COLONY BANKCORP INC
Form 10-Q
November 10, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR QUARTER ENDED SEPTEMBER 30, 2011 COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	58-1492391 (I.R.S. EMPLOYER IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750
ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000
REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED REPORTS REQUIRED TO BE FILED BY SECTIONS 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES x NO o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY AND POSTED ON ITS CORPORATE WEB SITE, IF ANY, EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED AND POSTED PURSUANT TO RULE 405 OF REGULATION S-T (§232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES).

YES x NO o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER OR A SMALLER REPORTING COMPANY. SEE DEFINITIONS OF "ACCELERATED FILER", "LARGE ACCELERATED FILER" AND "SMALLER REPORTING COMPANY" IN RULE 12b-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER o	ACCELERATED FILER o
NON-ACCELERATED FILER o (DO NOT CHECK IF A SMALLER REPORTING COMPANY)	SMALLER REPORTING COMPANY x

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES o NO x

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

CLASS	OUTSTANDING AT NOVEMBER 10, 2011
COMMON STOCK, $1 PAR VALUE	8,439,258

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Forward Looking Statement Disclosure

Statements in this Quarterly Report regarding future events or performance are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 (the PSLRA) and are made pursuant to the safe harbors of the PSLRA. Actual results of Colony Bankcorp, Inc. (the Company) could be quite different from those expressed or implied by the forward-looking statements. Any statements containing the words “could,” “may,” “will,” “should,” “plan,” “believe,” “anticipates,” “estimates,” “predicts,” “expects,” “projections,” “potential,” “continue,” or wo import, constitute “forward-looking statements”, as do any other statements that expressly or implicitly predict future events, results, or performance. Factors that could cause results to differ from results expressed or implied by our forward-looking statements include, among others, risks discussed in the text of this Quarterly Report as well as the following specific items:

- General economic conditions, whether national or regional, that could affect the demand for loans or lead to increased loan losses;

- Competitive factors, including increased competition with community, regional, and national financial institutions, that may lead to pricing pressures that reduce yields the Company achieves on loans and increase rates the Company pays on deposits, loss of the Company’s most valued customers, defection of key employees or groups of employees, or other losses;

- Increasing or decreasing interest rate environments, including the shape and level of the yield curve, that could lead to decreases in net interest margin, lower net interest and fee income, including lower gains on sales of loans, and changes in the value of the Company’s investment securities;

- Changing business or regulatory conditions, or new legislation, affecting the financial services industry that could lead to increased costs, changes in the competitive balance among financial institutions, or revisions to our strategic focus;

- Changes or failures in technology or third party vendor relationships in important revenue production or service areas, or increases in required investments in technology that could reduce our revenue, increase our costs or lead to disruptions in our business.

- Readers are cautioned not to place undue reliance on our forward-looking statements, which reflect management’s analysis only as of the date of the statements. The Company does not intend to publicly revise or update forward-looking statements to reflect events or circumstances that arise after the date of this report.

Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission (SEC).

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PART 1. FINANCIAL INFORMATION
ITEM 1

FINANCIAL STATEMENTS

THE FOLLOWING FINANCIAL STATEMENTS ARE PROVIDED FOR COLONY BANKCORP, INC. AND ITS WHOLLY-OWNED SUBSIDIARY BANK, COLONY BANK

A. CONSOLIDATED BALANCE SHEETS – SEPTEMBER 30, 2011 AND DECEMBER 31, 2010.

B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010.

C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010.

D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010.

THE CONSOLIDATED FINANCIAL STATEMENTS FURNISHED HAVE NOT BEEN AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, BUT REFLECT, IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS (CONSISTING SOLELY OF NORMAL RECURRING ADJUSTMENTS) NECESSARY FOR A FAIR PRESENTATION OF THE RESULTS OF OPERATIONS FOR THE PERIODS PRESENTED.

THE RESULTS OF OPERATIONS FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2011 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2011 AND DECEMBER 31, 2010
(DOLLARS IN THOUSANDS)

ASSETS	September 30, 2011 (Unaudited)	December 31, 2010 (Audited)
Cash and Cash Equivalents		
Cash and Due from Banks	$ 16,777	$ 16,613
Federal Funds Sold	10,561	32,536
Securities Purchased Under Agreement to Resell	--	5,000
	27,338	54,149
Interest-Bearing Deposits	4,409	50,727
Investment Securities		
Available for Sale, at Fair Value	313,119	303,838
Held to Maturity, at Cost (Fair Value of $48 and $53, as of September 30, 2011 and December 31, 2010, Respectively)	49	48
	313,168	303,886
Federal Home Loan Bank Stock, at Cost	5,573	6,063
Loans	740,999	813,250
Allowance for Loan Losses	(16,910)	(28,280)
Unearned Interest and Fees	(59)	(61)
	724,030	784,909
Premises and Equipment	26,024	27,148
Other Real Estate	20,662	20,208
Other Intangible Assets	268	295
Other Assets	24,511	28,273
Total Assets	$ 1,145,983	$ 1,275,658
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-Bearing	$ 88,491	$ 102,959
Interest-Bearing	859,865	956,165
	948,356	1,059,124
Borrowed Money		
Securities Sold Under Agreements to Repurchase	--	20,000
Subordinated Debentures	24,229	24,229
Other Borrowed Money	71,000	75,076
	95,229	119,305
Other Liabilities	4,467	4,271
Commitments and Contingencies		
Stockholders' Equity		

Preferred Stock, Par Value $1,000 a Share; Authorized 10,000,000 Shares, Issued 28,000 Shares	27,623	27,506
Common Stock, Par Value $1 a Share; Authorized 20,000,000 Shares, Issued 8,442,258 and 8,442,958 Shares as of September 30, 2011 and December 31, 2010, Respectively	8,442	8,443
Paid-In Capital	29,166	29,171
Retained Earnings	29,466	28,479
Restricted Stock - Unearned Compensation	(10)	(41)
Accumulated Other Comprehensive Income (Loss), Net of Tax	3,244	(600)
	97,931	92,958
Total Liabilities and Stockholders' Equity	$ 1,145,983	$ 1,275,658

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	9/30/2011	9/30/2010	9/30/2011	9/30/2010
Interest Income				
Loans, Including Fees	$10,920	$12,899	$33,623	$39,370
Federal Funds Sold	19	28	91	68
Deposits with Other Banks	11	10	37	27
Investment Securities				
U.S. Government Agencies	1,703	1,448	5,397	5,119
State, County and Municipal	44	26	102	74
Corporate Obligations and Asset-Backed Securities	23	23	68	113
Dividends on Other Investments	12	7	36	15
	12,732	14,441	39,354	44,786
Interest Expense				
Deposits	3,124	4,309	10,228	13,179
Federal Funds Purchased	--	182	338	549
Borrowed Money	865	888	2,646	2,722
	3,989	5,379	13,212	16,450
Net Interest Income	8,743	9,062	26,142	28,336
Provision for Loan Losses	2,250	4,200	6,000	10,850
Net Interest Income After Provision for Loan Losses	6,493	4,862	20,142	17,486
Noninterest Income				
Service Charges on Deposits	835	879	2,391	2,722
Other Service Charges, Commissions and Fees	296	291	941	849
Mortgage Fee Income	57	89	161	229
Securities Gains	813	922	1,945	1,800
Other	422	483	1,760	1,623
	2,423	2,664	7,198	7,223
Noninterest Expenses				
Salaries and Employee Benefits	3,639	3,474	10,778	10,538
Occupancy and Equipment	1,040	1,149	3,084	3,355
Other	3,411	4,492	10,385	11,231
	8,090	9,115	24,247	25,124
Income (Loss) Before Income Taxes	826	(1,589)	3,093	(415)
Income Taxes (Benefits)	268	(555)	940	(586)
Net Income (Loss)	558	(1,034)	2,153	171
Preferred Stock Dividends	350	350	1,050	1,050

Net Income (Loss) Available to Common Stockholders	$208	$(1,384)	$1,103	$(879)
Net Income (Loss) Per Share of Common Stock				
Basic	$0.02	$(0.16)	$0.13	$(0.11)
Diluted	$0.02	$(0.16)	$0.13	$(0.11)
Cash Dividends Declared Per Share of Common Stock	$0.00	$0.00	$0.00	$0.00
Weighted Average Basic Shares Outstanding	8,442,278	8,447,855	8,441,070	8,049,267
Weighted Average Diluted Shares Outstanding	8,442,278	8,447,855	8,441,070	8,049,267

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	09/30/11	09/30/10	09/30/11	09/30/10
Net Income (Loss)	$558	$(1,034)	$2,153	$171
Other Comprehensive Income (Loss), Net of Tax				
Gains (Losses) on Securities Arising During the Year	2,663	(161)	5,128	3,654
Reclassification Adjustment	(537)	(609)	(1,284)	(1,188)
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effect	2,126	(770)	3,844	2,466
Comprehensive Income (Loss)	$2,684	$(1,804)	$5,997	$2,637

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)
(DOLLARS IN THOUSANDS)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$2,153	$171
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	1,389	1,631
Provision for Loan Losses	6,000	10,850
Securities Gains	(1,945)	(1,800)
Amortization and Accretion	2,538	2,982
Loss on Sale of Other Real Estate and Repossessions	996	1,691
Unrealized Loss on Other Real Estate	481	824
(Increase) Decrease in Cash Surrender Value of Life Insurance	(120)	1
Other Prepaids, Deferrals and Accruals, Net	1,995	6,255
Gain on Sale of Property and Equipment	2	2
	13,489	22,607
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Investment Securities Available for Sale	(286,202)	(250,973)
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	31,268	38,636
Held to Maturity	6	8
Proceeds from Sale of Investment Securities		
Available for Sale	251,044	211,597
(Increase) Decrease in Interest-Bearing Deposits in Other Banks	46,318	(14,806)
Decrease in Net Loans to Customers	45,342	54,488
Purchase of Premises and Equipment	(267)	(384)
Proceeds from Sale of Other Real Estate and Repossessions	7,593	8,794
Federal Home Loan Bank Stock	490	45
Proceeds from Sale of Premises and Equipment	2	--
	95,594	47,405
CASH FLOWS FROM FINANCING ACTIVITIES		
Noninterest-Bearing Customer Deposits	(14,468)	(8,103)
Interest-Bearing Customer Deposits	(96,300)	(44,265)
Securities Sold Under Agreements to Repurchase	(20,000)	(15,000)
Dividends Paid On Preferred Stock	(1,050)	(1,050)
Proceeds from Issuance of Common Stock	--	5,078
Principal Payments on Other Borrowed Money	(4,076)	(39,000)
Proceeds from Other Borrowed Money	--	19,000
Proceeds from Secured Borrowings	--	5,469
	(135,894)	(77,871)

Net (Decrease) in Cash and Cash Equivalents	(26,811)	(7,859)
Cash and Cash Equivalents at Beginning of Period	54,149	42,429
Cash and Cash Equivalents at End of Period	$27,338	$34,570

The accompanying notes are an integral part of these statements.

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COLONY BANKCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Presentation

Colony Bankcorp, Inc. (the Company) is a bank holding company located in Fitzgerald, Georgia. The Company merged all of its operations into one sole subsidiary effective August 1, 2008. The consolidated financial statements include the accounts of Colony Bankcorp, Inc. and its wholly-owned subsidiary, Colony Bank (which includes its wholly-owned subsidiary, Colony Mortgage Corp.), Fitzgerald, Georgia. All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of Colony Bankcorp, Inc. conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

All dollars in notes to consolidated financial statements are rounded to the nearest thousand.

In the opinion of management, all adjustments necessary for a fair presentation of financial position and results of operations for the interim dates and interim periods are included herein.

Nature of Operations

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in middle and south Georgia. Colony Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Chester, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Pitts, Quitman, Rochelle, Savannah, Soperton, Sylvester, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2011. Such reclassifications had no effect on previously reported stockholders' equity or net income.

Concentrations of Credit Risk

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At September 30, 2011, approximately 85 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. The continued downturn of the housing and real estate market that began in 2007 has resulted in an increase of problem loans secured by real estate. These loans are centered primarily in the Company's larger MSA markets. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

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(1) Summary of Significant Accounting Policies (Continued)

Concentrations of Credit Risk (Continued)

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of Colony depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit rating is monitored by management to minimize credit risk.

Investment Securities

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities, which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

The Company evaluates each held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

Federal Home Loan Bank Stock

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

Loans

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectibility of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectibility of principal. Loans are returned to an accrual status when factors indicating doubtful collectibility on a timely basis no longer exist.

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(1) Summary of Significant Accounting Policies (Continued)

Loans Modified in a Troubled Debt Restructuring (TDR)

Loans are considered to have been modified in a TDR when due to a borrower's financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available.

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (i) changes in the composition of the loan portfolio, (ii) the extent of loan concentrations within the portfolio, (iii) the effectiveness of the Company's lending policies, procedures and internal controls, (iv) the experience, ability and effectiveness of the Company's lending management and staff, and (v) national and local economics and business conditions.

Loans identified as losses by management, internal loan review and/or regulatory agencies are charged off.

During 2011, the Company continues its methodology regarding the look-back period for charge-off experience to one year. The current methodology resulted in significant loan loss provisions for 2010 and 2009.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Premises and Equipment

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

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Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows

Description	Life in Years	Method
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5-10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

Intangible Assets

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Statement of Cash Flows

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks and federal funds sold. Cash flows from demand deposits, NOW accounts, savings accounts, loans and certificates of deposit are reported net.

Securities Purchased Under Agreement to Resell and Securities Sold Under Agreements to Repurchase

The Company purchases certain securities under agreements to resell. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the consolidated balance sheets.

The Company sells securities under agreements to repurchase. These repurchase agreements are treated as borrowings. The obligations to repurchase securities sold are reflected as a liability and the securities underlying the agreements are reflected as assets in the consolidated balance sheets.

Advertising Costs

The Company expenses the cost of advertising in the periods in which those costs are incurred.

Income Taxes

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

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Part I (Continued)
Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statement of income.

Other Real Estate

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less costs to sell. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in other losses.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners and are not reported in the consolidated statements of operations but as a separate component of the equity section of the consolidated balance sheets. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Accounting Standards Updates

ASU No. 2010-20, "Receivables (Topic 830) – Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which any entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 became effective for the Company's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period became effective for the Company's financial statements that include periods beginning on or after January 1, 2011. ASU 2011-01, "Receivables (Topic 310) – Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20," temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of the then proposed ASU 2011-02, "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring," which is further discussed below.

ASU No. 2011-02, "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession: and (b) the debtor is experiencing financial difficulties. ASU 2011-02 became effective for the Corporation on July 1, 2011, and applied retrospectively to restructurings

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Part I (Continued)
Item 1 (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Accounting Standards Updates (Continued)

occurring on or after January 1, 2011. Adoption of ASU 2011-02 did not have a significant impact on the Corporation's financial statements.

ASU No. 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 will be effective for the Corporation on January 1, 2012 and is not expected to have a significant impact on the Corporation's financial statements.

ASU No. 2011-04, "Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements.

ASU No. 2011-05, "Comprehensive Income (Topic 220) – Presentation of Comprehensive Income." ASU 2011-05 amends Topic 220, "Comprehensive Income," to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. ASU 2011-05 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements.

(2) Cash and Balances Due from Banks

Components of cash and balances due from banks are as follows as of September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Cash on Hand and Cash Items	$ 7,835	$ 8,898
Noninterest-Bearing Deposits with Other Banks	8,942	7,715
	$ 16,777	$ 16,613

The Company is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. Reserve balances totaled $1.0 million and $916 thousand at September 30, 2011 and

December 31, 2010.

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(3) Investment Securities

Investment securities as of September 30, 2011 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies Mortgage-Backed	$ 299,085	$ 5,148	$ (50)	$ 304,183
State, County & Municipal	6,639	81	(32)	6,688
Corporate Obligations	2,000	127	(11)	2,116
Asset-Backed Securities	479	--	(347)	132
	$ 308,203	$ 5,356	$ (440)	$ 313,119
Securities Held to Maturity:				
State, County and Municipal	$ 49	$ --	$ (1)	$ 48

The amortized cost and fair value of investment securities as of September 30, 2011, by contractual maturity, are shown hereafter. Expected maturities will differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due After One Year Through Five Years	$ 831	$ 842	$ 49	$ 48
Due After Five Years Through Ten Years	5,490	5,650	--	--
Due After Ten Years	2,797	2,444	--	--
	9,118	8,936	49	48
Mortgage-Backed Securities	299,085	304,183	--	--
	$ 308,203	$ 313,119	$ 49	$ 48

Investment securities as of December 31, 2010 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
U.S. Government Agencies Mortgage-Backed	$ 299,019	$ 1,763	$ (2,319)	$ 298,463

State, County & Municipal		3,248		35		(27	)		3,256
Corporate Obligations		2,000		102		(115	)		1,987
Asset-Backed Securities		479		--		(347	)		132
	$	304,746	$	1,900	$	(2,808	)	$	303,838
Securities Held to Maturity:									
State, County and Municipal	$	48	$	5	$	--		$	53

Proceeds from the sale of investments available for sale during first nine months of 2011 totaled $251,044 compared to $211,597 for the first nine months of 2010. The sale of investments available for sale during 2011 resulted in gross realized gains of $1,947 and gross realized losses of $(2) and the sale of investments available for sale during 2010 resulted in gross realized gain of $1,800 and losses of $0.

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(3) Investment Securities (Continued)

Nonaccrual securities are securities for which principal and interest are doubtful of collection in accordance with original terms and for which accruals of interest have been discontinued due to payment delinquency. Fair value of securities on nonaccrual status totaled $132 and $132 as of September 30, 2011 and December 31, 2010, respectively.

Investment securities having a carry value approximating $96,497 and $123,789 as of September 30, 2011 and December 31, 2010, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at September 30, 2011 and December 31, 2010 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2011						
U.S. Government Agencies Mortgage-Backed	$27,184	$(48)	$1,950	$(2)	$29,134	$(50)
State, County and Municipal	1,521	(31)	78	(2)	1,599	(33)
Corporate Obligations	--	--	989	(11)	989	(11)
Asset-Backed Securities	--	--	132	(347)	132	(347)
	$28,705	$(79)	$3,149	$(362)	$31,854	$(441)
December 31, 2010						
U.S. Government Agencies Mortgage-Backed	$152,287	$(2,319)	$--	$--	$152,287	$(2,319)
State, County and Municipal	1,777	(27)	--	--	1,777	(27)
Corporate Obligations	--	--	885	(115)	885	(115)
Asset-Backed Securities	--	--	132	(347)	132	(347)
	$154,064	$(2,346)	$1,017	$(462)	$155,081	$(2,808)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2011, the debt securities with unrealized losses have depreciated 1.37 percent from the Company's amortized cost basis. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

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Part I (Continued)
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(4) Loans

The following table presents the composition of loans segregated by class of loans, as of September 30, 2011 and December 31, 2010.

	September 30, 2011	December 31, 2010
Commercial and Industrial		
Commercial	$ 51,652	$ 53,220
Industrial	13,772	10,552
Real Estate		
Commercial Construction	63,104	72,309
Residential Construction	2,628	4,373
Commercial	320,122	362,878
Residential	195,433	207,472
Farmland	47,686	52,778
Consumer and Other		
Consumer	30,938	33,564
Other	15,664	16,104
Total Loans	$ 740,999	$ 813,250

Commercial and industrial loans are extended to a diverse group of businesses within the company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

Credit Quality Indicators. As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade assigned to commercial and consumer loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the Company's geographic markets.

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

- Grades 1 and 2 – Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the "pass" classification.

- Grades 3 and 4 – Loans assigned these "pass" risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.

- Grade 5 – This grade includes "special mention" loans on management's watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.

- Grade 6 – This grade includes "substandard" loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.

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(4) Loans (Continued)

- Grades 7 and 8 – These grades correspond to regulatory classification definitions of "doubtful" and "loss," respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company's problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

The following table presents the loan portfolio by credit quality indicator (risk grade) as of September 30, 2011 and December 31, 2010. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes.

September 30, 2011

	Pass	Special Mention	Substandard	Total Loans
Commercial and Industrial				
Commercial	$45,872	$947	$ 4,833	$51,652
Industrial	13,285	14	473	13,772
Real Estate				
Commercial Construction	29,186	2,963	30,955	63,104
Residential Construction	2,323	305	--	2,628
Commercial	268,519	12,665	38,938	320,122
Residential	177,106	7,597	10,730	195,433
Farmland	45,651	1,124	911	47,686
Consumer and Other				
Consumer	29,798	364	776	30,938
Other	15,417	110	137	15,664
Total Loans	$627,157	$26,089	$ 87,753	$740,999

December 31, 2010

	Pass	Special Mention	Substandard	Total Loans
Commercial and Industrial				
Commercial	$48,732	$2,498	$ 1,990	$53,220
Industrial	10,059	169	324	10,552
Real Estate				
Commercial Construction	33,523	10,064	28,722	72,309
Residential Construction	3,974	204	195	4,373
Commercial	294,186	11,847	56,845	362,878
Residential	183,518	9,196	14,758	207,472
Farmland	49,500	1,838	1,440	52,778

Consumer and Other				
Consumer	32,046	727	791	33,564
Other	14,553	1,186	365	16,104
Total Loans	$670,091	$37,729	$105,430	$813,250

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of $50,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired.

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Part I (Continued)
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(4) Loans (Continued)

In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due.

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of September 30, 2011 and December 31, 2010:

September 30, 2011

	Accruing Loans					
	30-89 Days Past Due	90 Days or More Past Due	Total Accruing Loans Past Due	Nonaccrual Loans	Current Loans	Total Loans
Commercial and Industrial						
Commercial	$1,700	$--	$1,700	$1,464	$48,488	$51,652
Industrial						