest paid is also affected by general economic conditions, particularly changes in market interest rates, and by government policies and the action of regulatory authorities. Net interest income divided by average earning assets is referred to as net interest margin. For the years December 31, 2006, 2005 and 2004, the Company's net interest margin was 3.29%, 3.56% and 3.97%, respectively.

Net interest income during 2006, 2005 and 2004 totaled \$22,990,000, \$25,373,000 and \$26,790,000, respectively, representing a 9% decrease in 2006 from 2005 and a 5% decrease in 2005 compared to 2004. Net interest income has fallen since 2004 as rising market interest rates have caused interest expense to increase more quickly than interest income.

The high level of competition in the local markets and increasing market interest rates will continue to put downward pressure on the net interest margin of the Company. Currently, the Company's largest market, Ames, Iowa, has nine banks, two thrifts, four credit unions and several other financial investment companies. Multiple banks are also located in the Company's other communities creating similarly competitive environments.

Provision for Loan Losses

The provision for loan losses reflects management's judgment of the expense to be recognized in order to maintain an adequate allowance for loan losses. The Company's credit for loan losses for the year ending December 31, 2006 was \$183,000 compared to a provision expense of \$331,000 during the same period last year. A reduction in the specific reserve for a problem credit and declining loan demand allowed a decrease in the required level of the allowance for loan losses calculated by the Banks. This decrease in estimated allowance created the credit for loan losses. The \$331,000 of provision expense for loan losses during 2005 was lower than the \$479,000 recorded in 2004 primarily as the result of a lower level of problem loans in 2005. Refer to the Asset Quality and Credit Risk Management discussion for additional details with regard to loan loss provision expense.

Management believes the allowance for loan losses to be adequate to absorb probable losses in the current portfolio. This statement is based upon management's continuing evaluation of inherent risks in the current loan portfolio, current levels of classified assets and general economic factors. The Company will continue to monitor the allowance and make future adjustments to the allowance as conditions dictate.

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Noninterest Income and Expense

Total noninterest income is comprised primarily of fee-based revenues from trust and agency services, bank related service charges on deposit activities, net securities gains generated primarily by the Company's equity holdings, merchant and ATM fees related to electronic processing of merchant and cash transactions and secondary market income.

Noninterest income during 2006, 2005 and 2004 totaled \$6,674,000, \$5,613,000 and \$5,269,000, respectively, representing a 19% increase in 2006 from 2005 and a 7% increase in 2005 from 2004. The increase in 2006 is primarily the result of a first quarter \$471,000 gain on the foreclosure of a commercial real estate property where the fair market value determined by an independent appraisal exceeded the loan carrying amount, an increase of \$339,000 in realized gains on the sale of securities in the Company's equity portfolio, and higher trust department income. The higher non-interest income in 2005 compared to 2004 related to higher realized gains on the sale of securities and improved trust department income.

Noninterest expense for the Company consists of all operating expenses other than interest expense on deposits and other borrowed funds. Historically, the Company has not had any material expenses relating to discontinued operations, extraordinary losses or adjustments from a change in accounting principles. Salaries and employee benefits are the largest component of the Company's operating expenses and comprise 61% of noninterest expenses in 2006.

Noninterest expense during 2006, 2005 and 2004 totaled \$15,504,000, \$15,210,000 and \$14,935,000, respectively, representing a 2% increase in both 2006 and 2005. Lower incentive compensation for senior officers of the Company and Banks in 2006 and 2005 contributed to the limited increase in noninterest expense. The percentage of noninterest expense to average assets was 1.89% in 2006, compared to 1.83% and 1.88% during 2005 and 2004, respectively.

Provision for Income Taxes

The provision for income taxes for 2006, 2005 and 2004 was \$3,399,000, \$3,836,000 and \$4,255,000, respectively. This amount represents an effective tax rate of 24% during 2006, compared to 25% and 26% for 2005 and 2004, respectively. The Company's marginal federal tax rate is currently 35%. The difference between the Company's effective and marginal tax rate is primarily related to investments made in tax exempt securities.

Balance Sheet Review

The Company's assets are comprised primarily of loans and investment securities. Average earning asset maturity or repricing dates are less than five years for the combined portfolios as the assets are funded for the most part by short term deposits with either immediate availability or less than one year average maturities. This exposes the Company to risk with regard to changes in interest rates that are more fully explained in Item 7A of this report "Quantitative and Qualitative Disclosures about Market Risk".

Total assets increased to \$838,853,000 in 2006 compared to \$819,384,000 in 2005, a 2% increase. The securities portfolio grew \$21 million and federal funds sold grew by \$13 million, offset by a decline of \$11 million in the Company's loan portfolio when comparing year end 2006 and 2005.

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Loan Portfolio

Net loans for the year ended December 31, 2006 totaled \$429,123,000, down from the \$440,318,000 as of December 31, 2005, a decrease of 3%. The decrease in loan volume can be primarily attributed to softening loan demand in 2006 and the payoff of a large loan from a local municipality. Loans are the primary contributor to the Company's revenues and cash flows. The average yield on loans was 166 and 129 basis points higher in 2006 and 2005, respectively, in comparison to the average tax-equivalent investment portfolio yields.

Types of Loans

The following table sets forth the composition of the Company's loan portfolio for the past five years ending at December 31, 2006.

(dollars in thousands)	2006	2005	2004	2003	2002
Real Estate					
Construction	\$ 30,600	\$ 23,973	\$ 21,042	\$ 13,126	\$ 13,518
1-4 family residential	103,620	102,043	97,612	84,645	81,239
Commercial	139,149	153,920	160,176	150,723	136,351
Agricultural	31,092	30,606	27,443	24,297	21,693
Commercial	73,760	71,430	57,189	38,555	40,097
Agricultural	33,434	32,216	30,713	27,815	26,022
Consumer and other	24,276	33,340	24,584	23,242	19,921
Total loans	435,931	447,528	418,759	362,403	338,841
Deferred loan fees, net	276	445	644	819	777
Total loans net of deferred fees	\$ 435,655	\$ 447,083	\$ 418,115	\$ 361,584	\$ 338,064

The Company's loan portfolio consists of real estate loans, commercial loans, agricultural loans and consumer loans. As of December 31, 2006, gross loans totaled approximately \$436 million, which equals approximately 64% of total deposits and 52% of total assets. The Company's peer group (consisting of 413 bank holding companies with total assets of \$500 to \$1,000 million) loan to deposit ratio as of September 30, 2006 was a much higher 90%. The primary factor relating to the lower loan to deposit ratio for the Company compared to peer group averages is a more conservative underwriting philosophy. As of December 31, 2006, the majority of the loans were originated directly by the Banks to borrowers within the Banks' principal market areas. There are no foreign loans outstanding during the years presented.

Real estate loans include various types of loans for which the Banks hold real property as collateral and consist of loans primarily on commercial properties and single family residences. Real estate loans typically have fixed rates for up to five years, with the Company's loan policy permitting a maximum fixed rate maturity of up to 15 years. The majority of construction loan volume is to contractors to construct commercial buildings and these loans generally have maturities of up to 12 months. The Banks originate residential real estate loans for sale to the secondary market for a fee.

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Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, floor-plans, inventory and accounts receivable; capital expenditure loans to finance equipment and other fixed assets; and letters of credit. These loans generally have short maturities, have either adjustable or fixed rates and are unsecured or secured by inventory, accounts receivable, equipment and/or real estate.

Agricultural loans play an important part in the Banks' loan portfolios. Iowa is a major agricultural state and is a national leader in both grain and livestock production. The Banks play a significant role in their communities in financing operating, livestock and real estate activities for area producers.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Banks' consumer lending is for vehicles, consolidation of personal debts, household appliances and improvements.

The interest rates charged on loans vary with the degree of risk and the amount and maturity of the loan. Competitive pressures, market interest rates, the availability of funds and government regulation further influence the rate charged on a loan. The Banks follow a loan policy, which has been approved by both the board of directors of the Company and the Banks, and is overseen by both Company and Bank management. These policies establish lending limits, review and grading criteria and other guidelines such as loan administration and allowance for loan losses. Loans are approved by the Banks' board of directors and/or designated officers in accordance with respective guidelines and underwriting policies of the Company. Credit limits generally vary according to the type of loan and the individual loan officer's experience. Loans to any one borrower are limited by applicable state and federal banking laws.

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Maturities and Sensitivities of Loans to Changes in Interest Rates as of December 31, 2006

The contractual maturities of the Company's loan portfolio are as shown below. Actual maturities may differ from contractual maturities because individual borrowers may have the right to prepay loans with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years	Total
Real Estate				
Construction	\$ 24,304	\$ 5,823	\$ 473	\$ 30,600
1-4 family residential	6,129	45,227	52,264	103,620
Commercial	23,027	88,078	28,044	139,149
Agricultural	2,528	5,105	23,459	31,092
Commercial	30,653	34,349	8,758	73,760
Agricultural	22,310	9,769	1,355	33,434
Consumer and other	4,212	16,365	3,699	24,276
Total loans	\$ 113,163	\$ 204,716	\$ 118,052	\$ 435,931

	After one year but within five years	After five years
Loan maturities after one year with:		
Fixed rates	\$ 175,326	\$ 24,159
Variable rates	29,390	93,893
	\$ 204,716	\$ 118,052

Loans Held For Sale

Mortgage origination funding awaiting delivery to the secondary market totaled \$526,000 and \$981,000 as of December 31, 2006 and 2005, respectively. Residential mortgage loans are originated by the Banks and sold to several secondary mortgage market outlets based upon customer product preferences and pricing considerations. The mortgages are sold in the secondary market to eliminate interest rate risk and to generate secondary market fee income. It is not anticipated at the present time that loans held for sale will become a significant portion of total assets.

Investment Portfolio

Total investments as of December 31, 2006 were \$354,572,000, an increase of \$21 million or 6% from the prior year end. As of December 31, 2006 and 2005, the investment portfolio comprised 42% and 41% of total assets, respectively.

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The following table presents the market values, which represent the carrying values due to the available-for-sale classification, of the Company's investment portfolio as of December 31, 2006, 2005 and 2004, respectively. This portfolio provides the Company with a significant amount of liquidity.

	2006	2005	2004
(dollars in thousands)			
U.S. treasury securities	\$ 509	\$ 516	\$ 531
U.S. government agencies	139,745	134,288	137,634
States and political subdivisions	119,908	108,373	113,818
Corporate bonds	60,624	59,567	77,573
Equity securities	33,786	30,766	33,904
Total	\$ 354,572	\$ 333,510	\$ 363,460

Investments in states and political subdivisions represent purchases of municipal bonds located primarily in the state of Iowa and contiguous states.

Investment in other securities includes corporate debt obligations of companies located and doing business throughout the United States. The debt obligations were all within the credit ratings acceptable under the Company's investment policy with the exception of the corporate debt obligations of one corporation that has a Moody's sub investment quality rating of Ba1 as of December 31, 2006. These corporate bonds had a fair market and carrying value as of December 31, 2006 of \$1,776,000 and \$1,759,000, respectively. The Company does not consider the corporate bonds to be other than temporarily impaired as of December 31, 2006. As of December 31, 2006, the Company did not have securities from a single issuer, except for the United States Government or its agencies, which exceeded 10% of consolidated stockholders' equity. The equity securities portfolio consists primarily of financial and utility stocks as of December 31, 2006, 2005, and 2004.

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Investment Maturities as of December 31, 2006

The investments in the following table are reported by contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years but within ten years	After ten years	Total
U.S. treasury securities	-	\$ 509	-	-	\$ 509
U.S. government agencies	\$ 39,959	65,484	\$ 26,273	\$ 3,441	139,745
States and political subdivisions	15,763	38,733	56,692	13,307	124,495
Corporate bonds	10,246	35,366	15,012	-	60,624
Total	\$ 65,968	\$ 140,092	\$ 97,977	\$ 16,748	\$ 320,785
Weighted average yield					
U.S. treasury	-	5.20%	-	-	5.20%
U.S. government agencies	3.36%	4.22%	6.43%	6.38%	4.21%
States and political subdivisions*	5.40%	6.14%	6.45%	6.33%	6.21%
Corporate bonds	3.88%	5.28%	5.92%	-	5.20%
Total	3.93%	5.02%	6.36%	6.34%	5.24%

* Yields on tax-exempt obligations of states and political subdivisions have been computed on a tax-equivalent basis.

Deposits

Types of Deposits

Total deposits equaled \$680,356,000 and \$668,342,000 as of December 31, 2006 and 2005, respectively. The increase of \$12,014,000 can be attributed to deposit growth at First National, Randall-Story Bank and United Bank. The deposit category seeing the largest balance increases was demand and interest-bearing checking (NOW) accounts.

The Company's primary source of funds is customer deposits. The Company attempts to attract noninterest-bearing deposits, which are a low-cost funding source. In addition, the Banks offer a variety of interest-bearing accounts designed to attract both short-term and longer-term deposits from customers. Interest-bearing accounts earn interest at rates established by Bank management based on competitive market factors and the Company's need for funds. While nearly 75% of the Banks' certificates of deposit mature in the next year, it is anticipated that a majority of these certificates will be renewed. Rate sensitive certificates of deposits in excess of \$100,000 are subject to somewhat higher volatility with regard to renewal volume as the Banks adjust rates based upon funding needs. In the event a substantial volume of certificates are not renewed, the Company has sufficient liquid assets and borrowing lines to fund significant runoff. A sustained reduction in deposit volume would have a significant negative impact on the Company's operation and liquidity. The Company has \$7,406,000 of brokered deposits as of December 31, 2006 and did not have any brokered deposits as of December 31, 2005.

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Average Deposits by Type

The following table sets forth the average balances for each major category of deposit and the weighted average interest rate paid for deposits during the years ended December 31, 2006, 2005 and 2004.

	2006		2005		2004	
(dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	\$ 70,095	-	\$ 69,577	-	\$ 65,785	-
Interest bearing demand deposits	153,619	2.44%	154,156	1.63%	154,332	0.80%
Money market deposits	134,078	3.16%	141,492	2.12%	146,479	1.25%
Savings deposits	26,870	0.99%	27,686	0.90%	28,599	0.47%
Time certificates < \$100,000	182,241	3.88%	173,966	3.18%	173,581	2.87%
Time certificates > \$100,000	99,123	4.46%	90,687	3.41%	70,076	2.51%
	\$ 666,026		\$ 657,564		\$ 638,852	

Deposit Maturity

The following table shows the amounts and remaining maturities of time certificates of deposit that had balances of \$100,000 and over as of December 31, 2006, 2005 and 2004.

	2006	2005	2004
(dollars in thousands)			
3 months or less	\$ 33,393	\$ 25,933	\$ 20,613
Over 3 through 12 months	45,898	47,279	29,217
Over 12 through 36 months	20,047	26,431	17,131
Over 36 months	2,893	1,399	2,103
Total	\$ 102,231	\$ 101,042	\$ 69,064

Borrowed Funds

Borrowed funds that may be utilized by the Company are comprised of Federal Home Loan Bank (FHLB) advances, federal funds purchased, Treasury, Tax, and Loan option notes, and repurchase agreements. Borrowed funds are an alternative funding source to deposits and can be used to fund the Company's assets and unforeseen liquidity needs. FHLB advances are loans from the FHLB that can mature daily or have longer maturities for fixed or floating rates of interest. Federal funds purchased are borrowings from other banks that mature daily. Securities sold under agreement to repurchase (repurchase agreements) are similar to deposits as they are funds lent by various Bank customers; however, the bank pledges investment securities to secure such borrowings. The Company's repurchase agreements normally reprice daily. Treasury, Tax, and Loan option notes consist of short term borrowing of tax deposits from the federal government and are not a significant source of borrowing for the Company.

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The following table summarizes the outstanding amount of, and the average rate on, borrowed funds as of December 31, 2006, 2005 and 2004.

(dollars in thousands)	2006		2005		2004	
	Balance	Average Rate	Balance	Average Rate	Balance	Average Rate
Federal funds purchased and repurchase agreements	\$ 34,728	4.42%	\$ 34,660	3.38%	\$ 64,072	1.99%
Other short-term borrowings	1,470	4.92%	2,861	4.52%	\$ -	-%
FHLB term advances	2,000	5.03%	-	-%	-	-%
Total	\$ 38,198	4.47%	\$ 37,521	3.46%	\$ 64,072	1.99%

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Average Annual Borrowed Funds

The following table sets forth the average amount of, the average rate paid and maximum outstanding balance on, borrowed funds for the years ended December 31, 2006, 2005 and 2004.

	2006		2005		2004	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
(dollars in thousands)						
Federal funds purchased & repurchase agreements	\$ 34,692	4.24%	\$ 55,337	2.72%	\$ 38,211	1.62%
Other short-term borrowings	1,029	5.73%	1,096	4.29%	-	-%
FHLB term advances	667	5.03%	-	-%	-	-%
Total	\$ 36,388	4.30%	\$ 56,443	2.75%	\$ 38,211	1.62%

Maximum Amount
Outstanding during the year

Federal funds purchased and repurchase agreements	\$ 44,928	\$ 70,489	\$ 65,391
Other short-term borrowings	2,415	\$ 5,000	-
FHLB term advances	2,000	-	-

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 that assist customers with their credit needs to conduct business. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. As of December 31, 2006, the financial instruments most likely impact on revenues, expenses, or cash flows of the Company would come from unidentified credit risk causing higher provision expense for loan losses in future periods. These financial instruments are not expected to have a significant impact on the liquidity or capital resources of the Company. For additional information, see footnote 10 of the "Notes to Consolidated Statements" and the "Liquidity and Capital Resources" section of this discussion.

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Contractual Obligations

The following table sets forth the balance of contractual obligations by maturity period as of December 31, 2006 (in thousands).

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Deposits	\$ 680,356	\$ 608,990	\$ 67,236	\$ 4,130	\$ -
Other Borrowings	38,198	36,198	-	2,000	-
Operating Lease Obligation	84	21	42	21	-
Purchase Obligations	1,966	624	1,248	94	-
Total	\$ 720,604	\$ 645,833	\$ 68,526	\$ 6,245	\$ -

Purchase obligations include data processing and Internet banking services contracts that include termination provisions that would accelerate all future payments in the event the Company changed service providers prior to the contracts' expirations.

Asset Quality Review and Credit Risk Management

The Company's credit risk is centered in the loan portfolio, which on December 31, 2006 totaled \$429,123,000 as compared to \$440,318,000 as of December 31, 2005, a decrease of 3%. Net loans comprise 51% of total assets as of the end of 2006. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of a transaction and to quantify and manage credit risk on a portfolio basis. As the following chart indicates, the Company's credit risk management practices have resulted in a low level of non-performing assets that total \$3,857,000 as of December 31, 2006. The Company's level of problem assets as a percentage of assets of 0.46% as December 31, 2006 compares favorably to the average for FDIC insured institutions as of September 30, 2006 of 0.55%.

Non-performing Assets

The following table sets forth information concerning the Company's non-performing assets for the past five years ending December 31, 2006.

(dollars in thousands)	2006	2005	2004	2003	2002
Non-performing assets:					
Nonaccrual loans					
Loans 90 days or more past due	\$ 291	\$ 606	\$ 1,896	\$ 1,756	\$ 2,015
and still accruing	758	83	80	431	394
Total non-performing loans	1,049	689	1,976	2,187	2,409
Other real estate owned	2,808	1,742	772	159	295
Total non-performing assets	\$ 3,857	\$ 2,431	\$ 2,748	\$ 2,346	\$ 2,704

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The accrual of interest on non-accrual and other impaired loans is discontinued at 90 days or when, in the opinion of management, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Interest income on restructured loans is recognized pursuant to the terms of the new loan agreement. Interest income on other impaired loans is monitored and based upon the terms of the underlying loan agreement. However, the recorded net investment in impaired loans, including accrued interest, is limited to the present value of the expected cash flows of the impaired loan or the observable fair market value of the loan's collateral.

At December 31, 2006 and 2005, the Company had impaired loans of approximately \$1,049,000 and \$689,000, respectively. The allowance for loan losses related to these impaired loans was approximately \$142,000 and \$55,000 at December 31, 2006 and 2005, respectively. The average balances of impaired loans for the years ended December 31, 2006 and 2005 were \$1,729,000 and \$1,645,000, respectively. For the years ended December 31, 2006, 2005, and 2004, interest income which would have been recorded under the original terms of such loans was approximately \$42,000, \$41,000 and \$239,000, respectively, with \$1,000, none, and \$211,000, respectively, recorded. Loans greater than 90 days past due and still accruing interest were approximately \$758,000 and \$83,000 at December 31, 2006 and 2005, respectively. There are no other potential problem loans that cause management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Summary of the Allowance for Loan Losses

The provision for loan losses represents an expense charged against earnings to maintain an adequate allowance for loan losses. The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial condition of the borrower; a realistic determination of value and adequacy of underlying collateral; the condition of the local economy and the condition of the specific industry of the borrower; an analysis of the levels and trends of loan categories; and a review of delinquent and classified loans.

The adequacy of the allowance for loan losses is evaluated quarterly by management and the respective Bank boards. This evaluation focuses on specific loan reviews, changes in the type and volume of the loan portfolio given the current economic conditions and historical loss experience. Any one of the following conditions may result in the review of a specific loan: concern about whether the customer's cash flow or collateral are sufficient to repay the loan; delinquent status; criticism of the loan in a regulatory examination; the accrual of interest has been suspended; or other reasons, including when the loan has other special or unusual characteristics which warrant special monitoring.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgment about information available to them at the time of their examination.

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Analysis of the Allowance for Loan Losses

The Company's policy is to charge-off loans when, in management's opinion, the loan is deemed uncollectible, although concerted efforts are made to maximize future recoveries. The following table sets forth information regarding changes in the Company's allowance for loan losses for the most recent five years.

(dollars in thousands)	2006	2005	2004	2003	2002
Balance at beginning of period	\$ 6,765	\$ 6,476	\$ 6,051	\$ 5,758	\$ 5,446
Charge-offs:					
Real Estate					
Construction	-	-	-	24	-
1-4 Family Residential	6	-	19	5	-
Commercial	-	28	93	-	40
Agricultural	-	-	-	-	-