HAWTHORN BANCSHARES, INC.
Form 10-Q
August 15, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2011

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________to__________

Commission File Number: 0-23636
HAWTHORN BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Missouri	**43-1626350**
(State or other jurisdiction of of incorporation or organization)	(I.R.S. Employer Identification No.)
300 Southwest Longview Boulevard, Lee s Summit, Missouri	**64081**
(Address of principal executive offices)	(Zip Code)

(816) 347-8100
(Registrant s telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes o No

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

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

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

As of August 15, 2011 the registrant had 4,652,994 shares of common stock, par value $1.00 per share, outstanding

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets *(unaudited)*

	June 30, 2011	December 31, 2010
ASSETS		
Loans	$ 868,798,817	$ 898,472,463
Allowances for loan losses	(13,863,050)	(14,564,867)
Net loans	854,935,767	883,907,596
Investment in available-for-sale securities, at fair value	219,697,283	178,977,550
Federal funds sold and securities purchased under agreements to resell	171,338	125,815
Cash and due from banks	35,068,582	50,853,985
Premises and equipment net	37,464,951	36,980,503
Other real estate owned and repossessed assets net	15,768,518	14,009,017
Accrued interest receivable	5,672,339	5,733,684
Mortgage servicing rights	2,271,915	2,355,990
Intangible assets net	750,796	977,509
Cash surrender value life insurance	2,036,197	2,001,965
Other assets	20,869,488	24,248,590
Total assets	$1,194,707,174	$1,200,172,204
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing demand	$ 148,139,814	$ 137,749,571
Savings, interest checking and money market	385,873,185	379,137,539
Time deposits $100,000 and over	132,783,863	124,566,760
Other time deposits	295,275,735	305,208,786
Total deposits	962,072,597	946,662,656
Federal funds purchased and securities sold under agreements to repurchase	28,689,667	30,068,453
Subordinated notes	49,486,000	49,486,000
Other borrowed money	43,656,668	66,985,978
Accrued interest payable	1,690,994	1,491,503
Other liabilities	4,766,987	3,989,303

Total liabilities	1,090,362,913	1,098,683,893
Stockholders equity:		
Preferred stock, $1,000 par value Authorized and issued 30,255 shares	29,079,479	28,841,242
Common stock, $1 par value Authorized 15,000,000 shares; issued 4,814,852, and 4,635,891 shares, respectively	4,635,891	4,635,891
Surplus	30,420,956	28,928,545
Retained earnings	41,318,862	41,857,302
Accumulated other comprehensive income, net of tax	2,405,891	742,149
Treasury stock; 161,858 shares, at cost	(3,516,818)	(3,516,818)
Total stockholders equity	104,344,261	101,488,311
Total liabilities and stockholders equity	$1,194,707,174	$1,200,172,204

See accompanying notes to consolidated financial statements.

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HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations ***(unaudited)***

	For the Three Months Ended June 30, 2011	For the Three Months Ended June 30, 2010	For the Six Months Ended June 30, 2011	For the Six Months Ended June 30, 2010
INTEREST INCOME				
Interest and fees on loans	$11,991,200	$13,633,597	$24,078,842	$27,052,073
Interest on debt securities:				
Taxable	1,342,958	1,118,098	2,497,854	2,182,077
Nontaxable	254,093	294,553	529,901	620,755
Interest on federal funds sold and securities purchased under agreements to resell	25	47	62	83
Interest on interest-bearing deposits	11,695	21,891	32,288	35,522
Dividends on other securities	40,661	34,750	84,361	85,447
Total interest income	13,640,632	15,102,936	27,223,308	29,975,957
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	447,813	554,453	931,504	1,185,206
Time deposit accounts $100,000 and over	432,649	651,252	895,821	1,362,634
Other time deposit accounts	1,315,987	1,850,082	2,738,789	3,848,733
Interest on federal funds purchased and securities sold under agreements to repurchase	12,628	19,123	25,983	39,663
Interest on subordinated notes	323,016	323,246	725,177	847,546
Interest on other borrowed money	326,008	590,653	642,967	1,267,014
Total interest expense	2,858,101	3,988,809	5,960,241	8,550,796
Net interest income	10,782,531	11,114,127	21,263,067	21,425,161
Provision for loan losses	1,883,334	2,150,000	3,633,336	4,655,000
Net interest income after provision for loan losses	8,899,197	8,964,127	17,629,731	16,770,161
NON-INTEREST INCOME				
Service charges on deposit accounts	1,419,272	1,427,202	2,729,763	2,723,290
Trust department income	228,771	200,644	423,866	379,506
Gain on sale of mortgage loans, net	215,996	297,201	462,230	521,774
Other	314,585	524,973	614,845	830,906
Total non-interest income	2,178,624	2,450,020	4,230,704	4,455,476

NON-INTEREST EXPENSE				
Salaries and employee benefits	4,333,620	4,550,320	9,010,693	9,207,441
Occupancy expense, net	584,685	604,734	1,223,049	1,226,406
Furniture and equipment expense	509,104	534,611	1,015,783	1,026,650
FDIC insurance assessment	396,266	435,020	875,013	845,198
Legal, examination, and professional fees	307,105	336,033	797,609	583,323
Advertising and promotion	269,700	296,834	501,875	575,023
Postage, printing, and supplies	295,774	286,190	564,481	574,356
Processing expense	812,808	856,495	1,634,885	1,706,860
Other real estate expense	548,436	1,506,291	1,040,869	2,012,746
Other	950,627	913,110	1,721,592	1,692,381
Total non-interest expense	9,008,125	10,319,638	18,385,849	19,450,384
Income before income taxes	2,069,696	1,094,509	3,474,586	1,775,253
Income tax expense	661,202	312,043	1,112,475	499,019
Net income	1,408,494	782,466	2,362,111	1,276,234
Preferred stock dividends	382,390	382,390	752,173	752,173
Accretion of discount on preferred stock	119,118	119,118	238,237	238,237
Net income available to common shareholders	$ 906,986	$ 280,958	$ 1,371,701	$ 285,824
Basic earnings per share	$ 0.19	$ 0.06	$ 0.29	$ 0.06
Diluted earnings per share	$ 0.19	$ 0.06	$ 0.29	$ 0.06

See accompanying notes to consolidated financial statements.

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HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders Equity and Comprehensive Income ***(unaudited)***

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stock - holders Equity
Balance, December 31, 2009	$ 28,364,768	$ 4,463,813	$ 26,970,745	$ 50,576,551	$ 912,224	$ (3,516,818)	$ 107,771,283
Net income				1,276,234			1,276,234
Change in unrealized gain (loss) on securities:							
Unrealized gain on debt securities available-for-sale, net of tax					1,145,269		1,145,269
Defined benefit pension plans:							
Amortization of prior service cost included in net periodic pension cost, net of tax					23,982		23,982
Total other comprehensive income							1,169,251
Total comprehensive income							2,445,485
Stock based compensation expense			48,542				48,542
Accretion of preferred stock discount	238,237			(238,237)			
Stock dividend			2,042,568	(2,042,568)			
Cash dividends declared, preferred stock				(756,375)			(756,375)
Cash dividends declared, common				(688,313)			(688,313)

stock							
Balance, June 30, 2010	**$ 28,603,005**	**$ 4,463,813**	**$ 29,061,855**	**$ 48,127,292**	**$ 2,081,475**	**$ (3,516,818)**	**$ 108,820,622**
Balance, December 31, 2010	**$ 28,841,242**	**$ 4,635,891**	**$ 28,928,545**	**$ 41,857,302**	**$ 742,149**	**$ (3,516,818)**	**$ 101,488,311**
Net income				2,362,111			2,362,111
Change in unrealized gain on securities:							
Unrealized gain on debt securities available-for-sale, net of tax					1,639,760		1,639,760
Defined benefit pension plans:							
Amortization of prior service cost included in net periodic pension cost, net of tax					23,982		23,982
Total other comprehensive income							1,663,742
Total comprehensive income							4,025,853
Stock based compensation expense			33,877				33,877
Accretion of preferred stock discount	238,237			(238,237)			
Stock dividend			1,458,534	(1,458,534)			
Cash dividends declared, preferred stock				(756,376)			(756,376)
Cash dividends declared, common stock				(447,404)			(447,404)
	$ 29,079,479	**$ 4,635,891**	**$ 30,420,956**	**$ 41,318,862**	**$ 2,405,891**	**$ (3,516,818)**	**$ 104,344,261**

Balance, June 30, 2011

See accompanying notes to consolidated financial statements.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows ***(unaudited)***

	Six Months Ended June 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 2,362,111	$ 1,276,234
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,633,336	4,655,000
Depreciation expense	963,122	1,005,026
Net amortization of debt securities, premiums, and discounts	406,130	283,997
Amortization of core deposit intangible assets	226,713	290,425
Stock based compensation expense	33,877	48,542
Loss on sales and dispositions of premises and equipment	667	59,621
Loss on sales and dispositions of other real estate owned and repossessions	258,885	1,234,995
Provision for other real estate owned	440,805	
Decrease in accrued interest receivable	61,345	692,372
Increase in cash surrender value -life insurance	(34,232)	(30,156)
Decrease (increase) in income tax receivable	1,112,475	(803,397)
Decrease in other assets	277,522	965,928
Increase (decrease) in accrued interest payable	199,491	(141,173)
Increase in other liabilities	777,683	831,382
Origination of mortgage loans for sale	(23,115,786)	(29,524,264)
Proceeds from the sale of mortgage loans	22,336,960	30,046,038
Gain on sale of mortgage loans, net	(462,230)	(521,774)
Decrease in net deferred tax asset	15,332	1,346,832
Other, net	23,982	23,982
Net cash provided by operating activities	9,518,188	11,739,610
Cash flows from investing activities:		
Net decrease in loans	20,636,247	27,991,681
Purchase of available-for-sale debt securities	(83,043,472)	(140,268,118)
Proceeds from maturities of available-for-sale debt securities	19,097,740	98,037,862
Proceeds from calls of available-for-sale debt securities	25,508,000	28,780,100
Proceeds from sales of FHLB stock	1,077,100	595,200
Purchases of premises and equipment	(1,487,479)	(239,112)
Proceeds from sales of premises and equipment	34,249	34,528
Proceeds from sales of other real estate owned and repossessions	3,421,481	4,802,109
Net cash (used) provided in investing activities	(14,756,134)	19,734,250
Cash flows from financing activities:		
Net increase (decrease) in demand deposits	10,390,244	(3,512,371)
Net increase in interest-bearing transaction accounts	6,971,783	38,040,414
Net decrease in time deposits	(1,952,085)	(19,492,569)

Net decrease in federal funds purchased and securities sold under agreements to repurchase	(1,378,786)	(1,476,597)
Repayment of Federal Home Loan Bank advances	(23,329,310)	(11,967,528)
Cash dividends paid preferred stock	(756,376)	(756,375)
Cash dividends paid common stock	(447,404)	(946,430)
Net cash provided by financing activities	(10,501,934)	(111,456)
Net (decrease) increase in cash and cash equivalents	(15,739,880)	31,362,404
Cash and cash equivalents, beginning of period	50,979,800	24,665,695
Cash and cash equivalents, end of period	$ 35,239,920	$ 56,028,099

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HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows *(unaudited) (continued)*

	Six Months Ended June 30, 2011	2010
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$5,760,750	$ 8,691,969
Income taxes	$	$ 200,000
Supplemental schedule of noncash investing and financing activities:		
Other real estate and repossessions acquired in settlement of loans	$5,943,302	$11,750,040

See accompanying notes to consolidated financial statements.

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HAWTHORN BANCSHARES, INC.
AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include all adjustments that, in the opinion of management, are necessary in order to make those statements not misleading. Management is required to make estimates and assumptions, including the determination of the allowance for loan losses, real estate acquired in connection with foreclosure or in satisfaction of loans, and fair values of investment securities available-for-sale that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Our Company s management has evaluated and did not identify any subsequent events or transactions requiring recognition or disclosure in the consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q, do not include all of the information and disclosures required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the consolidated financial statements and related notes filed in our Company s Annual Report on Form 10-K for the year ended December 31, 2010.

On July 1, 2011, our Company paid a special stock dividend of four percent to common shareholders of record at the close of business on May 12, 2011. For all periods presented, share information, including basic and diluted earnings per share have been adjusted retroactively to reflect this change.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2010 Annual Report on form 10-K.

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HAWTHORN BANCSHARES, INC.
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(Unaudited)

(2) Loans and Allowance for Loan Losses

A summary of loans, by major class within our Company s loan portfolio, at June 30, 2011 and December 31, 2010 are as follows:

	June 30, 2011	December 31, 2010
Commercial, financial, and agricultural	$127,627,653	$131,382,467
Real estate construction residential	28,646,137	31,834,174
Real estate construction commercial	50,836,737	56,052,910
Real estate mortgage residential	203,066,932	207,834,488
Real estate mortgage commercial	428,971,600	439,068,622
Installment and other consumer	29,475,102	32,132,336
Unamortized loan origination fees and costs, net	174,656	167,466
Total loans	$868,798,817	$898,472,463

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the communities of and surrounding Jefferson City, Clinton, Warsaw, Springfield, Branson and Lee s Summit, Missouri. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of the financing of vehicles.

At June 30, 2011, loans of $439,441,000 were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit.

Allowance for loan losses

The following table provides the balance in the allowance for loan losses at June 30, 2011 and December 31, 2010, and the related loan balance by impairment methodology. Loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, troubled debt restructurings, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb credit losses.

HAWTHORN BANCSHARES, INC.
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(Unaudited)

The following is a summary of the allowance for loan losses at or for the three and six months ended June 30, 2011 as follows:

	For the Three Months Ended June 30, 2011							
(in thousands)	**Commercial, Financial, and Agricultural**	**Real Estate Construction - Residential**	**Real Estate Construction - Commercial**	**Real Estate Mortgage - Residential**	**Real Estate Mortgage - Commercial**	**Installment Loans to Individuals**	**Unallocated**	**Total**
Allowance for loan losses:								
Balance, beginning of period	$2,257	$ 991	$ 1,356	$3,118	$3,709	$223	$748	$12,402
Additions:								
Provision for loan losses	313	(6)	(276)	306	1,264	62	220	1,883
Deductions:								
Loans charged off	45			466	160	138		809
Less recoveries on loans	(8)	(1)	(250)	(32)	(24)	(72)		(387)
Net loans charged off	37	(1)	(250)	434	136	66		422
Balance, end of period	$2,533	$ 986	$ 1,330	$2,990	$4,837	$219	$968	$13,863

	For the Six Months Ended June 30, 2011							
(in thousands)	**Commercial, Financial, and Agricultural**	**Real Estate Construction - Residential**	**Real Estate Construction - Commercial**	**Real Estate Mortgage - Residential**	**Real Estate Mortgage - Commercial**	**Installment Loans to Individuals**	**Unallocated**	**Total**
Allowance for loan losses:								

Balance, beginning of period	$2,931	$ 2,067	$ 1,339	$3,922	$3,458	$ 231	$617	$14,565
Additions:								
Provision for loan losses	406	404	(259)	533	2,091	107	351	3,633
Deductions:								
Loans charged off	873	1,547		1,539	741	247		4,947
Less recoveries on loans	(69)	(62)	(250)	(74)	(29)	(128)		(612)
Net loans charged off	804	1,485	(250)	1,465	712	119		4,335
Balance, end of period	$2,533	$ 986	$ 1,330	$2,990	$4,837	$ 219	$968	$13,863

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HAWTHORN BANCSHARES, INC.
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The tables provide other information regarding the allowance for loan losses and balance by type of allowance methodology at June 30, 2011 and December 31, 2010 as follows:

(in thousands)	Commercial, Financial, and Agricultural	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment Loans to Individuals	Unallocated	Total
June 30, 2011								
Allowance for loan losses:								
Individually evaluated for impairment	$ 1,465	$ 45	$ 274	$ 515	$ 3,187	$	$	$ 5,486
Collectively evaluated for impairment	1,068	941	1,056	2,475	1,650	219	968	8,377
Total	$ 2,533	$ 986	$ 1,330	$ 2,990	$ 4,837	$ 219	$ 968	$ 13,863
Loans outstanding:								
Individually evaluated for impairment	$ 5,366	$ 832	$ 10,994	$ 6,767	$ 31,961	$	$	$ 55,920
Collectively evaluated for impairment	122,261	27,814	39,843	196,300	397,011	29,650		812,879
Total	$ 127,627	$ 28,646	$ 50,837	$ 203,067	$ 428,972	$ 29,650	$	$ 868,799
December 31, 2010								
Allowance for loan losses:								
Individually evaluated for	$ 1,737	$ 1,553	$ 201	$ 1,117	$ 1,768	$	$	$ 6,376

impairment								
Collectively evaluated for impairment	1,194	514	1,138	2,805	1,690	231	617	8,189
Total	$ 2,931	$ 2,067	$ 1,339	$ 3,922	$ 3,458	$ 231	$ 617	$ 14,565
Loans outstanding:								
Individually evaluated for impairment	$ 3,660	$ 3,586	$ 11,783	$ 8,040	$ 29,076	$	$	$ 56,145
Collectively evaluated for impairment	127,722	28,248	44,270	199,795	409,993	32,299		842,327
Total	$ 131,382	$ 31,834	$ 56,053	$ 207,835	$ 439,069	$ 32,299	$	$ 898,472

Loans, or portions of loans, are charged off to the extent deemed uncollectible. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. Once the fair value for a collateral dependent loan has been determined, any impaired amount is typically charged off unless the loan has other income streams to support repayment. For impaired loans which have other income streams to support repayment, a specific reserve is established for the amount determined to be impaired.

Impaired loans

Impaired loans totaled $56,091,828 and $56,270,543 at June 30, 2011 and December 31, 2010 respectively, and are comprised of loans on non-accrual status and loans which have been classified as troubled debt restructurings.

The categories of impaired loans at June 30, 2011 and December 31, 2010 are as follows:

	June 30, 2011	**December 31, 2010**
Non-accrual loans	$ 49,543,857	$ 50,586,887
Troubled debt restructurings continuing to accrue interest	6,547,971	5,683,656
Total impaired loans	$ 56,091,828	$ 56,270,543

At June 30, 2011, loans classified as trouble debt restructurings (TDR) totaled $23,913,139, of which $17,365,168 were on non-accrual status and $6,547,971 were on accrual status. At December 31, 2010, loans classified as TDR totaled $22,080,431, of which $16,396,775 were on non-accrual status and $5,683,656 was on accrual status. Reserves allocated to troubled debt restructurings were $1,781,000 and $1,359,000 at June 30, 2011 and December 31, 2010, respectively.

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HAWTHORN BANCSHARES, INC.
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Interest income recognized on loans in non-accrual status and contractual interest that would be recorded had the loans performed in accordance with their original contractual terms is as follows:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2011	**2010**	**2011**	**2010**
Contractual interest due on non-accrual loans	$612,472	$784,350	$1,218,908	$1,278,237
Interest income recognized on loans in non-accrual status	32,802	(9,134)	32,840	4,220
Net reduction in interest income	$579,670	$793,484	$1,186,068	$1,274,017

The specific reserve component of our Company s allowance for loan losses at June 30, 2011 and December 31, 2010 was determined by using fair values of the underlying collateral obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows. The recorded investment varies from the unpaid principal balance primarily due to partial charge-offs taken resulting from current appraisals received. The amount recognized as interest income on impaired loans continuing to accrue interest, primarily related to troubled debt restructurings, was $71,482 and $318,709 for the six months ended June 30, 2011 and June 30, 2010, respectively. Average recorded investment in impaired loans is calculated on a monthly basis during the period.

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HAWTHORN BANCSHARES, INC.
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The following table provides additional information about impaired loans at June 30, 2011 and December 31, 2010, respectively, segregated between loans for which an allowance has been provided and loans for which no allowance has been provided:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized For the Period Ended Three Months	Six Months
At June 30, 2011						
With no related allowance recorded:						
Commercial, financial and Agricultural	$ 3,063,278	$ 3,148,134	$	$ 2,150,452	$ 11,074	$
Real estate construction residential	659,870	824,500		1,731,871		
Real estate construction commercial	8,235,882	9,348,798		8,251,242		
Real estate residential	2,488,885	3,269,889		3,429,353	11,698	7,014
Real estate commercial	12,796,159	14,527,062		9,977,051	18,040	
Consumer	172,191	209,667		203,899	1,349	
Total	$27,416,265	$31,328,050	$	$25,743,868	$ 42,161	$ 7,014
With an allowance recorded:						
Commercial, financial and Agricultural	$ 2,302,712	$ 2,193,991	$1,465,198	$ 1,818,910	$ 4,400	$ 2,208
Real estate construction residential	171,982	181,002	45,000	172,315		
Real estate construction commercial	2,758,396	4,013,396	274,000	2,067,649		
Real estate residential	4,277,926	4,385,847	514,978	3,998,773	54,472	27,140
	19,164,547	19,705,512	3,186,738	17,998,970	3,289	1,648

Real estate commercial						
Total	$28,675,563	$30,479,748	$5,485,914	$26,056,617	$ 62,161	$30,996
Total impaired loans	$56,091,828	$61,807,798	$5,485,914	$51,800,485	$104,322	$38,010
At December 31, 2010						
With no related allowance recorded:						
Commercial, financial and Agricultural	$ 441,861	$ 629,296	$			
Real estate construction residential	1,769,622	2,355,936				
Real estate construction commercial	8,297,388	9,393,368				
Real estate residential	2,463,735	2,950,560				
Real estate commercial	12,939,973	14,869,833				
Consumer	125,858	132,688				
Total	$26,038,437	$30,331,681	$			
With an allowance recorded:						
Commercial, financial and Agricultural	$ 3,217,995	$ 3,260,009	$1,737,159			
Real estate construction residential	1,816,276	1,848,593	1,552,406			
Real estate construction commercial	3,485,517	4,740,517	201,147			
Real estate residential	5,576,292	5,669,041	1,117,141			
Real estate commercial	16,136,025	16,215,862	1,767,893			
Total	$30,232,106	$31,734,022	$6,375,746			
Total impaired loans	$56,270,543	$62,065,703	$6,375,746			

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It is our Company s policy to discontinue the accrual of interest income on loans when management believes that the borrower s financial condition, after consideration of business conditions and collection efforts, is such that the collection of interest is doubtful, or upon which principal or interest has been in default for a period of 90 days or more and the asset is not both well secured and in the process of collection. Subsequent interest payments received on such loans are applied to principal if any doubt exists as to the collectability of such principal; otherwise, such receipts are recorded as interest income on a cash basis.

Age Analysis of Past Due and Non-Accrual Loans

	Current or Less Than 30 Days Past Due	30 - 89 Days Past Due	90 Days Past Due And Still Accruing	Non-Accrual	Total
June 30, 2011					
Commercial, Financial, and Agricultural	$123,586,765	$ 737,482	$	$ 3,303,406	$127,627,653
Real Estate Construction Residential	27,814,284			831,853	28,646,137
Real Estate Construction Commercial	39,833,780	8,679		10,994,278	50,836,737
Real Estate Mortgage Residential	197,059,787	1,391,903	98,631	4,516,611	203,066,932
Real Estate Mortgage Commercial	398,975,412	270,671		29,725,518	428,971,601
Installment and Other Consumer	28,977,502	499,973	91	172,191	29,649,757
Total	$816,247,530	$2,908,708	$98,722	$49,543,857	$868,798,817
December 31, 2010					
Commercial, Financial, and Agricultural	$127,315,586	$ 534,865	$	$ 3,532,016	$131,382,467
Real Estate Construction Residential	28,200,876	47,400		3,585,898	31,834,174
Real Estate Construction Commercial	45,511,088	474,934		10,066,888	56,052,910
Real Estate Mortgage Residential	199,386,784	2,775,654		5,672,050	207,834,488
Real Estate Mortgage Commercial	409,906,845	1,557,599		27,604,178	439,068,622
Installment and Other Consumer	31,784,217	356,812	32,916	125,857	32,299,802
Total	$842,105,396	$5,747,264	$32,916	$50,586,887	$898,472,463

The following table provides information about the credit quality of the loan portfolio using our Company s internal rating system reflecting management s risk assessment. Loans are placed on *watch* status when (1) one or more weaknesses which could jeopardize timely liquidation exits; or (2) the margin or liquidity of an asset is sufficiently tenuous that adverse trends could result in a collection problem. Loans classified as *substandard* are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified may have a well defined weakness or weaknesses that jeopardize the repayment of the debt. Such loans are characterized by the distinct possibility that our Company may sustain some loss if the deficiencies are not corrected. Loans are placed on *non-accrual* status when (1) deterioration in the financial condition of the borrower exists such that payment of full principal and interest is not expected, or (2) payment of principal or interest has been in default for a period of 90 days or more and the asset is not both well secured and in the process of collection.

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	Commercial	Real Estate Construction - Residential	Real Estate Construction - Commercial	Real Estate Mortgage - Residential	Real Estate Mortgage - Commercial	Installment and other Consumer	Total
At June 30, 2011							
Watch	$22,626,495	$ 8,109,338	$ 9,392,484	$13,097,712	$30,453,623	$ 419,571	$ 84,099,223
Substandard	4,412,920	829,405	1,991,878	4,163,925	14,582,568	411,775	26,392,471
Non-accrual	3,303,406	831,853	10,994,278	4,516,611	29,725,518	172,191	49,543,857
Total	$30,342,821	$ 9,770,596	$22,378,640	$21,778,248	$74,761,709	$1,003,537	$160,035,551
At December 31, 2010							
Watch	$21,981,367	$ 7,519,394	$ 9,400,584	$ 9,184,659	$35,050,206	$ 564,489	$ 83,700,699
Substandard	2,840,703	757,637	4,242,934	4,423,219	12,635,163	441,514	25,341,170
Non-accrual	3,532,016	3,585,898	10,066,888	5,672,050	27,604,178	125,857	50,586,887
Total	$28,354,086	$11,862,929	$23,710,406	$19,279,928	$75,289,547	$1,131,860	$159,628,756

(3) Real Estate Acquired in Settlement of Loans

	June 30, 2011	December 31, 2010
Commercial	$	$ 67,421
Real estate mortgage construction	12,803,203	13,229,199
Real estate mortgage	9,149,815	6,254,221
Total	$21,953,018	$19,550,841
Less valuation allowance for other real estate owned	(6,536,607)	(6,158,433)
Total	$15,416,411	$13,392,408

Balance at December 31, 2010	$19,550,841
Additions, net of charge-offs	5,583,613
Proceeds from sales	(3,123,105)
Net loss on sales	(58,331)

Total other real estate owned	$21,953,018
Less valuation allowance for other real estate owned	(6,536,607)
Balance at June 30, 2011	$15,416,411

Activity in the valuation allowance for other real estate owned in settlement of loans for the three and six months ended June 30, 2011 and 2010, respectively, is summarized as follows:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2011	**2010**	**2011**	**2010**
Balance, beginning of period	$ 6,319,098	$	$ 6,158,433	$
Provision for other real estate owned	280,140		440,805	
Charge-offs	(62,631)		(62,631)	
Balance, end of period	**$** 6,536,607	**$**	**$** 6,536,607	**$**

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(4) Investment Securities

A summary of investment securities by major category, at fair value, consisted of the following at June 30, 2011 and December 31, 2010.

	June 30, 2011	December 31, 2010
U.S. treasury	$ 2,048,203	$ 1,027,891
Government sponsored enterprises	67,212,769	53,341,551
Asset-backed securities	118,939,994	90,176,241
Obligations of states and political subdivisions	31,496,317	34,431,867
Total available for sale securities	$219,697,283	$178,977,550

All of our Company s investment securities are classified as available for sale, as discussed in more detail below. Asset backed securities include agency mortgage-backed securities, which are guaranteed by government sponsored entities and government agencies such as the FHLMC, FNMA and GNMA.

Investment securities which are classified as restricted equity securities primarily consist of Federal Home Loan Bank Stock and our Company s interest in statutory trusts. These securities are reported at cost in other assets in the amount of $5,064,850 and $6,141,950, as of June 30, 2011 and December 31, 2010, respectively.

The amortized cost and fair value of debt securities classified as available-for-sale at June 30, 2011 and December 31, 2010 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2011				
U.S Treasury	$ 1,999,561	$ 48,642	$	$ 2,048,203
Government sponsored enterprises	66,792,397	524,211	103,839	67,212,769
Asset-backed securities	115,927,700	3,093,068	80,775	118,939,993
Obligations of states and political subdivisions	30,609,854	907,160	20,696	31,496,318
Total available for sale securities	$215,329,512	$4,573,081	$ 205,310	$219,697,283
December 31, 2010				
U.S Treasury	$ 999,823	$ 28,068	$	$ 1,027,891
Government sponsored enterprises	53,516,545	327,051	502,045	53,341,551
Asset-backed securities	88,634,760	1,905,377	363,896	90,176,241
Obligations of states and political subdivisions	34,146,782	555,240	270,155	34,431,867
Total available for sale securities	$177,297,910	$2,815,736	$1,136,096	$178,977,550

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The amortized cost and fair value of debt securities classified as available-for-sale at June 30, 2011, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without prepayment penalties.

	Amortized cost	**Fair value**
Due in one year or less	$ 3,794,942	$ 3,832,846
Due after one year through five years	75,790,661	76,597,778
Due after five years through ten years	17,310,704	17,771,625
Due after ten years	2,505,505	2,555,041
	99,401,812	100,757,290
Asset-backed securities	115,927,700	118,939,993
Total	$215,329,512	$219,697,283

Debt securities with carrying values aggregating approximately $170,372,000 and $148,099,000 at June 30, 2011 and December 31, 2010, respectively, were pledged to secure public fund deposits, federal funds purchased lines, securities sold under agreements to repurchase, borrowing capacity at the Federal Reserve, and for other purposes as required or permitted by law.

Gross unrealized losses on debt securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2011 and December 31, 2010, were as follows:

	Less than 12 months		**12 months or more**			**Total**	
At June 30, 2011	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Number of Investment Positions**	**Fair Value**	**Unrealized Losses**
Government sponsored enterprises	$13,295,901	$(103,839)	$	$	12	$13,295,901	(103,839)
Asset-backed securities	10,382,348	(80,775)			10	10,382,348	$ (80,775)
Obligations of states and political subdivisions	1,122,000	(20,696)			6	1,122,000	(20,696)
	$24,800,249	$(205,310)	$	$	28	$24,800,249	$(205,310)

	Less than 12 months	**12 months or more**	**Total**

At December 31, 2010	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Number of Investment Positions	Fair Value	Unrealized Losses
Government sponsored enterprises	$20,504,526	$ (502,045)	$	$	19	$20,504,526	(502,045)
Asset-backed securities	21,177,793	(363,896)			20	21,177,793	$ (363,896)
Obligations of states and political subdivisions	8,038,946	(270,155)			29	8,038,946	(270,155)
	$49,721,265	$(1,136,096)	$	$	68	$49,721,265	$(1,136,096)

Our Company s available for sale portfolio consisted of approximately 358 securities at June 30, 2011. None of these securities had been in the loss position for 12 months or longer. The $205,000 unrealized loss included in other comprehensive income at June 30, 2011 was caused by interest rate fluctuations. Because the decline in fair value is attributable to changes in interest rates and not credit quality these investments were not considered other-than-temporarily impaired.

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Our Company s available for sale portfolio consisted of approximately 333 securities at December 31, 2010. None of these securities had been in the loss position for 12 months or longer. The $1,136,000 unrealized loss included in other comprehensive income at December 31, 2010 was caused by interest rate fluctuations. Because the decline in fair value is attributable to changes in interest rates and not credit quality these investments were not considered other-than-temporarily impaired.

During the six months ended June 30, 2011 and 2010, there were no proceeds from sales of securities and no components of investment securities gains and losses which have been recognized in earnings.

(5) Intangible Assets

A summary of other intangible assets at June 30, 2011 and December 31, 2010, respectively is as follows:

	June 30, 2011			December 31, 2010		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Amount**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Amount**
Amortizable intangible assets:						
Core deposit intangible	$4,795,224	$(4,044,428)	$ 750,796	$ 7,060,224	$(6,082,715)	$ 977,509
Mortgage servicing rights	3,084,915	(813,000)	2,271,915	3,067,368	(711,378)	2,355,990
Total intangible assets	$7,880,139	$(4,857,428)	$3,022,711	$10,127,592	$(6,794,093)	$3,333,499

Changes in the net carrying amount of other intangible assets for the three months ended June 30, 2011 are as follows:

	Core Deposit Intangible Asset	**Mortgage Servicing Rights**
Balance at December 31, 2010	**$ 977,509**	**$2,355,990**
Additions		220,554
Amortization	(226,713)	(304,629)
Balance at June 30, 2011	**$ 750,796**	**$2,271,915**

Mortgage servicing rights (MSRs) are amortized over the shorter of 7 years or the life of the loan. They are periodically reviewed for impairment and if impairment is indicated, recorded at fair value. At June 30, 2011 and December 31, 2010, no temporary impairment was recognized. The fair value of MSRs is based on the present value of expected cash flows, as further discussed in *Fair Value of Financial Instruments.* Mortgage loans serviced for others totaled approximately $300,040,000 and $298,325,000 at June 30, 2011 and December 31, 2010, respectively. Included in other noninterest income were real estate servicing fees for the three months ended June 30, 2011 and 2010 of $211,000, and $204,000, respectively, and for the six months ended June 30, 2011 and 2010 of $390,000 and

$396,000, respectively.

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The aggregate amortization expense of intangible assets subject to amortization for the three and six months ended June 30, 2011 and 2010 is as follows:

Aggregate amortization expense	For the Three Months Ended June 30, 2011	2010	For the Six Months Ended June 30, 2011	2010
Core deposit intangible asset	$108,687	$139,906	$226,713	$290,425
Mortgage servicing rights	155,390	152,102	304,629	286,976

Our Company s amortization expense on intangible assets in any given period may be different from the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions. The following table shows the estimated future amortization expense based on existing asset balances and the interest rate environment as of June 30, 2011 for the next five years:

	Core Deposit Intangible Asset	Mortgage Servicing Rights
2011	$208,050	$230,000
2012	408,062	435,000
2013	134,684	354,000
2014		288,000
2015		235,000

(6) Income Taxes

Our Company follows ASC Topic 740, *Income Taxes,* which addresses the accounting for uncertain tax positions. At June 30, 2011 and December 31, 2010, our Company had $221,000 of gross unrecognized tax benefits that if recognized would affect the effective tax rate. Our Company believes that during 2011 it is reasonably possible that there would be a reduction of $221,000 in gross unrecognized tax benefits as a result of the lapse of statute of limitations for the 2007 tax year. At June 30, 2011, total interest accrued on unrecognized tax benefits was approximately $40,000. As of June 30, 2011, there were no federal or state income tax examinations in process.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not our Company will realize the benefits of these temporary differences at June 30, 2011 and, therefore, has not established a valuation reserve.

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 32.0% and 28.5% for the three months ended June 30, 2011 and 2010, and 32.0% and 28.1% for the six months ended June 30, 2011 and 2010, respectively. The effective tax rate for the three and six months ended June 30, 2011 reflects a decrease in tax-exempt income as a percentage of total taxable income.

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(7) Employee Benefit Plans

Employee benefits charged to operating expenses are summarized in the table below.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Payroll taxes	$ 264,350	$283,673	$ 578,879	$ 605,640
Medical plans	434,470	393,503	876,789	798,355
401k match	67,414	73,776	135,013	153,788
Pension plan	227,592	216,298	455,185	432,597
Profit-sharing	16,000		39,000	72,470
Other	58,405	32,688	99,968	74,016
Total employee benefits	$1,068,231	$999,938	$2,184,834	$2,136,866

Our Company s profit-sharing plan includes a matching 401k portion, in which our Company matches the first 3% of eligible employee contributions. Our Company made annual contributions in an amount up to 6% of income before income taxes and before contributions to the profit-sharing and pension plans for all participants, limited to the maximum amount deductible for Federal income tax purposes, for each of the years shown. In addition, employees were able to make additional tax-deferred contributions.

Pension

Our Company also provides a noncontributory defined benefit pension plan for all full-time employees. An employer is required to recognize the funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Under our Company s funding policy for the defined benefit pension plan, contributions are made to a trust as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, a contribution might not be made in a particular year. Our Company made a $554,000 contribution to the defined benefit plan in 2010, and the minimum required contribution for 2011 is estimated to be $997,000. Our Company has contributed $767,000 to the plan for the year.

The following items are components of net pension cost for the periods indicated:

	Estimated 2011	**Actual 2010**
Service cost benefits earned during the year	$ 930,691	$ 844,178
Interest costs on projected benefit obligations	603,903	556,047
Expected return on plan assets	(702,852)	(613,982)
Amortization of prior service cost	78,628	78,628
Net periodic pension expense	$ 910,370	$ 864,871
Pension expense three months ended June 30, (actual)	$ 227,593	$ 216,299

Pension expense	six months ended June 30, (actual)	$ 455,185	$ 432,597

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(8) Stock Compensation

Our Company s stock option plan provides for the grant of options to purchase up to 506,188 shares of our Company s common stock to officers and other key employees of our Company and its subsidiaries. All options have been granted at exercise prices equal to fair value and vest over periods ranging from four to five years, except options issued in 2008 to acquire 10,705 shares that vested immediately.

The following table summarizes our Company s stock option activity:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value (000)
Outstanding at January 1, 2011 *	260,466	$24.44		
Granted				
Exercised				
Forfeited				
Expired				
Outstanding at June 30, 2011	260,466	$24.44	4.0	$
Exercisable at June 30, 2011	227,635	$24.69	3.7	$

* Options have been adjusted to reflect a 4% stock dividend paid on July 1, 2011.

Total stock-based compensation expense for the three months ended June 30, 2011 and 2010, was $12,000 and $19,000, respectively, and for the six months ended June 30, 2011 and 2010 was $34,000 and $48,000, respectively. As of June 30, 2011, the total unrecognized compensation expense related to non-vested stock awards was $123,000 and the related weighted average period over which it is expected to be recognized is approximately three years.

(9) Comprehensive Income

Activity in other comprehensive income for the six months ended June 30, 2011 and 2010 is shown in the *Consolidated Statements of Stockholders Equity and Comprehensive Income*. The first component of other comprehensive income is the unrealized holding gains and losses on available for sale securities. Our Company did not have any other-than temporary impairment (OTTI) as required to be reported under current accounting guidance for OTTI on debt securities during the periods reported. Under this guidance, credit-related losses on debt securities with OTTI are recorded in current earnings, while the noncredit- related portion of the overall gain or loss in fair value is recorded in other comprehensive income. The second component of other comprehensive income is pension gains and losses that arise during the period but are not recognized as components of net periodic benefit cost, and corresponding adjustments when these gains and losses are subsequently amortized to net periodic benefit cost.

(10) Preferred Stock

On December 19, 2008, our Company announced its participation in the U.S. Treasury Department s Capital Purchase Program (CPP), a voluntary program that provides capital to financially healthy banks. This program is designed to attract broad participation by banking institutions to help stabilize the financial system by encouraging lending. Our Company has used the funds received, as discussed below, to continue to provide loans to its customers and to look for ways to deploy additional funds to benefit the communities in our Company s market area.

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Participation in this program included our Company s issuance of 30,255 shares of senior preferred stock (with a par value of $1,000 per share) and a ten year warrant to purchase approximately 276,090 shares of common stock (see below for additional information) to the U.S. Department of Treasury in exchange for $30,255,000. The proceeds received were allocated between the preferred stock and the common stock warrant based upon their relative fair values. This resulted in the recording of a discount on the preferred stock upon issuance that reflects the value allocated to the warrant. The discount on the preferred stock will be accreted over five years, consistent with managements estimate of the life of the preferred stock. Such accretion will be treated as additional dividends on the preferred stock. The allocated carrying values of the senior preferred stock and common stock warrant at June 30, 2011 were $29,079,000 and $2,382,000, respectively.

The preferred shares carry a 5% cumulative dividend for the first five years and 9% thereafter if not redeemed. The preferred shares are redeemable after three years at par plus accrued dividends, or before three years if our Company raises Tier 1 capital in an amount equal to the preferred stock issued. The preferred stock generally does not have any voting rights, subject to an exception in the event our Company fails to pay dividends on the preferred stock for six or more quarterly periods, whether or not consecutive. Under such circumstances, the Treasury Department will be entitled to vote to elect two directors to the board until all unpaid dividends have been paid or declared and set apart for payment. Our Company is prohibited from paying any dividends with respect to shares of common stock unless all accrued and unpaid dividends are paid in full on the senior preferred stock for all past dividend periods. The Treasury Department may also transfer the senior preferred stock to a third party at any time.

The common stock warrant is exercisable immediately with a ten year term, in whole or in part, at an exercise price of $16.44 per share. The preferred stock and warrant are classified as stockholders equity in the consolidated balance sheet and qualify, for regulatory capital purposes, as Tier I capital. For the six months ended June 30, 2011, our Company had declared and paid $756,000 of dividends and amortized $238,000 of accretion of the discount on preferred stock.

(11) Earnings per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share gives effect to all dilutive potential common shares that were outstanding during the year. The calculations of basic and diluted earnings per share are as follows:

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	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Basic earnings per common share:				
Net income	$1,408,494	$ 782,466	$2,362,111	$1,276,234
Less:				
Preferred stock dividends	382,390	382,390	752,173	752,173
Accretion of discount on preferred stock	119,118	119,118	238,237	238,237
Net income available to common shareholders	$ 906,986	$ 280,958	$1,371,701	$ 285,824
Basic earnings per share	$ 0.19	$ 0.06	$ 0.29	$ 0.06
Diluted earnings per common share:				
Net income	$1,408,494	$ 782,466	$2,362,111	$1,276,234
Less:				
Preferred stock dividends	382,390	382,390	752,173	752,173
Accretion of discount on preferred stock	119,118	119,118	238,237	238,237
Net income available to common shareholders	$ 906,986	$ 280,958	$1,371,701	$ 285,824
Average shares outstanding	4,652,994	4,652,994	4,652,994	4,652,994
Effect of dilutive stock options				
Average shares outstanding including dilutive stock options	4,652,994	4,652,994	4,652,994	4,652,994
Diluted earnings per share	$ 0.19	$ 0.06	$ 0.29	$ 0.06

Under the treasury stock method, outstanding stock options are dilutive when the average market price of our Company s common stock, when combined with the effect of any unamortized compensation expense, exceeds the option price during the period, except when our Company has a loss from continuing operations available to common shareholders. In addition, proceeds from the assumed exercise of dilutive options along with the related tax benefit are assumed to be used to repurchase common shares at the average market price of such stock during the period.

The following options to purchase shares during the three and six months ended June 30, 2011 and 2010, respectively, were not included in the respective computations of diluted earnings per share because the exercise price of the option, when combined with the effect of the unamortized compensation expense, was greater than the average market price of the common shares and were considered anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Anti-dilutive shares option shares	260,466	298,382	260,466	298,382
Anti-dilutive shares warrant shares	276,090	276,090	276,090	276,090

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(12) Fair Value Measurements

Our Company uses fair value measurements to record fair value adjustments to certain financial and nonfinancial assets and liabilities. The FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The standard applies whenever other standards require (permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, FASB clarified the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. As of the six months ended June 30, 2011 and 2010, there were no transfers into or out of Level 2.

The fair value hierarchy is as follows:

Level 1 Inputs are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 Inputs are unobservable inputs for the asset or liability and significant to the fair value. These may be internally developed using our Company s best information and assumptions that a market participant would consider.

ASC Topic 820 also provides guidance on determining fair value when the volume and level of activity for the asset or liability has significantly decreased and on identifying circumstances when a transaction may not be considered orderly.

Our Company is required to disclose assets and liabilities measured at fair value on a recurring basis separate from those measured at fair value on a nonrecurring basis. Nonfinancial assets measured at fair value on a nonrecurring basis would include foreclosed real estate, long-lived assets, and core deposit intangible assets, which are reviewed when circumstances or other events indicate that impairment may have occurred.

Valuation methods for instruments measured at fair value on a recurring basis

Following is a description of our Company s valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

Available-for-sale securities

Available-for-sale securities are recorded at fair value on a recurring basis. Available-for-sale securities is the only balance sheet category our Company is required, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP), to carry at fair value on a recurring basis. Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, our Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things.

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		Fair Value Measurements Using		
Description	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
June 30, 2011				
U.S. treasury	$ 2,048,203	$	$ 2,048,203	$
Government sponsored enterprises	67,212,769		67,212,769	
Asset-backed securities	118,939,994		118,939,994	
Obligations of states and political subdivisions	31,496,317		31,496,317	
Total	$219,697,283		$219,697,283	$
December 31, 2010				
U.S. treasury	$ 1,027,891	$	$ 1,027,891	$
Government sponsored enterprises	53,341,551		53,341,551	
Asset-backed securities	90,176,241		90,176,241	
Obligations of states and political subdivisions	34,431,867		34,431,867	
Total	$178,977,550		$178,977,550	$

Valuation methods for instruments measured at fair value on a nonrecurring basis

Following is a description of our Company s valuation methodologies used for assets and liabilities recorded at fair value on a nonrecurring basis:

Impaired Loans

Our Company does not record loans at fair value on a recurring basis other than loans that are considered impaired. The net carrying value of impaired loans is generally based on fair values of the underlying collateral obtained through independent appraisals or internal evaluations, or by discounting the total expected future cash flows. Once the fair value of the collateral has been determined and any impairment amount calculated, a specific reserve allocation is made. Because many of these inputs are not observable, the measurements are classified as Level 3. As of June 30, 2011, our Company identified $28.7 million in impaired loans that had specific allowances for losses aggregating $5.5 million. Related to these loans, there was $3.8 million in charge-offs recorded during 2011.

Other Real Estate Owned and Repossessed Assets

Other real estate owned and repossessed assets consist of loan collateral which has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including autos, manufactured homes, and construction equipment. Other real estate owned assets are recorded as held for sale initially at the lower of the loan balance or fair value of the collateral less estimated selling costs. Our

Company relies on external appraisals and assessment of property values by our internal staff. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgment based on experience and expertise of internal specialists. Subsequent to foreclosure, valuations are updated periodically, and the assets may be written down to reflect a new cost basis. Because many of these inputs are not observable, the measurements are classified as Level 3.

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		Fair Value Measurements Using			
Description	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Gains (Losses)***
June 30, 2011					
Impaired loans:					
Commercial, financial, & agricultural	$ 837,514	$	$	$ 837,514	$ (860,168)
Real estate construction residential	126,982			126,982	(1,493,046)
Real estate construction commercial	2,484,396			2,484,396	
Real estate mortgage residential	3,762,948				