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2007

ANNUAL REPORT

TO

SHAREHOLDERS

HAWTHORN BANCSHARES, INC.

Lee's Summit, Missouri

Hawthorn BANCSHARES™

March 14, 2008

Dear Investors:

2007 was a challenging year for Hawthorn Bancshares, Inc. The Federal Reserve Board's actions tightened our spread between interest bearing assets and liabilities which resulted in net interest income decreasing $1,637,000 or 4.1% compared to 2006. Additionally, Company resources were focused on internally re-organizing and re-branding our four separate banking subsidiaries into one bank and one operating platform. Nonrecurring expenses related to the consolidation, which was completed during the 4th quarter of 2007, totaled $1,207,000. We knew that our investment in re-branding the entire organization would be sizable, but felt it was important to set a strong foundation for Hawthorn Bank under a single identity to make it easier for customers to do business with us and to distinguish Hawthorn Bank from the other banks in the region.

Capitalization, expressed in terms of tier one capital to adjusted average total assets (leverage ratio), was 9.12% at year-end 2007 compared to 8.77% at December 31, 2006. Total capital to risk-weighted assets was 13.24% at December 31, 2007 compared to 13.84% at year-end 2006. Both ratios continue to exceed the Federal Reserve's definition of "well capitalized". Shareholders received dividends totaling $0.84 per share in 2007 which was consistent with dividends paid in 2006. At December 31, 2007, our Company's dividend yield was 3.36%. Management is proud of our Company's healthy dividend.

Regarding 2007 financial highlights, total assets increased to $1,195,804,000. For 2007, return on average equity was 7.22% and the return on average assets was 0.67%, compared to 10.79% and 0.95% respectively for 2006.

Weakening Economy...Consumers Not Keeping Up...Price of Oil Hits another All Time High...Bearish Outlook...Sub-prime Lending Crisis...With headlines like these from major news sources, it is apparent that the financial industry is facing its greatest challenges in decades. Despite our challenging environment, Hawthorn Bancshares, Inc. is poised to weather these turbulent times. We increased the balance of our allowance for loan losses $267,000 to $9,282,000 at year-end 2007 (1.02% of outstanding loans). Net charge-offs for 2007 were $887,000 compared to $1,396,000 for 2006. While total non-performing loans did increase slightly from 0.62% of total loans at 2006 to 0.67% at year end 2007, this level is still considered manageable.

As we move forward in our strategic planning process, I assure you that Hawthorn Bancshares, Inc. will not lose sight of its long standing tradition of providing unrivaled customer service. Hawthorn Bancshares' philosophy of having local leadership in decision making roles will remain unchanged. The Directors and Management of our Company believe that Hawthorn Bancshares, Inc. has not reached its full financial potential. We are excited about things to come. Thank you for your continued support as we move forward with our strategic plan.

Sincerely,

James E. Smith

JAMES E. SMITH
Chairman & Chief Executive Officer

Hawthorn Bancshares | 300 S.W. Longview Blvd. | Lee's Summit, MO 6408-2101 | **T** 816.268.6318 | **F** 816.268.6318 | NASDAQ:HWBK

HAWTHORN BANCSHARES, INC.
DESCRIPTION OF BUSINESS

Our Company, Hawthorn Bancshares, Inc., is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Hawthorn was incorporated under the laws of the State of Missouri on October 23, 1992 as Exchange National Bancshares, Inc. and changed its name to Hawthorn Bancshares, Inc. in August 2007. Hawthorn owns all of the issued and outstanding capital stock of Union State Bancshares, Inc., which in turn owns all of the issued and outstanding capital stock of Hawthorn Bank. Hawthorn and Union State Bancshares each received approval from the Federal Reserve and elected to become a financial holding company on October 17, 2001.

Hawthorn acquired Hawthorn Bank and its constituent predecessor banks, as well as Union State Bancshares, in a series of transactions that are summarized as follows:

- On April 7, 1993 our Company acquired all of the issued and outstanding capital stock of The Exchange National Bank of Jefferson City, a national banking association, pursuant to a corporate reorganization involving an exchange of shares;
- On November 3, 1997, our Company acquired Union State Bancshares, Inc., and Union's wholly-owned subsidiary, Union State Bank and Trust of Clinton;
- Following the May 4, 2000 acquisition of Citizens State Bank of Calhoun by Union State Bank, Citizens State Bank merged into Union State Bank to form Citizens Union State Bank & Trust;
- On January 3, 2000, our Company acquired Osage Valley Bank;
- On June 16, 2000, Hawthorn acquired City National Savings Bank, FSB, which was then merged into Exchange National Bank; and
- On May 2, 2005, our Company acquired all of the issued and outstanding capital stock of Bank 10, a Missouri state bank.

On December 1, 2006, our Company announced its development of a strategic plan in which, among other things, Exchange National Bank, Citizens Union State Bank, Osage Valley Bank and Bank 10 would be consolidated into a single bank under a Missouri state trust charter. This consolidation was completed in October 2007, and our subsidiary bank is now known as Hawthorn Bank.

Except as otherwise provided herein, references herein to "Hawthorn" or our "Company" include Hawthorn and its consolidated subsidiaries, and references herein to our "Bank" refers to Hawthorn Bank and its constituent predecessors.

Our subsidiary Bank is a full service bank conducting a general banking business, offering its customers checking and savings accounts, debit cards, certificates of deposit, safety deposit boxes and a wide range of lending services, including commercial and industrial loans, residential real estate loans, single payment personal loans, installment loans and credit card accounts. In addition, our Bank provides trust services.

The deposit accounts of our Bank are insured by the Federal Deposit Insurance Corporation (the "FDIC") to the extent provided by law. The operations of our Bank are supervised and regulated by the FDIC and the Missouri Division of Finance. Periodic examinations of our Bank are conducted by representatives of the FDIC and the Missouri Division of Finance. Such regulations, supervision and examinations are principally for the benefit of depositors, rather than for the benefit of shareholders. Hawthorn Bancshares is subject to supervision and examination by the Federal Reserve Board.

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents selected consolidated financial information for our Company as of and for each of the years in the five-year period ended December 31, 2007. The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements of our Company, including the related notes, presented elsewhere herein.

(Dollars expressed in thousands, except share and per share data)

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Income Statement Data					
Interest income	$ 74,207	71,423	57,340	41,091	38,922
Interest expense	37,175	32,766	23,673	13,387	12,798
Net interest income	37,032	38,657	33,667	27,704	26,124
Provision for loan losses	1,154	1,326	1,322	942	1,092
Net interest income after provision for loan losses	35,878	37,331	32,345	26,762	25,032
Security gains (losses), net	(2)	(18)	(25)	(8)	38
Other noninterest income	10,223	8,618	7,290	5,741	6,666
Total noninterest income	10,221	8,600	7,265	5,733	6,704
Noninterest expense	35,054	30,148	25,368	20,383	18,536
Income before income taxes	11,045	15,783	14,242	12,112	13,200
Income taxes	3,245	4,908	4,327	3,807	4,156
Net income	$ 7,800	10,875	9,915	8,305	9,044
Dividends					
Declared on common stock	$ 3,504	3,503	3,503	3,378	3,183
Paid on common stock	3,504	3,503	3,378	3,378	2,988
Ratio of total dividends declared to net income	44.92%	32.21	35.33	40.67	35.19
Per Share Data					
Basic earnings per common share	$ 1.87	2.61	2.38	1.99	2.17
Diluted earnings per common share	1.85	2.59	2.36	1.98	2.15
Basic weighted average shares of common stock outstanding	4,171,163	4,169,847	4,169,847	4,169,847	4,169,432
Diluted weighted average shares of common stock outstanding	4,210,844	4,204,547	4,198,859	4,204,752	4,209,272

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Balance Sheet Data (at period end)					
Investment securities	$ 157,368	189,773	179,692	171,718	188,956
Loans	911,278	812,312	813,535	636,637	583,919
Total assets	1,195,804	1,142,712	1,126,470	923,874	875,596
Total deposits	921,257	899,865	881,455	726,649	665,262
Securities sold under agreements to repurchase and other short term borrowed funds	25,730	31,196	38,094	35,413	73,672
Subordinated notes	49,486	49,486	49,486	25,774	-
Other borrowed money	77,915	47,368	52,180	39,525	41,630
Total stockholders' equity	111,199	104,945	96,733	91,771	87,783
Earnings Ratios					
Return on average total assets	0.67%	0.95	0.91	0.93	1.09
Return on average stockholders' equity	7.22	10.79	10.47	9.16	10.45
Asset Quality Ratios					
Allowance for loan losses to loans	1.02	1.11	1.12	1.18	1.42
Nonperforming loans to loans (1)	0.67	0.62	1.11	0.96	0.52
Allowance for loan losses to nonperforming loans (1)	152.54	177.95	100.39	123.05	274.29
Nonperforming assets to loans and foreclosed assets (2)	0.92	0.96	1.30	0.97	0.54
Net loan charge-offs to average loans	0.10	0.17	0.15	0.29	0.03
Capital Ratios					
Average stockholders' equity to average total assets	9.34%	8.80	8.73	10.11	10.39
Total risk-based capital ratio	13.24	13.84	12.70	14.58	10.98
Tier 1 risk-based capital ratio	11.08	11.28	9.83	13.47	9.78
Leverage ratio	9.12	8.77	7.88	10.39	7.18

(1) Nonperforming loans consist of nonaccrual loans and loans contractually past due 90 days or more and still accruing interest.

(2) Nonperforming assets consist of nonperforming loans and foreclosed assets.

A WORD CONCERNING FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of our Company and its subsidiaries, including, without limitation:

- statements that are not historical in nature, and
- statements preceded by, followed by or that include the words "believes," "expects," "may," "will," "should," "could," "anticipates," "estimates," "intends" or similar expressions.

Forward-looking statements are not guarantees of future performance or results. They involve risks, uncertainties and assumptions. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- competitive pressures among financial services companies may increase significantly,
- costs or difficulties related to the integration of the business of Hawthorn and its acquisition targets may be greater than expected,
- changes in the interest rate environment may reduce interest margins,
- general economic conditions, either nationally or in Missouri, may be less favorable than expected,
- legislative or regulatory changes may adversely affect the business in which Hawthorn and its subsidiaries are engaged, and
- changes may occur in the securities markets.

We have described under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2007, and in other reports that we file with the SEC from time to time, additional factors that could cause actual results to be materially different from those described in the forward-looking statements. Other factors that we have not identified in this report could also have this effect. You are cautioned not to put undue reliance on any forward-looking statement, which speak only as of the date they were made.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

This overview of management's discussion and analysis highlights selected information in this document and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting estimates, you should carefully read this entire document. These have an impact on our Company's financial condition and results of operation.

Material Challenges and Risks: Our Company may experience difficulties in managing growth and in effectively integrating newly established branches. As part of our general strategy, our Company may continue to acquire banks and establish de novo branches that we believe provide a strategic fit. To the extent that our Company does grow, there can be no assurances that we will be able to adequately and profitably manage such growth.

The successes of our Company's growth strategy will depend primarily on the ability of our banking subsidiaries to generate an increasing level of loans and deposits at acceptable risk levels and on acceptable terms without significant increases in non-interest expenses relative to revenues generated. Our Company's financial performance also depends, in part, on our ability to manage various portfolios and to successfully introduce additional financial products and services. Furthermore, the success of our Company's growth strategy will depend on our ability to maintain sufficient regulatory capital levels and on general economic conditions that are beyond our control.

Revenue Source: Through its branch network, our Bank provides products and services in four defined geographic areas. The products and services offered include a broad range of commercial and personal banking services, including certificates of deposit, individual retirement and other time deposit accounts, checking and other demand deposit accounts, interest checking accounts, savings accounts, and money market accounts. Loans include real estate, commercial, installment, and other consumer loans. Other financial services include automatic teller machines, trust services, credit related insurance, and safe deposit boxes. The revenues generated by each business segment consist primarily of interest income, generated primarily from the loan and debt and equity security portfolios, and service charges and fees, generated from the deposit products and services. The geographic areas are defined to be communities surrounding Jefferson City, Clinton, Warsaw, Springfield, Branson and Lee's Summit, Missouri. The products and services are offered to customers primarily within their respective geographical areas. The business segment results which follow are consistent with our Company's internal reporting system which is consistent, in all material respects, with generally accepted accounting principles and practices prevalent in the banking industry.

Much of our Company's business is commercial, commercial real estate development, and mortgage lending. Our Company has experienced continued strong loan demand in the communities within which we operate even during economic slowdowns. Our Company's income from mortgage brokerage activities is directly dependent on mortgage rates and the level of home purchases and refinancings.

Our Company's primary source of revenue is net interest income derived primarily from lending and deposit taking activities. A secondary source of revenue is investment income. Our Company also derives income from trust, brokerage, credit card and mortgage banking activities and service charge income.

Our Company has prepared all of the consolidated financial information in this report in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In preparing the consolidated financial statements in accordance with U.S. GAAP, our Company makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

EXECUTIVE SUMMARY

Our Company's consolidated net income decreased $3,075,000 or 28.3% to $7,800,000 for 2007 compared to $10,875,000 for 2006 and followed a $960,000 or 9.7% increase for 2006 compared to 2005. Basic earnings per common share increased from $2.38 for 2005 to $2.61 for 2006 and decreased to $1.87 for 2007. Diluted earnings per common share increased from $2.36 for 2005 to $2.59 for 2006 and decreased to $1.85 for 2007. Return on average total assets increased from 0.91% for 2005 to 0.95% for 2006 and decreased to 0.67% for 2007. Return on average total stockholders' equity increased from 10.47% for 2005 to 10.79% for 2006 and decreased to 7.22% for 2007.

Average loans outstanding increased $24,065,000 or 2.9% to $848,771,000 for 2007 compared to $824,706,000 for 2006 and followed a $81,324,000 or 10.9% increase for 2006 compared to 2005.

Average commercial loans outstanding decreased approximately $1,184,000 or 0.79% for 2007 compared to 2006 and followed a $1,829,000 or 1.3% decrease for 2006 compared to 2005. Average real estate loans outstanding increased approximately $27,633,000 or 4.33% for 2007 compared to 2006 and followed a $25,785,000 or 5.4% increase for 2006 compared to 2005. Average consumer loans outstanding decreased approximately $2,384,000 or 6.7% for 2007 compared to 2006 and followed a $2,906,000 or 8.1% decrease for 2006 compared to 2005.

While much of the banking industry experienced a down turn in real estate lending due to problems in the sub-prime real estate market, our Company experienced an increase in our real estate lending operations. Our Company's real estate loan growth is primarily in the area of commercial real estate lending. Our Company does not make sub-prime residential real estate loans. It should be noted that consumer loans decreased on average in 2007 and 2006. These decreases reflect the low rates that exist in the consumer auto market that is fueled by manufacturers' low or zero rate financing programs. Our Company chose to not aggressively pursue consumer auto loans during the periods presented and as such this portion of the loan portfolio declined in balance.

Average investment securities and federal funds sold decreased $16,082,000 or 7.9% to $188,375,000 for 2007 compared to $204,457,000 for 2006 and followed a $36,489,000 or 15.1% decrease for 2006 compared to 2005. The decrease in average investment securities during 2007 and 2006 reflects the use of investment liquidity to fund our Company's growth in the loan portfolio.

Average deposits increased $17,024,000 or 1.9% to $903,881,000 for 2007 compared to $886,857,000 for 2006 and followed a $44,502,000 or 5.3% increase for 2006 compared to 2005. These increases are a result of our expanded branch network.

Average federal funds purchased and securities sold under agreements to repurchase decreased $11,289,000 or 26.7% to $31,061,000 for 2007 compared to $42,350,000 for 2006 and followed a $3,915,000 or 8.5% decrease for 2006 compared to 2005.

Average interest-bearing demand notes to U.S. Treasury decreased $499,000 or 70.1% to $205,000 for 2007 compared to $704,000 for 2006 and followed a $8,000 or 1.1% increase for 2006 compared to 2005. Balances in this account are governed by the U.S. Treasury's funding requirements. The decrease in 2007 is due to our Company changing from a Treasury Tax and Loan Note Option Depositary to a Treasury Tax and Loan Remittance bank.

Average subordinated notes was $49,486,000 in 2007 and 2006 and followed a $3,872,000 or 10.9% increase for 2006 compared to 2005. Our Company issued $23,712,000 of subordinated notes in March 2005. In 2005 the proceeds were used to provide part of the funding for the acquisition of Bank 10.

Average other borrowed money decreased $3,131,000 or 5.5% to $53,626,000 for 2007 compared to $56,757,000 for 2006 and followed a $8,327,000 or 17.2% increase for 2006 compared to 2005. The decrease in 2007 reflects a net decrease in Federal Home Loan Bank advances. The increase in 2006 reflects increased funding for loan growth.

Average stockholders' equity increased $7,231,000 or 7.2% to $108,052,000 for 2007 compared to $100,821,000 for 2006 and followed a $6,158,000 or 6.5% increase for 2006 compared to 2005. The increases represent net income retained in excess of dividends declared plus adjustments for unrealized gains or losses on debt and equity securities, net of taxes.

CRITICAL ACCOUNTING POLICIES

The following accounting policies are considered most critical to the understanding of our Company's financial condition and results of operations. These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. Because these estimates and judgments are based on current circumstances, they may change over time or prove to be inaccurate based on actual experiences. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of a materially different financial condition and/or results of operations could reasonably be expected. The impact and any associated risks related to our critical accounting policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations," where such polices affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 of our consolidated financial statements.

Allowance for Loan Losses

We have identified the accounting policy related to the allowance for loan losses as critical to the understanding of our Company's results of operations, since the application of this policy requires significant management assumptions and estimates that could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The impact and any associated risks related to these policies on our business operations are discussed in the "Lending and Credit Management" section below.

Income Taxes

Our Company estimates income tax expense based on amounts expected to be owed to various tax jurisdictions. Accrued taxes represent the net estimated amount due or to be received from taxing jurisdictions either currently or in the future and are reported in other assets or other liabilities on the Consolidated Balance Sheet. In estimating accrued taxes, our Company assesses the relative merits and risks of the appropriate tax treatment considering statutory, judicial and regulatory guidance in the context of the tax position. Because of the complexity of tax laws and regulations, interpretation can be difficult and subject to legal judgment given specific facts and circumstances. It is possible that others, given the same information, may at any point in time reach different reasonable conclusions regarding the estimated amounts of accrued taxes.

Changes in the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations being conducted by various taxing authorities, and newly enacted statutory, judicial and regulatory guidance that impact the relative merits and risks of tax positions. These changes, when they occur, affect accrued taxes and can be significant to the operating results of our Company. Management believes the accrual for tax liabilities is adequate for all open audit years based on its assessment of many factors, including past experience and interpretations of tax law applies to the fact of each matter. Our Company's state and federal income tax returns for 2004 to 2007 are open tax years. As of December 31, 2007, there were no federal or state income tax examinations in process.

Effective January 1, 2007, our Company adopted Financial Accounting Standards Board (FASB) Interpretation 48, *Accounting for Uncertainty in Income Taxes,* an Interpretation of FAS No. 109, *Accounting for Income Taxes* (FIN 48). The interpretation defines the threshold for recognizing the financial impact of uncertain tax provisions in accordance with FAS 109. An enterprise must recognize, in its financial statements, the best estimate of the impact of a tax position if that position is "more-likely-than-not" of being sustained on audit based solely on the technical merits of the position on the reporting date.

In evaluating whether the probable recognition threshold has been met, FIN 48 requires the presumption that the tax position will be evaluated during an audit by taxing authorities. The term "more-likely-than-not" is defined as a likelihood of more than 50 percent. Individual tax positions that fail to meet the recognition threshold will generally result in (a) reductions in deferred tax assets or increases in deferred tax liabilities or (b) increases in a liability for income taxes payable or reduction of an income tax refund receivable.

Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and reviewed for impairment in accordance with Statement of Financial Accounting Standard (SFAS) No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets.*

Our Company performs an annual review of goodwill and intangible assets for impairment to determine whether the carrying value of underlying assets may not be recoverable. Our Company measures recoverability based upon the future cash flows expected to result from the use of the underlying asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying value of the underlying asset, Our Company recognizes an impairment loss. The impairment loss recognized represents the amount by which the carrying value of the underlying asset exceeds the fair value of the underlying asset. As such adjustments become necessary, they are reflected in the results of operations in the periods in which they become known.

RESULTS OF OPERATIONS ANALYSIS

Net Interest Income

The following table provides a comparison of fully taxable equivalent earnings, including adjustments to interest income and tax expense for interest on tax-exempt loans and investments.

(Dollars expressed in thousands)

	Year Ended December 31,		
	2007	2006	2005
Interest income	$ 74,207	71,423	57,340
Fully taxable equivalent (FTE) adjustment	997	1,009	882
Interest income (FTE basis)	75,204	72,432	58,222
Interest expense	37,175	32,766	23,673
Net interest income (FTE basis)	38,029	39,666	34,549
Provision for loan losses	1,154	1,326	1,322
Net interest income after provision for loan losses (FTE basis)	36,875	38,340	33,227
Noninterest income	10,221	8,600	7,265
Noninterest expense	35,054	30,148	25,368
Income before income taxes (FTE basis)	12,042	16,792	15,124
Income taxes	3,245	4,908	4,327
FTE adjustment	997	1,009	882
Income taxes (FTE basis)	4,242	5,917	5,209
Net income	$ 7,800	10,875	9,915
Average total earning assets	$ 1,038,274	1,031,423	985,848
Net interest margin	3.66%	3.85%	3.50%

Comparison of Years ended December 31, 2007, 2006, and 2005

Our Company's consolidated net income decreased by $3,075,000 or 28.3% to $7,800,000 for the year ended December 31, 2007 compared to $10,875,000 for 2006. Our Company's net income increased by $960,000 or 9.7% to $10,875,000 for the year ended December 31, 2006 compared to $9,915,000 for 2005.

Our Company's primary source of earnings is net interest income, which is the difference between the interest earned on interest earning assets and the interest paid on interest bearing liabilities. Net interest income on a fully taxable equivalent basis decreased $1,637,000 or 4.1% to $38,029,000 for 2007 compared to $39,666,000 for 2006, and followed a $5,117,000 or 14.8% increase for 2006 compared to 2005. Measured as a percentage of average earning assets, the net interest margin (expressed on a fully taxable equivalent basis) increased from 3.50% for 2005 to 3.85% for 2006, and decreased to 3.66% for 2007. While our Company increased the yield earned on interest earning assets to 7.24% in 2007 versus 7.02% in 2006, this increase was more than offset by an increase in the rates paid on interest bearing liabilities to 4.08% versus 3.63% in 2006. The increase in the net interest margin in 2006 reflects both higher rates earned on net interest earning assets and a larger volume of interest earning assets than in the prior period. The increase in net interest margin in 2005 reflects increases in interest rates during 2005.

The provision for loan losses decreased $172,000 or 12.9% to $1,154,000 for 2007 compared to $1,326,000 for 2006 and followed a $4,000 or 0.3% increase for 2006 compared to 2005. The provision reflects the amounts management determined necessary to maintain the allowance for loan losses at a level that was adequate to cover probable losses in the loan portfolio. The allowance for loan losses totaled $9,282,000 or 1.0% of loans outstanding at December 31, 2007 compared to $9,015,000 or 1.1% of loans outstanding at December 31, 2006 and $9,085,000 or 1.1% of loans outstanding at December 31, 2005. The allowance for loan losses expressed as a percentage of nonperforming loans was 152.5% at December 31, 2007, 177.9% at December 31, 2006 and 100.39% at December 31, 2005. Further discussion of managements' methodology related to the allowance and provision for loan losses may be found in the Lending and Credit Management section of this report.

Average Balance Sheets

The following table presents average balance sheets, net interest income, average yields of earning assets, and average costs of interest bearing liabilities on a fully taxable equivalent basis for each of the years in the three-year period ended December 31, 2007.

(Dollars expressed in thousands)

	Year Ended December 31,								
	2007			2006			2005		
	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)	Average Balance	Interest Income/ Expense(1)	Rate Earned/ Paid(1)
ASSETS									
Loans: (2) (4)	$ 848,771	$ 65,636	7.73%	$ 824,706	$ 62,729	7.61%	$ 743,382	$ 49,437	6.65%
Investment in debt and equity securities: (3)									
Government sponsored enterprises	117,208	5,614	4.79	129,437	5,645	4.36	156,553	4,963	3.17
State and municipal	53,971	2,969	5.50	53,465	2,894	5.41	45,442	2,505	5.51
Other	5,883	312	5.30	6,818	316	4.63	6,765	259	3.83
Federal funds sold	11,313	615	5.44	14,737	748	5.08	32,195	1,019	3.17
Interest bearing deposits in other financial institutions	1,128	58	5.14	2,260	100	4.42	1,511	39	2.58
Total interest earning assets	1,038,274	75,204	7.24	1,031,423	72,432	7.02	985,848	58,222	5.91
All other assets	127,336			124,036			106,528		
Allowance for loan losses	(9,110)			(9,309)			(8,630)		
Total assets	$ 1,156,500			$ 1,146,150			$ 1,083,746		
LIABILITIES AND STOCKHOLDERS' EQUITY									
NOW accounts	$ 110,658	$ 1,482	1.34%	$ 106,605	$ 1,390	1.30%	$ 125,303	$ 1,666	1.33%
Savings	46,634	260	0.56	52,137	298	0.57	55,826	319	0.57
Money market	159,767	5,668	3.55	157,643	5,186	3.29	145,004	3,618	2.5
Time deposits of $100,000 and over	141,645	7,045	4.97	122,594	5,251	4.28	105,661	3,330	3.15
Other time deposits	318,469	14,826	4.66	314,966	12,466	3.96	292,721	8,741	2.99
Total time deposits	777,173	29,281	3.77	753,945	24,591	3.26	724,515	17,674	2.44
Federal funds purchased and securities sold under agreements to repurchase	31,061	1,381	4.45	42,350	1,811	4.28	46,265	1,256	2.71
Interest - bearing demand notes to U.S. Treasury	205	11	5.37	704	31	4.4	696	20	2.87
Subordinated notes	49,486	3,617	7.31	49,486	3,528	7.13	44,614	2,747	6.16
Other borrowed money	53,626	2,885	5.38	56,757	2,805	4.94	48,430	1,976	4.08
Total interest - bearing liabilities	911,551	37,175	4.08	903,242	32,766	3.63	864,520	23,673	2.74
Demand deposits	126,708			132,912			117,840		
Other liabilities	10,189			9,175			6,723		
Total liabilities	1,048,448			1,045,329			989,083		
Stockholders' equity	108,052			100,821			94,663		
Total liabilities and stockholders' equity	$ 1,156,500			$ 1,146,150			$ 1,083,746		
Net interest income		$ 38,029			$ 39,666			$ 34,549	
Net interest margin			3.66%			3.85%			3.50%

(1) Interest income and yields are presented on a fully taxable equivalent basis using the Federal statutory income tax rate of 35%, net of nondeductible interest expense. Such adjustments totaled $997,000, $1,009,000 and $882,000 for the years ended December 31, 2007, 2006 and 2005, respectively.
(2) Nonaccruing loans are included in the average amounts outstanding.
(3) Average balances based on amortized cost.
(4) Fees and costs on loans are included in interest income.

Rate Volume Analysis

The following table presents, on a fully taxable equivalent basis, an analysis of changes in net interest income resulting from changes in average volumes of earning assets and interest bearing liabilities and average rates earned and paid. The change in interest due to the combined rate/volume variance has been allocated to rate and volume changes in proportion to the absolute dollar amounts of change in each.

(Dollars expressed in thousands)

	Year Ended December 31, 2007 Compared to December 31, 2006			Year Ended December 31, 2006 Compared to December 31, 2005		
	Total	Change due		Total	Change due	
	Change	Volume	Rate	Change	Volume	Rate
Interest income on a fully taxable equivalent basis:						
Loans: (1) (3)	$ 2,907	1,850	1,057	$ 13,292	5,745	7,547
Investment in debt and equity securities:						
Government sponsored entities	(31)	(558)	527	682	(962)	1,644
State and municipal(2)	75	27	48	389	435	(46)
Other	(4)	(46)	42	57	2	55
Federal funds sold	(133)	(183)	50	(271)	(711)	440
Interest bearing deposits in other financial Institutions	(42)	(56)	14	61	25	36
Total interest income	2,772	1,034	1,738	14,210	4,534	9,676

Continued on next page

	Year Ended December 31, 2007 Compared to December 31, 2006			Year Ended December 31, 2006 Compared to December 31, 2005		
	Total	Change due		Total	Change due	
	Change	Volume	Rate	Change	Volume	Rate
Interest expense:						
NOW accounts	92	54	38	(276)	(245)	(31)
Savings	(38)	(30)	(8)	(21)	(21)	-
Money market	482	71	411	1,568	336	1,232
Time deposits of $100,000 and over	1,794	881	913	1,921	593	1,328
Other time Deposits	2,360	140	2,220	3,725	705	3,020
Federal funds purchased and securities sold under agreements to repurchase	(430)	(500)	70	555	(114)	669
Interest-bearing demand notes to U.S. Treasury	(20)	(26)	6	11	-	11
Subordinated notes	89	-	89	781	319	462
Other borrowed money	80	(160)	240	829	372	457
Total interest expense	4,409	430	3,979	9,093	1,945	7,148
Net interest income on a fully taxable equivalent basis	$ (1,637)	604	(2,241)	$ 5,117	2,589	2,528

(1) Nonaccruing loans are included in the average amounts outstanding.

(2) Interest income and yields are presented on a fully taxable equivalent basis using the federal statutory income tax rate of 35%, net of nondeductible interest expense. Such adjustments totaled $997,000, $1,009,000 and $882,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

(3) Fees and costs on loans are included in interest income.

Provision for loan losses

The provision for loan losses for 2007 was $1,154,000 compared to $1,326,000 for 2006. Loans charged off, net of recoveries, for 2007 were $887,000 compared to $1,396,000 for 2006. Approximately $373,000 of the 2007 net charge-offs is represented by various commercial loans, $358,000 is represented by real estate loans, and approximately $156,000 is represented by various consumer loans.

The provision for loan losses for 2006 was $1,326,000 compared to $1,322,000 for 2005. Loans charged off, net of recoveries for 2006 were $1,396,000 compared to $1,151,000 for 2005. Approximately $603,000 of the 2006 net charge-offs is represented by various commercial loans, $454,000 is represented by real estate loans, and approximately $339,000 is represented by various consumer credits.

Further discussion of managements' methodology related to the allowance and provision for loan losses may be found in the Lending and Credit Management section of this report.

Years Ended December 31, 2007 and 2006

Noninterest Income and Expense

Noninterest income and noninterest expense for the years ended December 31, 2007 and 2006 were as follows:

(Dollars expressed in thousands)

		Year Ended December 31,		Increase (decrease)	
		2007	2006	Amount	%
Noninterest Income					
Service charges on deposit accounts	$	5,394	5,730	(336)	(5.9) %
Trust department income		968	799	169	21.2
Mortgage loan servicing fees, net		341	433	(92)	(21.2)
Gain on sales of mortgage loans		666	432	234	54.2
Loss on sales and calls of debt securities		(2)	(18)	16	(88.9)
Other		2,854	1,224	1,630	133.2
	$	10,221	8,600	1,621	18.8 %
Noninterest Expense					
Salaries and employee benefits	$	18,733	17,019	1,714	10.1 %
Occupancy expense, net		2,202	1,994	208	10.4
Furniture and equipment expense		2,879	2,301	578	25.1
Legal, examination, and professional fees		1,583	1,431	152	10.6
Advertising and promotion		1,196	897	299	33.3
Postage, printing, and supplies		1,297	1,147	150	13.1
Impairment and other real-estate owned expense		681	119	562	472.3
Processing expense		1,470	1,009	461	45.7
Amortization of intangible assets		922	1,033	(111)	(10.7)
Other		4,091	3,198	893	27.9
	$	35,054	30,148	4,906	16.3 %

As discussed in our Company's description of business, our Company completed its plan to consolidate four bank subsidiary charters under one charter in October 2007. The plan also included re-branding the name and logo, a major communications network conversion, outsourcing of data processing, and implementing new technologies such as remote capture. As a result of these events, noninterest expense reflects approximately $1,207,000 in nonrecurring expenses as noted in more detail below. Offsetting these additional expenses were the sales of three of our subsidiary bank charters to other institutions for $1,200,000 included in other noninterest income.

Noninterest income increased $1,621,000 or 18.8% to $10,221,000 for 2007 compared to $8,600,000 for 2006. Trust department income increased $169,000 or 21.2% due primarily to the collection of more transactional based distribution fees during 2007 compared to 2006. Mortgage loan servicing fees decreased $91,000 or 21.2% to $341,000 compared to $432,000 as a result in a decrease in the amount of mortgage loans serviced. Our Company was servicing $209,734,000 of mortgage loans at December 31, 2007 compared to $215,701,000 at December 31, 2006. Gain on sales of mortgage loans increased $234,000 or 54.2% due to an increase in volume of loans originated and sold to the secondary market from approximately $39,575,000 in 2007 to approximately $38,768,000 in 2006. Even though the volume or loans originated and sold has increased over the comparable period in the prior year, our total loan serving portfolio declined due to both increased prepayments of existing loans and an increase in the volume of loans sold without retention of the servicing rights. Our Company recognized $2,000 in loss on sales and calls of debt securities during the 2007 compared to $18,000 during 2006. Other income increased $1,629,000 or 133.0%. $1,200,000 of the increase represents the amount received from the sales of Osage Valley Bank, Bank 10, and Exchange National Bank's bank charters and $254,000 of the increase reflects recovery of prior years' legal and collection costs as a result of settlement of a lawsuit in our Company's favor.

Noninterest expense increased $4,906,000 or 16.3% to $35,054,000 for 2007 compared to $30,148,000 for 2006. Salaries and benefits increased $1,714,000 or 10.1%, furniture and equipment expense increased $578,000 or 25.1%, advertising and promotion increased $299,000 or 33.3%, other real-estate owned loan expense increased $562,000 or 472.3%, processing expense increased $461,000 or 45.7% and other noninterest expense increased $893,000 or 27.9%. Salaries and benefits reflects $290,000 decrease in management's estimate of anticipated incentive payments, profit sharing and pension contributions for 2007 versus 2006. Excluding this decrease, salaries and employee benefits increased $2,004,000 or 11.8%. This increase reflects normal salary increases, additional personnel resulting from staffing for a newly opened branch facility in Columbia, Missouri, and additional holding company personnel required for the implementation of our Company's strategic plan. The $578,000 increase in furniture and equipment expense primarily reflects $324,000 loss on dispositions of furniture and equipment resulting from software and equipment becoming obsolete after our Company completed a major network conversion. The remaining increase is a result of two new Clinton branch facilities opening during the fourth quarter of 2007. The $299,000 increase in advertising and promotion reflects nonrecurring costs associated with the re-branding of our Company's name and logo. The $562,000 increase in other real-estate owned expense represents $378,000 impairment write-down on two properties in other real-estate owned and an $184,000 increase in additional expenses related to properties in other real estate. The $461,000 increase in processing expense reflects nonrecurring costs associated with the merger of the bank subsidiaries and software and network conversion. The $893,000 increase in other noninterest expense reflects expenses in various other categories including, but not limited to, conversion costs, travel, meals and entertainment, security, telephone and internet, directors fees, and insurance.

Income taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 29.4% for 2007 compared to 31.1% for 2006. The decrease in the effective tax rate for 2007 is due to an increase in non-taxable income as a percentage of total income in the current year and a decrease in income before taxes. In addition, our Company reorganized its corporate structure in the 4th quarter of 2007. This change in structure resulted in an increase in deferred tax assets at December 31, 2007 and a corresponding decrease in current state tax expense for the year then ended. As a result of this change in structure, our Company anticipates an increase in state income tax expense in future periods and a corresponding increase in the overall effective income tax rate.

Fourth Quarter Results for 2007

As mentioned above, our Company experienced higher noninterest expenses in the fourth quarter 2007 compared to third quarter 2007 and fourth quarter 2006 resulting from several events that took place during the fourth quarter 2007. A communications network conversion was completed, our data processing operation was outsourced and converted to a new system, a remote item capture system was installed to facilitate the outsourced data processing environment, and two Clinton branch locations were opened while two older Clinton locations were closed. These nonrecurring costs caused significant increases in furniture and equipment expense, advertising and promotion, processing expense, security, and conversion errors and omission. Other significant increases in noninterest expense were seen in real estate loan collection expenses, other real estate owned impairment charges, and donations.

Comparing fourth quarter 2007 to third quarter 2007:

Our Company's net income of $993,000 for the fourth quarter ended December 31, 2007 declined $1,144,000, compared to $2,137,000 for the third quarter ended September 30, 2007. Net interest income of $9,486,000 increased $161,000 from third quarter 2007 due to an increase in net interest margin due to higher average earning assets and a decrease in the rates paid on interest bearing liabilities during the current period.

The fourth quarter 2007 provision for loan losses of $550,000 was $325,000 higher than third quarter 2007's provision of $225,000 and was based upon management's determination of the loan loss reserve required to cover probable losses in the loan portfolio at year-end.

Noninterest income of $2,753,000 for fourth quarter 2007 increased $658,000 from third quarter 2007's noninterest income of $2,095,000. $325,000 of this increase represented funds received from the sale of the third bank charter that was available as the result of our consolidation project. The remaining increase represented higher fees in service charge income and trust department income.

Noninterest expense of $10,313,000 for fourth quarter 2007 increased $2,152,000 from third quarter 2007's noninterest expense of $8,161,000.

Furniture and equipment expenses increased $444,000 from $638,000 for the third quarter of 2007 to $1,082,000 for the fourth quarter. $324,000 of this increase reflects a loss on disposition of obsolete furniture and equipment resulting from our completion of the major network and data processing conversion during the fourth quarter. The remaining increase is a result of two new Clinton branch facilities opened during the fourth quarter of 2007. Advertising and promotion increased $242,000 from $309,000 for the third quarter of 2007 to $551,000 for the fourth quarter and reflects nonrecurring costs associated with the re-branding of our Company's name and logo. Processing expenses increased $267,000 from $325,000 for the third quarter of 2007 to $592,000 for the fourth quarter primarily due to final billings for the communication network and data processing conversion. Conversion related charge-offs of unreconciled differences increased $128,000 from $68,000 third quarter 2007 to $196,000 for the fourth quarter. Other real-estate owned loan expenses increased $558,000 from $33,000 third quarter 2007 to $591,000 for the fourth quarter. Our Company recognized $378,000 of impairment losses on two parcels of other real estate owned and incurred additional expenses related to properties in other real estate owned. Donations increased from $66,000 third quarter 2007 to $147,000 for the fourth quarter due to payment of charitable contribution commitments at year-end.

Comparing fourth quarter 2007 to fourth quarter 2006:

Our Company's net income of $993,000 for the fourth quarter ended December 31, 2007 declined $1,402,000, compared to net income of $2,395,000 for the fourth quarter ended December 31, 2006. Fourth quarter 2007 net interest income decreased $153,000 from fourth quarter ended December 31, 2006 due to a lower net interest margin resulting from an increase in the rates paid on interest bearing liabilities from 2006 to 2007.

The fourth quarter 2007 provision for loan losses of $550,000 was $152,000 higher than fourth quarter 2006's provision of $398,000 and was based upon management's determination of the loan loss reserve required to cover probable losses in the loan portfolio at year-end.

Noninterest income of $2,753,000 for fourth quarter 2007 increased $644,000 from fourth quarter 2006's noninterest income of $2,109,000. $325,000 of this increase represented funds received from the sale of the third bank charter that was available as the result of our consolidation project. The remaining increase represented higher fees in service charge income and trust department income.

Noninterest expense of $10,313,000 for fourth quarter 2007 increased $2,416,000 from fourth quarter 2006's noninterest expense of $7,897,000.

Salaries and employee benefits increased $502,000 from $4,077,000 for the fourth quarter 2006 to $4,579,000 for the fourth quarter 2007. Salaries and benefits reflects $290,000 decrease in management's estimate of anticipated incentive payments, profit sharing and pension contributions for 2007 versus 2006. Excluding this decrease, salaries and employee benefits increased $795,000 which reflects normal salary increases, additional personnel resulting from staffing for a newly opened branch facility in Columbia, Missouri, and additional holding company personnel required for the implementation of our Company's strategic plan. Variances in other categories of noninterest expense between the two periods are the result of the events described in the preceding section.

Years Ended December 31, 2006 and 2005

Noninterest Income and Expense

Noninterest income and noninterest expense for the years ended December 31, 2006 and 2005 were as follows:

(Dollars expressed in thousands)

		Year Ended December 31,		Increase (decrease)	
		2006	2005	Amount	%
Noninterest Income					
Service charges on deposit accounts	$	5,730	4,245	1,485	35.0 %
Trust department income		799	810	(11)	(1.4)
Mortgage loan servicing fees, net		433	427	6	(1.4)
Gain on sales of mortgage loans		432	676	(244)	(36.1)
Loss on sales and calls of debt securities		(18)	(25)	7	(28.0)
Other		1,224	1,132	92	8.1
	$	8,600	7,265	1,335	18.4 %
Noninterest Expense					
Salaries and employee benefits	$	17,019	13,920	3,099	22.3 %
Occupancy expense, net		1,995	1,600	395	24.7
Furniture and equipment expense		2,301	2,150	151	7.0
Legal, examination, and professional fees		1,431	1,420	11	0.8
Advertising and promotion		897	819	78	9.5
Postage, printing, and supplies		1,147	976	171	17.5
Processing expense		1,009	751	258	34.4
Amortization of intangible assets		1,033	807	226	28.0
Other		3,316	2,925	391	13.4
	$	30,148	25,368	4,780	18.8 %

Noninterest income increased $1,335,000 or 18.4% to $8,600,000 for 2006 compared to $7,265,000 for 2005. Approximately $890,000 of the increase in noninterest income is attributed to the acquisition of Bank 10. Bank 10 contributed a full year of noninterest income during 2006 compared to eight months in 2005. Excluding noninterest income associated with the acquisition, service charge income increased $698,000 or 22.1%. Gain on sales of mortgage loans decreased $244,000 or 36.1% due to a decrease in volume of loans originated and sold to the secondary market from approximately $38,768,000 in 2005 to approximately $20,457,000 in 2005. Mortgage rates increased during 2006. As a result, there were fewer loans refinanced during 2006 and 2005 resulting in the decreased volume of loans sold.

Noninterest expense increased $4,780,000 or 18.8% to $30,148,000 for 2006 compared to $25,368,000 for 2005. Approximately $2,253,000 of the increase in noninterest expense is attributed to the acquisition of Bank 10. Bank 10 contributed a full year of noninterest income during 2006 compared to eight months in 2005. Excluding costs associated with the acquisition, salaries and benefits increased $1,683,000 or 14.3%, occupancy expense increased $213,000 or 16.7%, postage, printing and supplies increased $99,000 or 13.0%, processing expense increased $121,000 or 22.2% and other noninterest expense increased $295,000 or 11.4%. In addition to the increase in salaries and employee benefits represented by normal salary increases and additional hire, $218,000 of the increase reflects share-based compensation expense recorded as a result of the adoption of SFAS No. 123R, $254,000 reflects increased pension expense, and $187,000 reflects increased profitsharing expense. The increase in occupancy expense primarily reflects additional costs associated with three new branch facilities. The increase in postage, printing and supplies reflects both higher postage rates and additional mail volume. The increase in processing expense reflects higher cost associated with various data processing systems utilized by our Company.

Income taxes

Income taxes as a percentage of earnings before income taxes as reported in the consolidated financial statements were 31.1% for 2006 compared to 30.4% for 2005. The increase in the effective tax rate is due to an decrease in state taxable income as a percentage of total income in the current year.

Lending and Credit Management

Interest earned on the loan portfolio is a primary source of interest income for our Company. Net loans represented 75.4% of total assets as of December 31, 2007. Total loans increased steadily from December 31, 2005 through December 31, 2007 due to relatively stable local economies and reasonable interest rates as well as an expanded branch network.

Lending activities are conducted pursuant to an established loan policy approved by our Bank's Board of Directors. The Bank's credit review process is comprised of a regional loan committee with an established approval limit. In addition, a senior loan committee reviews all credit relationships in aggregate over an established dollar amount. The senior loan committee meets weekly and is comprised of senior managers of the Bank.

The following table shows the composition of the loan portfolio by major category and each category as a percentage of the total portfolio as of the dates indicated.

(Dollars expressed in thousands)

	December 31,									
	2007		2006		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial, financial and agricultural	$ 151,488	16.6%	$ 145,697	17.9%	$ 154,868	19.0%	$ 141,151	22.2%	$130,931	22.4%
Real estate -- Construction	147,432	16.2	150,891	16.6	139,316	17.2	65,075	8.0	46,672	7.3
Real estate -- Mortgage	575,552	63.2	478,854	52.6	480,531	59.2	392,656	48.3	364,620	57.3
Installment loans to individuals	36,806	4.0	36,870	4.0	38,820	4.8	37,755	4.6	41,696	6.5
Total loans	$ 911,278	100.0%	$ 812,312	100.0%	$ 813,535	100.0%	$ 636,637	100.0%	$583,919	100.0%

Our Company experienced loan growth of $98,966,000 or 12.2% from 2006 to 2007. This growth is primarily in our Bank's commercial and real estate mortgage lending. Commercial loans increased $5,791,000 or 4.0% from 2006 to 2007 and real estate loans increased $96,698,000 or 20.2%. The increase in our Company's commercial loan portfolio occurred throughout our Bank's regions. This growth was the result of management's intent to increase the variable rate asset base. The growth in the real estate mortgage area was primarily the result of our Company's expansion into the Columbia, Missouri market. Additionally, our Company is continuing to experience loan growth in the Branson and Springfield, Missouri markets as a result of lending for investment and income producing properties. These properties generate a measurable cash flow that can be monitored and supports the extension of credit. Our Company's lending activities in the real estate construction market decreased $3,459,000 or 2.3% from 2006 to 2007 due to the slow down in the housing industry and residential construction industry. Management anticipates that construction lending will be closely monitored during 2008.

The $9,171,000 decrease in commercial loans between December 31, 2005 and December 31, 2006 reflects the payoff of two loans for approximately $3,297,000 that were classified as impaired at December 31,2005. Our Company recognized an additional charge-off of $315,000 on one of those credits during 2006. An additional $1,862,000 represents the payoff of one credit that moved to the commercial finance market. $3,711,000 represents reductions in lines of credits of various other borrowers. The $11,575,000 increase in real estate construction loans is primarily represented by two large commercial construction projects in the Kansas City area. $12,062,000 of the increase in Commercial, Financial and Agricultural loans between December 31, 2004 and December 31, 2005 reflects the loans of Bank 10. $48,895,000 of the increase in Real Estate Construction loans and $75,168,000 of the increase in Real Estate Mortgage loans reflects loans of Bank 10.

Our Company does not participate in extending credit to sub-prime residential real estate markets. While much publicity has been directed at this market during the past year, our Company extends credit to its local community market through traditional mortgage products.

Loans at December 31, 2007 mature as follows:

(Dollars expressed in thousands)

		Over One Year Through Five Years		Over Five Years		
	One Year Or Less	**Fixed Rate**	**Floating Rate**	**Fixed Rate**	**Floating Rate**	**Total**
Commercial, financial, and agricultural	$ 86,204	$ 26,179	$ 35,756	$ 449	$ 2,900	$ 151,488
Real estate - construction	147,432	-	-	-	-	147,432
Real estate - mortgage	135,314	311,850	51,555	34,165	42,668	575,552
Installment loans to individuals	19,024	16,875	177	635	95	36,806
Total loans	$ 387,974	$ 354,904	$ 87,488	$ 35,249	$ 45,663	$ 911,278

Our Company generally does not retain long-term fixed rate residential mortgage loans in its portfolio. Fixed rate loans conforming to standards required by the secondary market are offered to qualified borrowers, but are not funded until our Company has a non-recourse purchase commitment from the secondary market at a predetermined price. At December 31, 2007 our Company was servicing approximately $209,000,000 of loans sold to the secondary market.

Mortgage loans retained in our Company's portfolio generally include provisions for rate adjustments at one to three year intervals. Commercial loans and real estate construction loans generally have maturities of less than one year. Installment loans to individuals are primarily fixed rate loans with maturities from one to five years.

The provision for loan losses is based on management's evaluation of the loan portfolio in light of national and local economic conditions, changes in the composition and volume of the loan portfolio, changes in the volume of past due and nonaccrual loans, value of underlying collateral and other relevant factors. The allowance for loan losses which is reported as a deduction from loans is available for loan charge-offs. This allowance is increased by the provision charged to expense and is reduced by loan charge-offs net of loan recoveries.

Management, through the establishment of a senior loan committee, formally reviews all loans in excess of certain dollar amounts (periodically established) at least annually. Currently, loans in excess of $1,000,0000 in aggregate and all adversely classified credits identified by management as containing more than usual risk are reviewed. On a monthly basis, the senior loan committee reviews and reports to the Board of Directors past due, "classified", and "watch list" loans in order to classify or reclassify loans as "loans requiring attention," "substandard," "doubtful," or "loss". During this review, management also determines what loans should be considered "impaired". Management follows the guidance provided in Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan,* (SFAS 114) in identifying and measuring loan impairment. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement the loan is considered to be impaired. Once a loan has been identified as impaired management generally measures impairment based upon the fair value of the underlying collateral. Management believes, but there can be no assurance, that these procedures keep management informed of possible problem loans. Based upon these procedures, both the allowance and provision for loan losses are adjusted to maintain the allowance at a level considered adequate by management for probable losses inherent in the loan portfolio.

The following table summarizes loan loss experience for the years indicated:

(Dollars expressed in thousands)

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Analysis of allowance for loan losses:					
Balance beginning of year	$ 9,015	9,085	7,496	8,267	7,121
Allowance for loan losses of acquired companies at date of acquisitions	-	-	1,418	-	212
Charge-offs:					
Commercial, financial, and agricultural	524	809	589	1,596	58
Real estate — construction	56	84	185	-	-
Real estate — mortgage	413	474	286	26	86
Installment loans to individuals	314	484	261	236	340
Total charge-offs	1,307	1,851	1,321	1,858	484
Recoveries:					
Commercial, financial, and agricultural	151	206	40	18	164
Real estate — construction	11	13	-	-	-
Real estate — mortgage	100	91	28	-	-
Installment loans to individuals	158	145	102	127	162
Total recoveries	420	455	170	145	326
Net charge-offs	887	1,396	1,151	1,713	158
Provision for loan losses	1,154	1,326	1,322	942	1,092
Balance at end of year	$ 9,282	9,015	9,085	7,496	8,267
Loans outstanding:					
Average	$ 848,772	824,706	743,382	601,363	539,912
End of period	911,278	812,312	813,535	636,637	583,919
Allowance for loan losses to loans outstanding:					
Average	1.09 %	1.09	1.22	1.25	1.53
End of period	1.02	1.11	1.12	1.18	1.42
Net charge-offs to average loans outstanding	0.10	0.17	0.15	0.29	0.03

The following table is a summary of the allocation of the allowance for loan losses as of the dates indicated:

(Dollars expressed in thousands)

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Allocation of allowance for loan losses at end of period:					
Commercial, financial, and agricultural	$ 3,762	3,114	2,687	3,700	3,979
Real estate — construction	590	755	764	288	201
Real estate — mortgage	3,873	3,526	4,138	2,563	2,538
Installment loans to individuals	419	529	473	429	561
Unallocated	638	1,091	1,023	516	988
Total	$ 9,282	9,015	9,085	7,496	8,267
Percent of categories to total loans:					
Commercial, financial, and agricultural	16.6 %	17.9	19.0	22.2	22.4
Real estate — construction	16.2	18.6	17.1	10.2	8.0
Real estate — mortgage	63.2	59.0	59.1	61.7	62.5
Installment loans to individuals	4.0	4.5	4.8	5.9	7.1
Total	100.0	100.0	100.0	100.0	100.0

Nonperforming loans, defined as loans on nonaccrual status, loans 90 days or more past due, and restructured loans totaled $6,085,000 or 0.67% of total loans at December 31, 2007 compared to $5,066,000 or 0.62% of total loans at December 31, 2006. The following table summarizes our Company's nonperforming assets at the dates indicated:

(Dollars expressed in thousands)

			December 31,		
	2007	2006	2005	2004	2003
Nonaccrual loans:					
Commercial, financial, and agricultural	$ 2,983	2,495	5,705	4,213	1,520
Real estate — construction	866	1,657	1,760	-	59
Real estate — mortgage	658	644	1,090	1,246	1,270
Installment loans to individuals	32	73	56	30	55
Total nonaccrual loans	4,539	4,869	8,611	5,489	2,904
Loans contractually past - due 90 days or more and still accruing:					
Commercial, financial, and agricultural	454	5	238	12	66
Real estate — construction	158	-	-	-	-
Real estate — mortgage	864	170	187	591	4
Installment loans to individuals	70	22	14	-	40
Total loans contractually past -due 90 days or more and still accruing	1,546	197	439	603	110
Restructured loans	-	-	-	-	-
Total nonperforming loans	6,085	5,066	9,050	6,092	3,014
Other real estate	2,337	2,720	1,568	30	47
Repossessions	-	15	-	42	73
Total nonperforming assets	$ 8,422	7,801	10,618	6,164	3,134
Loans	$ 911,278	812,313	813,535	636,637	583,919
Allowance for loan losses to loans	1.02 %	1.11	1.12	1.18	1.42
Nonperforming loans to loans	0.67	0.62	1.11	0.96	0.52
Allowance for loan losses to nonperforming loans	152.54	177.95	100.39	123.05	274.29
Nonperforming assets to loans and foreclosed assets	0.92	0.96	1.30	0.97	0.54

As can be seen from the preceding table, our Company's 2007 year-end nonperforming assets of $8,422,000 increased slightly from the 2006 year-end total of $7,801,000 and decreased significantly from the 2005 year-end total of $10,618,000. Nonaccrual loans decreased by $330,000 at December 31, 2007 and followed a $3,742,000 decrease from December 31, 2005 to December 31, 2006. However our Company has experienced an increase in loans that are contractually past-due 90 days or more and still accruing. Loans in this category increased $1,049,000 to $1,546,000 at December 31, 2007 compared to $197,000 at December 31, 2006 and $497,000 at December 31, 2005. Our Company has experienced an increase in its loan delinquencies much like the rest of the banking industry as current economic conditions negatively impact our borrowers' ability to keep their debt payments current. While these delinquencies are primarily in the less than thirty day past due category, management believes close monitoring of these credits will mitigate potential higher delinquency levels and/or losses. Management believes these loans are well secured and is actively focused on managing and collecting these accounts to prevent further deterioration.

It is our Company's policy to discontinue the accrual of interest income on loans when the full collection of principal or interest is in doubt, or when the payment of principal or interest has become contractually 90 days past due unless the obligation is 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 collectibles of such principal; otherwise, such receipts are recorded as interest income. Interest on year-end nonaccrual loans, which would have been recorded under the original terms of the loans, was approximately $745,000, $896,000 and $767,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Approximately $330,000, $63,000 and $253,000 was actually recorded as interest income on such loans for the year ended December 31, 2007, 2006 and 2005, respectively.

A loan is considered impaired when it is probable a creditor will be unable to collect all amounts due - both principal and interest - according to the contractual terms of the loan agreement. In addition to nonaccrual loans at December 31, 2007 included in the table above, which were considered impaired, management has identified additional loans totaling approximately $4,027,000 which are not included in the nonaccrual table above but are considered by management to be impaired compared to $9,187,000 in December 31, 2006.

Once a loan has been identified as impaired (as defined by paragraph 8 of SFAS 114), *Accounting by Creditors for Impairment of a Loan,* management generally measures impairment based upon the fair value of the underlying collateral. In general, market prices for loans in our portfolio are not available, and we have found the fair value of the underlying collateral to be more readily available and reliable than discounting expected future cash flows to be received. Once a fair value of collateral has been determined and the impairment amount calculated, a specific reserve allocation is made. At December 31, 2007, $3,256,000 of our Company's allowance for loan losses was allocated to impaired loans totaling approximately $8,565,000.

As of December 31, 2007 and 2006 approximately $11,645,000 and $7,102,000, respectively, of loans not included in the nonaccrual table above or identified by management as being "impaired" were classified by management as having more than normal risk which raised doubts as to the ability of the borrower to comply with present loan repayment terms. The $4,543,000 increase in classified loans is the result of several borrowers who have experienced cash flow problems and as well as some deterioration in collateral value. Management elected to allocate non-specific reserves to these credits based upon the inherent risk present. This increase in reserves was the result of our Company's internal loan review process which assesses credit risk. In addition to the classified list, our Company also maintains an internal loan watch list of loans which for various reasons, not all related to credit quality, management is monitoring more closely than the average loan in the portfolio. Loans may be added to this list for reasons which are temporary and correctable, such as the absence of current financial statements of the borrower, or a deficiency in loan documentation. Other loans are added as soon as any problem is detected which might affect the borrower's ability to meet the terms of the loan. This could be initiated by the delinquency of a scheduled loan payment, deterioration in the borrower's financial condition identified in a review of periodic financial statements, a decrease in the value of the collateral securing the loan, or a change in the economic environment within which the borrower operates. Once a loan is placed on our Company's watch list, its condition is monitored closely. Any further deterioration in the condition of the loan is evaluated to determine if the loan should be assigned to a higher risk category.

The allowance for loan losses is available to absorb probable loan losses regardless of the category of loan to be charged off. The allowance for loan losses consists of three components: asset-specific reserves, reserves based on expected loss estimates, and unallocated reserves.

The asset-specific component applies to loans evaluated individually for impairment and is based on management's best estimate of proceeds from liquidating collateral. The actual timing and amount of repayments and the ultimate realizable value of the collateral may differ from management's estimate.

The expected loss component is generally determined by applying percentages to pools of loans by asset type. These pre-established percentages are based upon standard bank regulatory classification percentages as well as average historical loss percentages. These expected loss estimates are sensitive to changes in delinquency status, realizable value of collateral, and other risk factors.

The unallocated portion of the allowance is based on management's evaluation of conditions that are not directly reflected in the determination of the asset-specific component and the expected loss component discussed above. The evaluation of inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they may not be identified with specific problem credits or portfolio segments. Conditions evaluated in connection with the unallocated portion of the allowance include general economic and business conditions affecting our key lending areas, credit quality trends (including trends in substandard loans expected to result from existing conditions), collateral values, specific industry conditions within portfolio segments, bank regulatory examination results, and findings of our internal loan review department.

The underlying assumptions, estimates and assessments used by management to determine these components are continually evaluated and updated to reflect management's current view of overall economic conditions and relevant factors impacting credit quality and inherent losses. Changes in such estimates could significantly impact the allowance and provision for credit losses. Our Company could experience credit losses that are different from the current estimates made by management.

At December 31, 2007, management allocated $8,644,000 of the $9,282,000 total allowance for loan losses to specific loans and loan categories and $638,000 was unallocated. Considering the size of several of our Company's lending relationships and the loan portfolio in total, management believes that the December 31, 2007 allowance for loan losses is adequate.

Our Company does not lend funds for the type of transactions defined as "highly leveraged" by bank regulatory authorities or for foreign loans. Additionally, our Company does not have any concentrations of loans exceeding 10% of total loans which are not otherwise disclosed in the loan portfolio composition table. Our Company does not have any interest-earning assets which would have been included in nonaccrual, past due, or restructured loans if such assets were loans.

Investment Portfolio

Our Company classifies its debt and equity securities into one of the following two categories:

Held-to-Maturity - includes investments in debt securities which our Company has the positive intent and ability to hold until maturity.

Available-for-Sale - includes investments in debt and equity securities not classified as held to maturity or trading (i.e., investments which our Company has no present plans to sell in the near-term but may be sold in the future under different circumstances).

Debt securities classified as held-to-maturity are carried at amortized cost, while debt and equity securities classified as trading or available-for-sale are carried at estimated market value. Unrealized holding gains and losses from available-for-sale securities are excluded from earnings and reported, net of applicable taxes, as a separate component of stockholders' equity until realized.

Our Company does not engage in trading activities and accordingly does not have any debt or equity securities classified as trading securities. Historically our Company's practice had been to purchase and hold debt instruments until maturity unless special circumstances exist. However, since the investment portfolio's major function is to provide liquidity and to balance our Company's interest rate sensitivity position, certain debt securities are classified as available-for-sale.

At December 31, 2007, debt and equity securities classified as available-for-sale represented 13.2% of total consolidated assets. Future levels of held-to-maturity and available-for-sale investment securities can be expected to vary depending upon liquidity and interest sensitivity needs as well as other factors.

The following table presents the composition of the investment portfolio by major category.

(Dollars expressed in thousands)

	2007 Available - for-Sale	2006 Available - for-Sale	2005 Available - for-Sale
U.S. Treasuries	$ -	$ 1,068	$ -
Government sponsored enterprises	87,370	121,769	113,005
Asset-backed securities	10,892	5,068	6,250
Obligations of states and political subdivisions	53,480	55,661	53,426
Other debt securities	-	-	708
Total debt securities	151,742	183,566	173,389
Federal Home Loan Bank of Des Moines Stock	3,979	3,808	3,904
Federal Reserve Bank Stock	-	752	752
Midwest Independent Bank Stock	151	151	151
Federal Agricultural Mortgage Corporation	10	10	10
Other equity securities	1,486	1,486	1,486
Total investments	$ 157,368	$ 189,773	$ 179,692

As of December 31, 2007, the maturity of debt securities in the investment portfolio was as follows:

(Dollars expressed in thousands)

Available-for-Sale	One Year Or Less	Over One Through Five Years	Over Five Through Ten Years	Over Ten Years	Weighted Average Yield (1)
Government sponsored enterprises	$ 37,798	$ 42,988	$ 6,335	$ 250	4.70%
Asset-backed (2)	507	6,977	3,408	-	4.92
States and political subdivisions (3)	3,440	17,354	21,233	11,452	5.38
Total available-for-sale debt securities	$ 41,745	$ 67,319	$ 30,976	$ 11,702	4.95%
Weighted average yield (1)	4.63%	4.94%	5.28%	5.28%	

(1) Weighted average yield is based on amortized cost.

(2) Asset-backed securities have been included using historic repayment speeds. Repayment speeds were determined from actual portfolio experience during the twelve months ended December 31, 2007 calculated separately for each mortgage-backed security. These repayment speeds are not necessarily indicative of future repayment speeds and are subject to change based on changing mortgage interest rates.

(3) Rates on obligations of states and political subdivisions have been adjusted to fully taxable equivalent rates using the statutory Federal income tax rate of 35%.

At December 31, 2007, $5,230,000 of debt securities classified as available-for-sale in the table above had variable rate provisions with adjustment periods ranging from one week to twelve months.

Risk Management

Market risk arises from exposure to changes in interest rates and other relevant market rate or price risk. Our Company faces market risk in the form of interest rate risk through transactions other than trading activities. Market risk from these activities, in the form of interest rate risk, is measured and managed through a number of methods. Our Company uses financial modeling techniques to measure interest rate risk. These techniques measure the sensitivity of future earnings due to changing interest rate environments. Guidelines established by our Company's Asset/Liability Management Committee and approved by our Company's Board of Directors are used to monitor exposure of earnings at risk. General interest rate movements are used to develop sensitivity as our Company feels it has no primary exposure to a specific point on the yield curve. For the year ended December 31, 2007, our Company utilized both a 200 basis point immediate and gradual move in interest rates (both upward and downward) applied to both a parallel and a proportional yield curve. Due to the significant movements in interest rate experienced during 2007, our Company anticipates using a 300 basis point change in interest rates in its interest rate risk model during 2008.

Interest Sensitivity

At December 31, 2007, our Company monitored its static gap report with the goal being to limit potential changes in net interest income due to changes in interest rates to acceptable limits. Our Company applied a plus or minus 2.00% interest rate change utilizing both an immediate and a gradual interest shock and measured against both parallel and proportional yield curves. The resulting net interest income changes ranged from approximately (14.5)% to 11.5% depending on the scenario.

The following table represents the estimated interest rate sensitivity and periodic and cumulative gap positions calculated as of December 31, 2007. Significant assumptions used for this table included: loans will repay at historic repayment rates; interest-bearing demand accounts and savings accounts are interest sensitive due to immediate repricing, and fixed maturity deposits will not be withdrawn prior to maturity. A significant variance in actual results from one or more of these assumptions could materially affect the results reflected in the table.

(Dollars expressed in thousands)

		Year 1	Year 2	Year 3	Year 4	Year 5	Over 5 years or no stated Maturity	Total
ASSETS								
Investments in debt and equity securities	$	63,072	30,917	20,332	9,845	4,066	29,137	157,369
Interest-bearing deposits		133	-	-	-	-	-	133
Federal funds sold and securities purchased under agreements to resell		664	-	-	-	-	-	664
Loans		496,716	119,669	168,387	36,473	52,235	28,516	901,996
Total	$	560,585	150,586	188,719	46,318	56,301	57,653	1,060,162
LIABILITIES								
Savings, Now deposits	$	-	-	-	-	-	111,175	111,175
Rewards checking, Super Now, money market deposits		153,934					64,113	218,047
Time deposits		379,927	36,868	27,912	5,790	3,053	130	453,680
Federal funds purchased and securities sold under agreements to repurchase		25,730	-	-	-	-	-	25,730
Subordinated notes		25,774	-	-	23,712	-	-	49,486
Other borrowed money		48,158	12,734	16,063	576	259	125	77,915
Total	$	633,523	49,602	43,975	30,078	3,312	175,543	936,033
Interest-sensitivity GAP								
Periodic GAP	$	(72,938)	100,984	144,744	16,240	52,989	(117,890)	124,129
Cumulative GAP	$	(72,938)	28,046	172,790	189,030	242,019	124,129	124,129
Ratio of interest-earnings assets to interest-bearing liabilities								
Periodic GAP		0.88	3.04	4.29	1.54	17.00	0.33	1.13
Cumulative GAP		0.88	1.04	1.24	1.25	1.32	1.13	1.13

Liquidity

The role of liquidity management is to ensure funds are available to meet depositors' withdrawal and borrowers' credit demands while at the same time maximizing profitability. This is accomplished by balancing changes in demand for funds with changes in the supply of those funds. Liquidity to meet the demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from external sources, principally depositors. Due to the nature of services offered by our Company, management prefers to focus on transaction accounts and full service relationships with customers. Management believes it has the ability to increase deposits at any time by offering rates slightly higher than the market rate.

Our Company's Asset/Liability Committee (ALCO), primarily made up of senior management, has direct oversight responsibility for our Company's liquidity position and profile. A combination of daily, weekly and monthly reports provided to management detail the following: internal liquidity metrics, composition and level of the liquid asset portfolio, timing differences in short-term cash flow obligations, available pricing and market access to the financial markets for capital and exposure to contingent draws on our Company's liquidity.

Our Company has a number of sources of funds to meet liquidity needs on a daily basis. The deposit base, consisting of consumer and commercial deposits and large dollar denomination ($100,000 and over) certificates of deposit, is a source of funds. Our Company has an insignificant amount of deposits on which the rate paid exceeded the market rate by more that 50 basis points when the account was established.

At December 31, 2007 and 2006, our Company had certificates and other time deposits in denominations of $100,000 or more which mature as follows:

(Dollars expressed in thousands)

	December 31, 2007	December 31, 2006
Three months or less	$ 41,533	$ 35,420
Over three months through six months	35,565	35,629
Over six months through twelve months	44,271	51,033
Over twelve months	18,374	13,804
	$ 139,743	$ 135,886

Securities sold under agreements to repurchase generally mature the next business day; however, certain agreements with local political subdivisions and select businesses are fixed rate agreements with original maturities generally ranging from 30 to 120 days. Information relating to securities sold under agreements to repurchase is as follows:

(Dollars expressed in thousands)

	At End of Period		For the Period Ending		
	Balance	Weighted Average Interest Rate	Maximum Month-end Balance	Average Balance	Weighted Average Interest Rate
December 31, 2007	$ 18,365	3.24 %	$ 28,705	$ 26,807	4.23 %
December 31, 2006	27,320	4.35	56,027	41,309	4.25
December 31, 2005	33,293	3.30	63,482	45,832	2.70

Other sources of funds available to meet daily needs include the sales of securities under agreements to repurchase and funds made available under a treasury tax and loan note agreement with the federal government. Also, the Bank is a member of the Federal Home Loan Bank of Des Moines (FHLB). As a member of the FHLB, the Bank has access to credit products of the FHLB. At December 31, 2007, the amount of available credit from the FHLB totaled $39,774,000. As of December 31, 2007, the Bank had $77,915,000 in outstanding borrowings with the FHLB. Under agreements with unaffiliated banks, the Bank may borrow up to $75,000,000 in federal funds on an unsecured basis and $8,000,000 on a secured basis at December 31, 2007. As of December 31, 2007, the Bank had $7,365,000 in federal funds purchased. Finally, our Company has $20,000,000 line of credit with a correspondent bank that had no balance outstanding at December 31, 2007.

Our Company's liquidity depends primarily on the dividends paid to it as the sole shareholder of our subsidiary Bank. As discussed in note 3 to our Company's consolidated financial statements, the Bank may pay up to $25,079,000 in dividends to our Company without regulatory approval subject to the ongoing capital requirements of the Bank.

In the normal course of business, our Company enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through our Company's various risk management processes. Management considers both on-balance sheet and off-balance sheet transactions in its evaluation of our Company's liquidity. In the section entitled, "Other Off-Balance Sheet Activities", we disclose that our Company has $147,095,000 in unused loan commitments and standby letters of credit as of December 31, 2007. While this commitment level would be difficult to fund given our Company's current liquidity resources, we know that the nature of these commitments are such that the likelihood of such a funding demand is very low.

For the years ended December 31, 2007, 2006 and 2005, net cash provided by operating activities was $13,388,000 in 2007, $16,637,000 in 2006, and $16,892,000 in 2005. $3,075,000 of the decrease between 2007 and 2006 reflects a lower level of net income. The variances in net cash provided by operating activities between 2006 and 2005 is primarily the result of differences in the timing of tax payments.

Net cash used in investing activities was $73,439,000 in 2007, $14,565,000 in 2006, and $61,449,000 in 2005. The increase in cash used in investing activities from 2007 to 2006 is primarily due to an increase in loans and purchases of premises and equipment for three new branch facilities partially offset by lower purchases of debt securities and lower proceeds received from maturities of debt securities . The decrease in cash used in investing activities from 2006 to 2005 is primarily due to a smaller increase in the loan portfolio as well as the purchase of Bank 10 in 2005.

Net cash provided by financing activities was $42,925,000 in 2007, $3,198,000 in 2006, and $26,580,000 in 2005. The increase in cash provided by financing activities from 2007 to 2006 is primarily the result of an increase in interest-bearing transaction accounts, time deposits, and a net increase in federal home loan borrowings partially offset by a decrease in demand deposits. The reduction in cash provided by financing activities from 2006 to 2005 is primarily the result of the issuance of additional subordinated note of $23,712,000 in 2005.

Other Off-Balance Sheet Activities

In the normal course of business, our Company is party to activities that contain credit, market and operational risk that are not reflected in whole or in part in our Company's consolidated financial statements. Such activities include traditional off-balance sheet credit related financial instruments.

Our Company provides customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments, including both commitments to extend credit and letters of credit at December 31, 2007 are as follows:

(Dollars expressed in thousands)

	Amount of Commitment Expiration per Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Unused loan commitments	$ 141,414	$ 23,438	$ 93,954	$ 10,057	$ 13,965
Standby letters of credit	5,681	4,076	119	1,486	-

Since many of the unused commitments are expected to expire or be only partially used, the total amount of commitments in the preceding table does not necessarily represent future cash requirements.

Contractual Cash Obligations

The required payments of time deposits and other borrowed money, not including interest, at December 31, 2007 are as follows:

(Dollars expressed in thousands)

		Payments due by Period			
	Total	Less than 1 Year	1-3 Years	3-5 Years	Over 5 Years
Time deposits	$ 453,680	$ 379,927	$ 64,780	$ 8,843	$ 130
Other borrowed money	77,915	48,158	28,797	834	126

Capital

Risk-based capital guidelines for financial institutions were adopted by regulatory authorities effective January 1, 1991. These guidelines are designed to relate regulatory capital requirements to the risk profiles of the specific institutions and to provide more uniform requirements among the various regulators. Our Company is required to maintain a minimum risk-based capital to risk-weighted assets ratio of 8.00%, with at least 4.00% being "Tier 1" capital. In addition, a minimum leverage ratio, Tier 1 capital to adjusted total assets, of 3.00% must be maintained. However, for all but the most highly rated financial institutions, a leverage ratio of 3.00% plus an additional cushion of 100 to 200 basis points is expected.

Detail concerning our Company's capital ratios at December 31, 2007 is included in Note 3 of our Company's consolidated financial statements included elsewhere in this report.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (Statement 141R) and FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment to ARB No. 51* (Statement 160). Statements 141R and 160 require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Both statements are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. Statement 141R will be applied to business combinations occurring after the effective date. Statement 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date. Our Company is currently evaluating the impact of adopting Statement 141R and SFAS160 on its results of operations and financial position. However, it is not expected to have a material impact on our Company's financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 gives our Company the irrevocable option to carry most financial assets and liabilities at fair value that are not currently required to be measured at fair value. If the fair value option is elected, changes in fair value would be recorded in earnings at each subsequent reporting date. SFAS 159 is effective for our Company's 2008 fiscal year. Our Company is currently evaluating the impact the adoption of this statement could have on its financial condition and results of operations. However, it is not expected to have a material impact on our Company's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement.* SFAS No.157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The statement does not require any new fair value measures. The statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. Our Company is required to adopt SFAS 157 beginning on January 1, 2008. SFAS 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to opening retained earnings in the year of adoption. In November 2007, the FASB proposed a one-year deferral of SFAS No. 157's fair-value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. Our Company is currently evaluating the impact of adopting SFAS No. 157 on its results of operations and financial position. However, it is not expected to have a material impact on our Company's financial position or results of operations.

In September 2006, the FASB's Emerging Issues Task Force reached a consensus on Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). EITF 06-4 provides guidance on the accounting for arrangements in which an employer owns and controls the insurance policy and has agreed to share a portion of the cash surrender value and/or death benefit with the employee. This guidance requires an employer to record a postretirement benefit, in accordance with FASB Statement No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* or APB Opinion No. 12, *Omnibus Opinion-1967*, if there is an agreement by the employer to share a portion of the proceeds of a life insurance policy with the employee during the postretirement period. This guidance is effective for reporting periods beginning after December 15, 2007. Our Company is currently evaluating the impact of adopting EITF 06-4 on its financial position and results of operations. However, it is not expected to have a material impact on the financial position or results of operations.

Effective January 1, 2007, our Company adopted SFAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* SFAS No. 156 requires all separately recognized servicing assets and liabilities to be initially measured at fair value. In addition, entities are permitted to choose to either subsequently measure servicing rights at fair value and report changes in fair value in earnings, or amortize servicing rights in proportion to and over the estimated net servicing income or loss and assess the rights for impairment. Our Company is using the amortized cost method of accounting for servicing assets. The adoption had no material impact on our Company's financial position or results of operations.

Effects of Inflation

The effects of inflation on financial institutions are different from the effects on other commercial enterprises since financial institutions make few significant capital or inventory expenditures which are directly affected by changing prices. Because bank assets and liabilities are virtually all monetary in nature, inflation does not affect a financial institution as much as do changes in interest rates. The general level of inflation does underlie the general level of most interest rates, but interest rates do not increase at the rate of inflation as do prices of goods and services. Rather, interest rates react more to changes in the expected rate of inflation and to changes in monetary and fiscal policy.

Inflation does have an impact on the growth of total assets in the banking industry, often resulting in a need to increase capital at higher than normal rates to maintain an appropriate capital to asset ratio. In the opinion of management, inflation did not have a significant effect on our Company's operations for the three years ended December 31, 2007.

Quantitative and Qualitative Disclosures About Market Risk

Our Company's exposure to market risk is reviewed on a regular basis by our Company's Asset/Liability Committee and Board of Directors. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent and that the goal is to identify and minimize those risks. Tools used by our Bank's management include the standard gap report subject to different rate shock scenarios. At December 31, 2007, the rate shock scenario models indicated that annual net interest income could change by as much as 14.5% should interest rates rise or fall within 200 basis points from their current level over a one year period. However there are no assurances that the change will not be more or less than this estimate. Management further believes this is an acceptable level of risk.

CONSOLIDATED FINANCIAL STATEMENTS

The following consolidated financial statements of our Company and reports of our Company's independent auditors appear on the pages indicated.