TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
November 08, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2010
Commission File No. 000-50047

Calvin B. Taylor Bankshares, Inc.

(Exact name of registrant as specified in its Charter)

Maryland

(State of incorporation)

52-1948274

(I.R.S. Employer Identification No.)

24 North Main Street, Berlin, Maryland 21811

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (410) 641-1700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X]

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). N/A (not required at this time)

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

Large accelerated filer ____ Accelerated filer [X]
Non- accelerated filer ____ (Do not check if a smaller reporting company) Smaller reporting company ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). No [X]

On October 31, 2010, 3,000,508 shares of the registrant's common stock were issued and outstanding.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Form 10-Q
Index

Part I - Financial Information, Item 1 Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary

Consolidated Balance Sheets

	(unaudited) September 30 2010	December 31, 2009
Assets		
Cash and due from banks	$ 17,802,078	$ 15,117,190
Federal funds sold	39,505,701	28,222,472
Interest-bearing deposits	11,647,022	12,494,003
Investment securities available for sale	63,396,007	42,767,578
Investment securities held to maturity (approximate fair value of $34,065,738 and $38,897,082)	33,750,066	38,597,942
Loans, less allowance for loan losses of $628,765 and $637,761	238,211,468	240,061,869
Premises and equipment	6,379,529	6,594,757
Other real estate owned	1,208,000	1,433,000
Accrued interest receivable	1,054,801	1,292,604
Computer software	103,506	135,831
Bank owned life insurance	5,217,854	5,089,278
Other assets	1,366,546	1,721,772
	$ 419,642,578	$ 393,528,296
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	$ 83,789,185	$ 72,431,731
Interest-bearing	251,372,753	240,215,888
	335,161,938	312,647,619
Securities sold under agreements to repurchase	6,999,450	7,048,176
Note payable	28,345	48,519
Accrued interest payable	156,626	192,621
Deferred income taxes	880,035	1,026,786
Other liabilities	92,208	287,282
	343,318,602	321,251,003
Stockholders' equity		
Common stock, par value $1 per share authorized 10,000,000 shares, issued and outstanding 3,000,508 shares at September 30, 2010, and December 31, 2009	3,000,508	3,000,508
Additional paid-in capital	8,733,438	8,733,438
Retained earnings	63,213,404	58,975,278
	74,947,350	70,709,224
Accumulated other comprehensive income	1,376,626	1,568,069
	76,323,976	72,277,293
	$ 419,642,578	$ 393,528,296

See accompanying Notes to Consolidated Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Consolidated Statements of Income
(unaudited)

	For the three months ended September 30 2010	2009
Interest and dividend revenue		
Loans, including fees	$ 4,010,548	$ 3,978,452
U.S. Treasury and government agency securities	273,065	391,920
State and municipal securities	12,203	12,672
Federal funds sold	17,969	18,085
Interest-bearing deposits	12,618	26,100
Equity securities	6,315	10,081
Total interest and dividend revenue	4,332,718	4,437,310
Interest expense		
Deposits	475,095	591,775
Borrowings	9,646	10,648
Total interest expense	484,741	602,423
Net interest income	3,847,977	3,834,887
Provision for loan losses	52,500	(132,550)
Net interest income after provision for loan losses	3,795,477	3,967,437
Noninterest revenue		
Service charges on deposit accounts	238,221	243,108
ATM and debit card	151,000	147,965
Bank owned life insurance	43,931	43,962
Gain on sale of assets	(1,319)	-
Miscellaneous revenue	92,294	77,776
Total noninterest revenue	524,127	512,811
Noninterest expenses		
Salaries	882,680	902,057
Employee benefits	225,225	201,225
Occupancy	197,908	182,149
Furniture and equipment	122,121	103,669
Data processing	64,381	73,915
ATM and debit card	40,252	43,820
Deposit insurance premiums	72,966	151,637
Other operating	405,211	413,627
Total noninterest expenses	2,010,744	2,072,099
Income before income taxes	2,308,860	2,408,149
Income taxes	859,500	896,500
Net income	$ 1,449,360	$ 1,511,649
	$ 0.48	$ 0.50

Earnings per common share - basic and diluted

See accompanying Notes to Consolidated Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Consolidated Statements of Income
(unaudited)

	For the nine months ended September 30	
	2010	2009
Interest and dividend revenue		
Loans, including fees	$ 12,072,501	$ 12,005,793
U.S. Treasury and government agency securities	926,797	1,237,332
State and municipal securities	38,485	34,070
Federal funds sold	46,054	51,272
Interest-bearing deposits	46,129	132,880
Equity securities	35,321	50,150
Total interest and dividend revenue	13,165,287	13,511,497
Interest expense		
Deposits	1,461,333	1,951,112
Borrowings	25,783	26,682
Total interest expense	1,487,116	1,977,794
Net interest income	11,678,171	11,533,703
Provision for loan losses	653,500	497,050
Net interest income after provision for loan losses	11,024,671	11,036,653
Noninterest revenue		
Service charges on deposit accounts	718,756	743,186
ATM and debit card	417,041	400,557
Bank owned life insurance	128,576	130,052
Gain on sale of assets	183,920	-
Miscellaneous revenue	340,756	200,051
Total noninterest revenue	1,789,049	1,473,846
Noninterest expenses		
Salaries	2,627,163	2,705,716
Employee benefits	748,739	631,275
Occupancy	605,164	560,586
Furniture and equipment	353,370	340,636
Data processing	210,776	215,049
ATM and debit card	139,154	192,472
Deposit insurance premiums	218,654	417,034
Other operating	1,224,074	1,172,716
Total noninterest expenses	6,127,094	6,235,484
Income before income taxes	6,686,626	6,275,015
Income taxes	2,448,500	2,273,500
Net income	$ 4,238,126	$ 4,001,515
	$ 1.41	$ 1.32

Earnings per common share - basic and
diluted

See accompanying Notes to Consolidated Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows
(unaudited)

	For the nine months ended September 2010	2009
Cash flows from operating activities		
Interest and dividends received	$ 13,543,626	$ 14,029,927
Fees and commissions received	1,618,990	1,344,516
Interest paid	(1,523,110)	(2,132,182)
Cash paid to suppliers and employees	(5,806,785)	(5,894,557)
Income taxes paid	(2,190,956)	(1,944,434)
	5,641,765	5,403,270
Cash flows from investing activities		
Certificates of deposit purchased, net of maturities	826,102	3,315,503
Proceeds from maturities of investments available for sale	15,135,000	17,200,000
Purchase of investments available for sale	(36,198,861)	(34,149,247)
Proceeds from maturities of investments held to maturity	23,740,000	23,765,000
Purchase of investments held to maturity	(18,935,424)	(30,773,647)
Loans made, net of principal reductions	1,196,901	4,885,851
Proceeds from sale of repossessed loan collateral, net of cost of sale	217,551	39,510
Purchases of premises, equipment, and computer software	(193,317)	(750,181)
Proceeds from sale of premises and equipment	72,100	20,900
	(14,139,948)	(16,446,311)
Cash flows from financing activities		
Net increase (decrease) in		
Time deposits	1,404,046	(795,649)
Other deposits	21,110,274	30,354,512
Securities sold under agreements to repurchase	(48,726)	1,802,953
Payments on note payable	(20,174)	(19,002)
Common shares repurchased	-	(1,540,500)
	22,445,420	29,802,314
Net increase in cash and cash equivalents	13,947,237	18,759,273
Cash and cash equivalents at beginning of period	43,489,772	35,270,664
Cash and cash equivalents at end of period	$ 57,437,009	$ 54,029,937

See accompanying Notes to Consolidated Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows
(unaudited)

	For the nine months ended September 30, 2010	2009
Reconciliation of net income to net cash provided by operating activities		
Net income	$ 4,238,126	$ 4,001,515
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	653,500	497,050
(Gain) loss on sale of repossessed loan collateral	7,449	(1,203)
(Gain) on sale of premises, equipment and computer software	(55,061)	(3,593)
Amortization of premiums and accretion of discount, net	140,537	58,582
Depreciation and amortization	423,829	413,818
Decrease (increase) in		
Accrued interest receivable	237,803	459,780
Cash surrender value of bank owned life insurance	(128,576)	(130,052)
Other assets	355,227	321,851
Increase (decrease) in		
Accrued interest payable	(35,995)	(154,387)
Accrued income taxes	37,512	2,708
Other liabilities	(232,586)	(62,799)
	$ 5,641,765	$ 5,403,270
Composition of cash and cash equivalents		
Cash and due from banks	$ 17,802,078	$ 19,438,917
Federal funds sold	39,505,700	34,442,376
Interest-bearing deposits, except for time deposits	129,231	148,644
	$ 57,437,009	$ 54,029,937
Supplemental cash flows information:		
Non-cash transfers from loans to other real estate owned	$ -	$ 845,000

See accompanying Notes to Consolidated Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Notes to Consolidated Financial Statements (unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements conform with accounting principles generally accepted in the United States of America and to the instructions to Form 10-Q. Interim financial statements do not include all the information and footnotes required for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of financial position and results of operations for these interim periods have been made. These adjustments are of a normal recurring nature. Results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected in any other interim period or for the year ending December 31, 2010. For further information, refer to the audited consolidated financial statements and related footnotes included in the Company's Form 10-K for the year ended December 31, 2009.

Consolidation has resulted in the elimination of all significant intercompany accounts and transactions.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, and interest-bearing deposits except for time deposits. Federal funds are purchased and sold for one-day periods.

Per share data

Earnings per common share are determined by dividing net income by the weighted average number of common shares outstanding for the period, as follows:

	2010	2009
Three months ended September 30	3,000,508	3,011,098
Nine months ended September 30	3,000,508	3,025,271

2. Comprehensive Income

Comprehensive income consists of:

	For the nine months ended September 30,	
	2010	2009
Net income	$ 4,238,126	$ 4,001,515
Unrealized loss on investment securities available for sale, net of income taxes	(191,443)	(611,842)
Comprehensive income	$ 4,046,683	$ 3,389,673

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Notes to Consolidated Financial Statements (unaudited) (continued)

3. Investment Securities
Investment securities are summarized as follows:

	Amortized cost	Unrealized gains	Unrealized losses	Fair value
September 30, 2010				
Available for sale				
U.S. Treasury	$ 59,193,537	$ 1,301,245	$ 1,600	$ 60,493,182
State and municipal	366,057	6,750	1,484	371,323
Equity	1,691,841	1,053,164	213,503	2,531,502
	$ 61,251,435	$ 2,361,159	$ 216,587	$ 63,396,007
Held to maturity				
U.S. Treasury	$ 19,487,841	$ 272,627	$ -	$ 19,760,468
U.S. Government agency	10,003,128	21,550	-	10,024,678
State and municipal	4,259,097	21,664	169	4,280,592
	$ 33,750,066	$ 315,841	$ 169	$ 34,065,738
December 31, 2009				
Available for sale				
U.S. Treasury	$ 38,197,971	$ 950,429	$ -	$ 39,148,400
State and municipal	395,000	5,392	270	400,122
Equity	1,691,841	1,571,962	44,747	3,219,056
	$ 40,284,812	$ 2,527,783	$ 45,017	$ 42,767,578
Held to maturity				
U.S. Treasury	$ 25,498,390	$ 254,672	$ 8,999	$ 25,744,063
U.S. Government agency	10,000,000	30,808	650	10,030,158
State and municipal	3,099,552	23,309	-	3,122,861
	$ 38,597,942	$ 308,789	$ 9,649	$ 38,897,082

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Notes to Consolidated Financial Statements (unaudited) (continued)

3. Investment Securities (Continued)

The table below shows the gross unrealized losses and fair value of securities that are in an unrealized loss position as of September 30, 2010, aggregated by length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U. S. Treasury	$ 9,014,154	$ 1,600	$ -	$ -	$ 9,014,154	$ 1,600
State and municipal	365,366	1,653	-	-	365,366	1,653
Equity securities	243,748	148,069	243,770	65,434	487,518	213,503
	$ 9,623,268	$ 151,322	$ 243,770	$ 65,434	$ 9,867,038	$ 216,756

The debt securities for which an unrealized loss is recorded are issues of the U. S. Treasury and general and highly rated revenue obligations of states and municipalities. The Company has the ability and the intent to hold these securities until they are called or mature at face value. Equity securities for which an unrealized loss is recorded are issued by four local community banks or bank holding companies. Management believes that these fluctuations in fair value reflect market conditions, and are not indicative of other-than-temporary impairment of the investments.

The amortized cost and estimated fair value of debt securities, by contractual maturity and the amount of pledged securities, follow. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2010		December 31, 2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Available for sale				
Within one year	$ 38,197,449	$ 38,382,547	$ 15,106,388	$ 15,136,254
After one year through five years	19,365,576	19,584,458	21,490,230	21,822,893
After ten years	1,996,569	2,897,500	1,996,353	2,589,375
	$ 59,559,594	$ 60,864,505	$ 38,592,971	$ 39,548,522
Held to maturity				
Within one year	$ 11,942,919	$ 11,983,392	$ 16,042,286	$ 16,273,130
After one year through five years	21,807,147	22,082,346	22,555,656	22,623,952
	$ 33,750,066	$ 34,065,738	$ 38,597,942	$ 38,897,082
Pledged securities	$ 26,593,298	$ 27,902,281	$ 26,269,854	$ 27,142,948

Investments are pledged to secure deposits of federal and local governments. Pledged securities also serve as collateral for securities sold under agreements to repurchase.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Notes to Consolidated Financial Statements (unaudited) (continued)

4. Loan commitments

Loan commitments are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Outstanding loan commitments and letters of credit consist of:

	September 30, 2010	December 31, 2009
Loan commitments and lines of credit		
Construction and land development	$ 7,825,746	$ 10,231,711
Other	22,011,027	19,038,506
	$ 29,836,773	$ 29,270,217
Standby letters of credit	$ 1,742,979	$ 1,907,736

5. Assets Measured at Fair Value

The Company values investment securities classified as available for sale on a recurring basis and other real estate acquired through foreclosure at fair value on a non-recurring basis. The fair value hierarchy established in the Financial Accounting Standards Board Codification Topic 820 titled *Fair Value Measurements* defines three input levels for fair value measurement. Level 1 is based on quoted market prices in active markets for identical assets. Level 2 is based on significant observable inputs other than those in Level 1. Level 3 is based on significant unobservable inputs. The Company values US Treasury securities, government agency securities, and an equity investment in an actively traded public utility under Level 1. Municipal debt securities, equity investments in community banks, and other real estate acquired through foreclosure are valued under Level 2. The Company has no assets measured at fair value on a recurring or non-recurring basis that are valued under Level 3 criteria. At September 30, 2010, values for available for sale investment securities and other real estate owned were established as follows:

	Total	Level 1 Inputs	Level 2 Inputs
Investment securities available for sale (recurring)	$ 63,396,007	$ 60,493,182	$ 2,902,825
Other real estate owned (non-recurring)	1,208,000	-	1,208,000
	$ 64,604,007	$ 60,493,182	$ 4,110,825

The fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis, and the valuation methods used in estimating the fair value of financial instruments is disclosed in the Company’s Annual Report on Form 10-K. It is not practicable to report quarterly the fair value of financial assets and liabilities measured on a non-recurring basis.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Notes to Consolidated Financial Statements (unaudited) (continued)

6. New accounting standards

The following accounting pronouncements have been approved by the Financial Accounting Standards Board but had not become effective as of September 30, 2010. These pronouncements would apply to the Company if the Company or the Bank entered into an applicable activity.

ASU No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures About Fair Value Measurements." ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. Disclosures related to the gross presentation of Level 3 purchases, sales, issuances and settlements of assets and liabilities will be required for the Corporation beginning January 1, 2011.

ASU No. 2010-20, "Receivables (Topic 310) – Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." ASU 2010-20 requires expanded disclosures designed to facilitate financial statement users' evaluation of (i) the nature of inherent credit risk in the company's portfolio of financing receivables (which includes loans), (ii) how that risk is analyzed and assessed in arriving at an adequate level of the allowance for credit losses, and (iii) changes and reasons for changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, which is the level at which the company develops and documents its systematic method for determining an allowance for credit losses, and class of financing receivable, which is generally a further disaggregation of portfolio segment. The required disclosures include but are not limited to, a rollforward of the allowance for credit losses as well as information about modified, impaired, nonaccrual, and past due loans, as well as credit quality indicators. ASU 2010-20 will be 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 will be required for the Company's financial statements that include periods beginning on or after January 1, 2011.

The accounting policies adopted by management are consistent with accounting principles generally accepted in the United States of America and are consistent with those followed by peer Banks.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Part I. Financial Information

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

This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements appear in a number of places in this Report and include all statements regarding the intent, belief or current expectations of the Company, its directors, or its officers with respect to, among other things: (i) the Company's financing plans; (ii) trends affecting the Company's financial condition or results of operations; (iii) the Company's growth strategy and operating strategy; and (iv) the declaration and payment of dividends. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in the Company's filings with the Securities and Exchange Commission.

The following discussion of the financial condition and results of operations of the Registrant (the Company) should be read in conjunction with the Company's financial statements and related notes and other statistical information included elsewhere herein.

General

Calvin B. Taylor Bankshares, Inc. (Company) was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of Calvin B. Taylor Banking Company (Bank), a commercial bank that was established in 1890 and incorporated under the laws of the State of Maryland on December 17, 1907. The Bank operates nine banking offices in Worcester County, Maryland and one banking office in Ocean View, Delaware. The Bank's administrative office is located in Berlin, Maryland. The Bank is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Worcester County, Maryland, Ocean View, Delaware, and neighboring counties.

The Company currently engages in no business other than owning and managing the Bank. The Bank employed 91 full time equivalent employees as of September 30, 2010. The Bank hires seasonal employees during the summer. The Company has no employees other than those hired by the Bank.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United State of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions may affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Critical Accounting Policies

The Company’s financial condition and results of operations are sensitive to accounting measurements and estimates of inherently uncertain matters. When applying accounting policies in areas that are subjective in nature, management uses its best judgment to arrive at the carrying value of certain assets. One of the most critical accounting policies applied is related to the valuation of the loan portfolio.

The allowance for loan losses (ALLL) represents management’s best estimate of inherent probable losses in the loan portfolio as of the balance sheet date. It is one of the most difficult and subjective judgments. The adequacy of the allowance for loan losses is evaluated no less than quarterly. The determination of the balance of the allowance for loan losses is based on management’s judgments about the credit quality of the loan portfolio as of the review date. It should be sufficient to absorb losses in the loan portfolio as determined by management’s consideration of factors including an analysis of historical losses, specific reserves for non-performing or past due loans, delinquency trends, portfolio composition (including segment growth or shifting of balances between segments, products and processes, and concentrations of credit, both regional and by relationship), lending staff experience and changes, critical documentation and policy exceptions, risk rating analysis, interest rates and the competitive environment, economic conditions in the Bank’s service area, and results of independent reviews, including audits and regulatory examinations.

Financial Condition

Total assets of the Company increased $26.1 million (6.64%) from December 31, 2009 to September 30, 2010. Combined deposits and customer repurchase agreements increased $22.5 million (7.03%) during the same period. Much of the deposit and asset growth from the previous year-end to the end of the third quarter stems from seasonal activity, which is further discussed in the section titled Liquidity.

Average assets and average deposits increased $14.6 million and $12.7 million, respectively, from third quarter 2009 to third quarter 2010. Management believes that some of the year-to-year growth in deposits results from continuing market instability as a prolonged general economic recession is followed by a sluggish recovery. Consumers often seek the safety of conservatively run community banks when the stock market suffers a significant downturn. Increased deposit insurance limits also give customers a greater sense of security in bank deposits.

Loan Portfolio

During the first nine months of 2010, the Bank’s gross loan portfolio has dropped by $1.9 million (.77%). It is typical for the Bank to experience growth in both deposits and loans by the end of the second quarter. By late June, many seasonal merchants have drawn on their working capital lines of credit and, if the tourist season is successful, they are experiencing increased sales. Throughout the third quarter, seasonal merchants pay down their lines of credit. Due to the challenges of the current economy, management has been proactive in monitoring the repayment of seasonal lines.

The Company makes loans to customers located primarily in the Delmarva region. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region. Since late 2008, the local and regional economies have been adversely affected by a recession of national and international reach. Although economists consider that the recession ended in mid-2009, the Bank continues to experience higher than usual loan delinquencies and losses due to the after effects of the recession and the slow pace of recovery.

Loan Quality and the Allowance for Loan Losses

The allowance for loan losses (ALLL) represents an amount which management believes to be adequate to absorb identified and inherent losses in the loan portfolio as of the balance sheet date. Valuation of the allowance is completed no less than quarterly. The determination of the allowance is inherently subjective as it relies on estimates of potential loss related to specific loans, the effects of portfolio trends, and other internal and external factors.

The ALLL consists of (i) formula-based reserves comprised of potential losses in the balance of the loan portfolio segmented into homogeneous pools, (ii) specific reserves comprised of potential losses on loans that management has identified as impaired and (iii) unallocated reserves. Unallocated reserves are not associated with a specific portfolio segment or a specific loan, but may be appropriate if properly supported and in accordance with GAAP.

The Company evaluates loan portfolio risk for the purpose of establishing an adequate allowance for loan losses. In determining an adequate level for the formula-based portion of the ALLL, management considers historical loss experience for major types of loans. Homogenous categories of loans are evaluated based on loss experience in the most recent three years. Based on this evaluation, management applies a formula to the current portfolio which gives weight to portfolio size and loss experience for categories of real estate construction loans, other real estate secured loans, other loans to commercial borrowers, and other consumer loans. However, historical data may not be an accurate predictor of loss potential in the current loan portfolio.

Management also evaluates trends in delinquencies, the composition of the portfolio, concentrations of credit, and changes in lending products, processes, or staffing. Management further considers external factors such as the interest rate environment, competition, current local and national economic trends, and the results of recent independent reviews by auditors and banking regulators. The protracted slow-down in the real-estate market has affected both the price and time to market residential and commercial properties. Management closely monitors such trends and the potential effect on the Company. The impact of the current adverse economic conditions is reflected in historically high loan losses and provisions for loan losses in 2008, 2009, and the current year.

Management employs a risk rating system which gives weight to collateral status (secured vs. unsecured), and to the absence or improper execution of critical contract or collateral documents. Unsecured loans and those loans with critical documentation exceptions, as defined by management, are considered to have greater loss exposure. Management incorporates these factors in the formula-based portion of the ALLL. Additionally, consideration is given to those segments of the loan portfolio which management deems to pose the greatest likelihood of loss.

Management believes that in a general economic downturn, such as the region has experienced since mid-2008, the Bank has an increased likelihood of loss in unsecured loans - commercial and consumer, and in secured consumer loans. Reserves for these segments of the portfolio are included in the formula-based portion of the ALLL. As of September 30, 2010, management reserved 115 bp against all unsecured loans, and consumer loans secured by other than real estate. This reserve level has been increased quarterly for the past year in recognition of the prolonged economic challenges in our service area. Additionally, management reserved 10% against overdrawn checking accounts which are a distinct high risk category of unsecured loan. The Bank does not offer an approved overdraft loan product, so all overdrawn deposit balances result from unauthorized presentment of items against insufficient funds.

Borrowers whose cash flow is impaired as a result of prevailing economic conditions have also experienced depressed real estate values. Management recognizes that the combination of these circumstances – reduced revenue and depressed collateral values, may increase the likelihood of loss in the Bank's real estate secured loan portfolio. Management closely monitors conditions that might indicate deterioration of collateral value on significant loans and, when possible, obtains additional collateral as required to limit the Bank's loss exposure. The Bank foreclosed on commercial and consumer mortgage loans during 2009 and 2010, and expects more foreclosures in 2010. Foreclosures may result in loan losses, costs to hold real estate acquired in foreclosure, and losses on the sale of real estate acquired in foreclosure. While management is unable to predict the financial consequences of future foreclosure activity, provision for loss on likely loan foreclosures is included in specific reserves in the ALLL.

Historically, the absence or improper execution of a document has not resulted in a loss to the Bank, however, management recognizes that the Bank's loss exposure is increased until a critical contract or collateral documentation exception is cured. At September 30, 2010, Management reserved 10 bp against the outstanding balances of loans identified as having critical documentation exceptions.

The provision for loan losses is a charge to earnings in the current period to maintain the allowance at a level management has determined to be appropriate. The allowance is increased by current period provisions and by recoveries of amounts previously charged-off. The allowance is decreased when loans are charged-off as losses, which occurs when they are deemed to be uncollectible. Adjustments made to bring the balance in the allowance to the level established by management may result in an increase or decrease to expense. Provisions for loan losses of $52,500 and $653,500 were made for the third quarter of 2010 and year-to-date, respectively. This compares to provisions for loan losses of (132,500) and $497,050 for the comparable periods in 2009. The year-to-date increases in the level of the ALLL and the provision for loan loss reflect the consequences of the current economy. During this slow recovery period, borrowers continue to suffer personal and professional financial hardship, increasing the likelihood of loss on previously performing loans. As Management identifies loans with heightened loss potential, a provision for those losses is recorded.

Management considers the September 30, 2010 allowance appropriate and adequate to absorb identified and inherent losses in the loan portfolio. However, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required. As of September 30, 2010, management has not identified any loans which are anticipated to be wholly charged-off within the next 12 months.

The following is a schedule of transactions in the allowance for loan losses. The Bank experienced net charge-offs of $298,442 in the third quarter of 2010 and $662,496 for the year to date. As described earlier, management attributes the increased loan losses to the effects of the current economic recession on some of the Bank's customers and, subsequently, on the Bank.

Allowance for Loan Losses			
	For nine months ended September 30		For the year ended December 31
	2010	2009	2009
Balance at beginning of year	$ 637,761	$ 707,152	$ 707,152
Loans charged-off:			
Real estate			
Construction, land development, and land	100,000	75,000	75,000
Other mortgages	190,093	399,704	656,191
Commercial	353,251	83,105	200,357
Consumer	45,866	38,120	47,321
Total loan losses	689,210	595,929	978,869
Recoveries on loans previously charged off:			
Real estate			
Construction, land development, and land	-	-	-
Other mortgages	1,000	669	669
Commercial	774	276	40,364
Consumer	24,940	16,386	18,445
Total loan recoveries	26,714	17,331	59,478
Net loan charge-offs (recoveries)	662,496	578,598	919,391
Provision for loan losses charged to expense	653,500	497,050	850,000
Balance at end of period	$ 628,765	$ 625,604	$ 637,761
Gross loans outstanding at the end of the period	$ 238,840,233	$ 235,919,585	$ 240,699,630
Allowance for loan losses to gross loans outstanding at the end of the period	0.26%	0.27%	0.26%
Average loans outstanding during the period	$ 244,677,984	$ 239,930,765	$ 242,095,000
Annualized net charge-offs as a percentage of average loans outstanding during the period	0.36%	0.32%	0.77%

The accrual of interest on a loan is discontinued when principal or interest is ninety days past due or when the loan is determined to be impaired, unless collateral is sufficient to discharge the debt in full and the loan is in process of collection. When a loan is placed in nonaccruing status, any interest previously accrued but unpaid, is reversed from interest income. Interest payments received on nonaccrual loans may be recorded as cash basis income, or as a reduction of principal, depending on management's judgment on a loan by loan basis. Accrual of interest may be restored when all principal and interest are current and management believes that future payments will be received in accordance with the loan agreement.

Nonperforming loans are loans past due 90 or more days and still accruing plus nonaccrual loans. Nonperforming assets are comprised of nonperforming loans combined with real estate acquired in foreclosure and held for sale. The following table details the composition of nonperforming assets:

	September 30, 2010	September 30, 2009	December 31, 2009
Loans 90 days or more past due and still accruing			
Real estate			
Construction, land development, and land	$ 409,939	$ -	$ -
Residential 1 to 4 family	97,404	38,651	62,532
Second mortgages	-	-	87,245
Commercial properties	1,421,434	952,218	637,803
Commercial	-	-	-
Consumer	781	4,420	-
	1,929,558	995,289	787,580
Nonaccruing loans	2,873,392	1,450,876	1,023,083
Total nonperforming loans	4,802,950	2,446,165	1,810,663
Other real estate owned	1,208,000	829,500	1,433,000
Total nonperforming assets	$ 6,010,950	$ 3,275,665	$ 3,243,663
Interest not accrued on nonaccruing loans	$ 126,989	$ 55,698	$ 46,467
Interest included in net income on nonaccruing loans, year-to-date	$ 70,460	$ 24,307	$ 30,492

Not reflected in the table above, is a loan which has been the subject of ongoing collection efforts. Late in 2008, when the loan had a principal balance of $4,500,000, the Bank was notified that there was a lien on the property securing this loan that was superior to the Bank's first and third liens. The Bank was not aware of this superior lien at the time the loan was originated, and the Bank's settlement agent did not discover the lien during the title examination process. The Bank filed a claim with the title company that has insured its title and lien priority in the belief that the title company would indemnify the Bank for any losses resulting from the superior lien. For the next twenty-one months, the Bank engaged in a series of negotiations and mediations to settle the matter.

On October 25, 2010 a definitive agreement (Agreement) was executed by all parties who have a financial interest in this event. As a result of the Agreement, the Bank has been restored to a first lien position but incurred a loss of $100,000 that is reflected in this quarterly report. Concurrently, the Bank paid real estate taxes of $582,472 on the collateral property and has added that amount to the loan resulting in a first lien balance of $4,032,472. The title agent has escrowed funds to pay interest for a period of one year from the date of the Agreement. The Bank does not anticipate any additional loss on this credit as it believes its first lien is well secured. As of September 30, 2010 and December 31, 2009, this loan was 18 and 53 days past due, respectively.

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued, although management may categorize a performing loan as impaired based on knowledge of the borrower's financial condition, devaluation of collateral, or other circumstances that are deemed relevant to loan collection. Impaired loans may have specific reserves, or valuation allowances, allocated to them in the ALLL. Estimates of loss reserves on impaired loans may be determined based on any of the three following measurement methods which conform to authoritative accounting guidance: (1) the present value of future cash flows, (2) the fair value of collateral, if repayment of the loan is expected to be provided by underlying collateral, or (3) the loan's observable fair value. The Bank selects and applies, on a loan-by-loan basis, the appropriate valuation method. Loans determined to be impaired, but for which no specific valuation allowance is made because management believes the loan is secured with adequate collateral or the Bank will not take a loss on such loan, are grouped with other homogeneous loans for evaluation under formula-based criteria described previously.

Impaired loans including nonaccruing loans totaled $2,873,392 and $2,901,859, at September 30, 2010, and December 31, 2009, respectively.

	September 30, 2010	December 31, 2009
Impaired loans with valuation allowances,		
including nonaccruing loans	$ 650,033	$ 799,834
Valuation allowances on impaired loans	$ 130,007	$ 258,869
Impaired loans with no valuation allowances	$ 2,223,359	$ 2,102,025
Total impaired loans	$ 2,873,392	$ 2,901,859

Liquidity

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to provide sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. These funds can be obtained by converting assets to cash or by attracting new deposits. The Company's major sources of liquidity are loan repayments, maturities of short-term investments including federal funds sold, and increases in core deposits. Funds from seasonal deposits are generally invested in short-term U.S. Treasury Bills and overnight federal funds.

Due to its location in a seasonal resort area, the Bank typically experiences a decline in deposits, federal funds sold and investment securities throughout the first quarter of the year when business customers are using their deposits to meet cash flow needs. Beginning late in the second quarter and throughout the third quarter, additional sources of liquidity become more readily available as business borrowers start repaying loans, and the Bank receives deposits from seasonal business customers, summer residents and tourists.

Average liquid assets (cash and amounts due from banks, interest-bearing deposits in other banks, federal funds sold, and investment securities) compared to average deposits and retail repurchase agreements were 46.06% for the third quarter of 2010 compared to 45.16% for the same quarter of 2009.

The Company has available lines of credit, including overnight federal funds and reverse repurchase agreements, totaling $28,000,000 as of September 30, 2010.

Average net loans to average deposits were 72.94% versus 74.36% as of September 30, 2010 and 2009, respectively. Average net loans increased by 1.95% while average deposits grew by 3.94%. Funding for loan growth was provided by deposit increases. Because loans earn higher average rates than the Bank's cost of funds, this results in a positive effect on earnings. Average deposit balance increases occurred in all categories of interest-bearing accounts. Average non-interest bearing deposit balances decreased 2.61%. Neither changes in deposit portfolio composition nor the increase in outstanding loan balances has a negative impact on the Company's ability to meet liquidity demands.

-

Interest Rate Sensitivity

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary source of earnings, net interest income. Net interest income can fluctuate with significant interest rate movements. To lessen the impact of these margin swings, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to changes in market interest rates. The rate-sensitive position, or gap, is the difference in the volume of rate-sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate-sensitive assets and liabilities to reduce the impact of interest rate fluctuations on the net interest margin. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Interest rate sensitivity may be controlled on either side of the balance sheet. On the asset side, management exercises some control over maturities. Also, loans are written to provide repricing opportunities on fixed rate notes. The Company's investment portfolio, including federal funds sold, provides the most flexible and fastest control over rate sensitivity since it can generally be restructured more quickly than the loan portfolio.

On the liability side, deposit products are structured to offer incentives to attain the desired maturity distribution. Competitive factors sometimes make control over deposits more difficult and, therefore, less effective as an interest rate sensitivity management tool.

The asset mix of the balance sheet is continually evaluated in terms of several variables: yield, credit quality, appropriate funding sources, and liquidity. Management of the liability mix of the balance sheet focuses on expanding the various funding sources.

As of September 30, 2010, the Company was cumulatively asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Results of Operations

Net income for the three months ended September 30, 2010*,* was $1,449,360 ($.48 per share), compared to $1,511,649 ($.50 per share) for the same quarter of 2009, resulting in a decrease of $62,289 or 4.12%. Year to date net income has increased $236,611 ($.09 per share) from $4,001,515 ($1.32 per share) in 2009 to 4,238,126 ($1.41 per share) in 2010. The key components of net income are discussed in the following paragraphs.

For the third quarter of 2010 compared to 2009, net interest income increased $13,090 (.34%). Net interest income increased $144,468 (1.25%) in the first nine months of 2010 compared to the same period in 2009. The decrease in interest and dividend revenue continues a multi-year trend primarily attributable to extremely low market rates. In 2009, immediately repricable assets such as federal funds sold saw dramatic revenue declines. During 2010, the gradual downward repricing of debt securities and certificates of deposit in other banks has caused further erosion of revenues. Interest expense decreased in the third quarter of 2010 by $117,682 (19.53%) relative to the comparable period last year primarily due to lower rates on time deposits. For the year to date, interest expense is down $490,678 (24.81%) relative to last year.

The Company’s net interest income is one of the most important factors in evaluating its financial performance. Management uses interest rate sensitivity analysis to determine the effect of rate changes. Net interest income is projected over a one-year period to determine the effect of an increase or decrease in the prime rate of 100 basis points. If prime were to decrease one hundred basis points, and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience a decrease of approximately 5.1% in net interest income. Conversely, if prime were to increase one hundred basis points, and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience an increase in net interest income of the same percentage. The sensitivity analysis does not consider the likelihood of these rate changes nor whether management’s reaction to this rate change would be to reprice its loans or deposits or both.

The tax-equivalent quarterly yield on interest-earning assets decreased by 23 basis points from 4.83% for third quarter 2009 to 4.60% in 2010. The quarterly yield on interest-bearing liabilities decreased by 24 basis points from 1.00% in 2009 to .76% in 2010. In combination, these shifts contribute to a decrease in net margin on interest-earning assets of 9 basis points.

The following table presents information including average balances of interest-earning assets and interest-bearing liabilities, the amount of related interest income and interest expense, and the resulting yields by category of interest-earning asset and interest-bearing liability. In this table, dividends and interest on tax-exempt securities and loans are reported on a fully taxable equivalent basis, which is a non-GAAP measure as defined in SEC Regulation G and Item 10 of SEC Regulation S-K. Management believes that these measures provide better yield comparability as a tool for managing net interest income.

Average Balances, Interest, and Yields

	For the quarter ended September 30, 2010			For the quarter ended September 30, 2009		
	Average balance	Interest	Yield	Average balance	Interest	Yield
Assets						
Federal funds sold	$ 40,193,477	$ 17,969	0.18%	$ 37,585,106	$ 18,085	0.19%
Interest-bearing deposits	9,830,702	12,618	0.51%	12,284,308	26,100	0.84%
Investment securities	85,785,352	319,144	1.48%	81,079,391	446,496	2.18%
Loans, net of allowance	243,879,944	4,054,827	6.60%	239,223,663	4,019,226	6.67%
Total interest-earning assets	379,689,475	4,404,558	4.60%	370,172,468	4,509,907	4.83%
Noninterest-bearing cash	21,567,998			17,849,768		
Other assets	15,620,477			14,254,239		
Total assets	$ 416,877,950			$ 402,276,475		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
NOW	$ 58,830,531	59,925	0.40%	$ 51,424,450	37,201	0.29%
Money market	39,344,234	49,089	0.50%	36,663,323	45,981	0.50%
Savings	48,572,626	52,798	0.43%	45,026,198	56,096	0.49%
Other time	99,842,805	313,283	1.24%	98,448,988	452,497	1.82%
Total interest-bearing deposits	246,590,196	475,095	0.76%	231,562,959	591,775	1.01%
Securities sold under agreements to repurchase & federal funds purchased	7,311,711	9,153	0.50%	7,777,915	9,758	0.50%
Borrowed funds	30,727	493	6.37%	57,311	890	6.16%
Total interest-bearing liabilities	253,932,634	484,741	0.76%	239,398,185	602,423	1.00%
Noninterest-bearing deposits	87,778,354			90,127,491		
	341,710,988	484,741	0.56%	329,525,676	602,423	0.73%
Other liabilities	628,646			545,485		
Stockholders' equity	74,538,316			72,205,314		
Total liabilities and stockholders' equity	$ 416,877,950			$ 402,276,475		
Net interest spread			3.84%			3.83%
Net interest income		$ 3,919,817			$ 3,907,484	
Net margin on interest-earning assets			4.10%			4.19%
Tax equivalent adjustment in:						
Investment income		$ 27,561			$ 31,823	
Loan income		$ 44,279			$ 40,774	

Provisions for loan losses of $52,500 and ($132,550) were recorded during the third quarter of 2010 and 2009, respectively. Provisions for loan losses of $653,500 and 497,050 were recorded for the nine months ending September 30, 2010 and 2009, respectively. Net loans charged-off were $662,496 and $578,598 during the first nine months of 2010 and 2009, respectively. Management attributes the continued loan losses to the generally poor state of the economy which has had an adverse effect on certain borrowing customers. See Loan Quality and the Allowance for Loan Losses for a discussion of the provision for loan losses.

Noninterest revenue for the third quarter of 2010 is $11,316 (2.21%) higher than the comparable period last year. Noninterest revenue for the year-to-date is $315,203 (21.39%) more than last year. The favorable variances in both the quarter and the year-to-date are largely due to gains on the sale of old coins with high precious metal content that had been stored in the Bank’s vault for decades, as well as gains on the sale of real property to the State of Delaware for road expansion and related right of ways.

Noninterest expense for the third quarter of 2010 is $61,355 (2.96%), less than last year including a $78,671 reduction in FDIC premium expense. Noninterest expense year-to-date is $108,390 (1.74%) less than last year including a $198,380 decrease in FDIC premiums. In 2009, FDIC insurance premiums included the accrual of a special assessment to restore the deposit insurance fund to target levels. This special assessment is not expected to repeat in 2010.

Income taxes for the nine months ended September 30, 2010 are $175,000 (7.70%) higher than the same period last year, on a pre-tax income increase of $411,611 (6.56%).

Plans of Operation

The Bank offers a full range of deposit services including checking, NOW, Money Market, and savings accounts, and time deposits including certificates of deposit. The transaction, savings, and certificate of deposit accounts are tailored to the Bank’s principal market areas at rates competitive to those offered in the area. The Bank also offers Individual Retirement Accounts (IRA), Health Savings Accounts, and Education Savings Accounts. All deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the maximum amount allowed by law, which is currently $250,000 per depositor. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities. The Bank offers individual customers up to $50 million in FDIC insured deposits through the Certificate of Deposit Account Registry Services® network.

The Bank also offers a full range of short- to medium-term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. The Bank originates commercial and residential mortgage loans and real estate construction and acquisition loans. These lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank lends to directors and officers of the Company and the Bank under terms comparable to those offered to other borrowers entering into similar loan transactions. The Board of Directors approves all loans to officers and directors and reviews these loans every six months.

Other bank services include cash management services, 24-hour ATM’s, debit cards, safe deposit boxes, travelers’ checks, direct deposit of payroll and social security funds, and automatic drafts for various accounts. The Bank offers bank-by-phone and Internet banking services, including electronic bill-payment, to both commercial and retail customers. The Bank offers a remote capture service that enables commercial customers to electronically capture check images and make on-line deposits. The Bank also offers retail repurchase agreements, a non-deposit product which is not insured by FDIC.

Capital Resources and Adequacy

Total stockholders’ equity increased $4,046,683 from December 31, 2009 to September 30, 2010. This increase is attributable to comprehensive income recorded during the period, as detailed in Note 2 of the Notes to Financial Statements.

Under the capital guidelines of the Federal Reserve Board and the FDIC, the Company and Bank are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of stockholders' equity less accumulated other comprehensive income. In addition, the Company and the Bank must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 4%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

Tier one risk-based capital ratios of the Company as of September 30, 2010 and December 31, 2009 were 33.9% and 31.6%, respectively. Both are substantially in excess of regulatory minimum requirements.

Late in 2008, the Company and the Bank elected to participate in the Temporary Liquidity Guarantee Program (TLG). A component of TLG, the Transaction Account Guarantee Program (TAG), provides additional insurance protection to holders of transaction accounts with rates not exceeding a legislated limit. The Company’s participation in this program may have contributed to an increase in deposits in the Bank as investors seek the safety of insured deposits in community banks. Deposit insurance premiums have increased as a result of the higher deposit balances, the higher insurance limits, participation in TAG, and higher insurance rates. Management does not expect to pass all of the additional insurance premium costs on to customers. Effective July 1, 2010, the Bank no longer participates in TAG due to the rate limitations imposed on banks that extended their participation. Deposits in the Bank continue to be insured up to the limits provided under standard FDIC deposit insurance rules. Management does not expect withdrawal from the TAG program to have a significant effect on deposit balances.

In the most stable economic times, the Company cannot reliably predict the effect of changing government policies on earnings, or loan and deposit levels. Management expects 2010 to see a continuation of higher than usual fees associated with loan collection, and additional loan defaults. The full impact of the dramatic developments of 2008 and 2009 on future results of operation of the Company and the Bank, are uncertain. Although some key economic indicators are stabilizing or improving in early 2010, management recognizes that loan defaults may continue into the early months of a recovery as customers struggle to stabilize business or personal finances and property values remain at levels well below the market peak in mid-2008.

Website Access to SEC Reports

The Bank maintains an Internet website at

www.taylorbank.com. The Company’s periodic SEC reports, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, are accessible through this website. Access to these filings is free of charge. The reports are available as soon as practicable after they are filed electronically with the SEC.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company’s principal market risk exposure relates to interest rates on interest-earning assets and interest-bearing liabilities. Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the Bank are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management monitors and seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

At September 30, 2010, the Company’s interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 23.48%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. The Bank has classified its demand mortgage and commercial loans as immediately repriceable. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans and change the rates rests with management.

Item 4. Controls and procedures

Disclosure controls and procedures are designed and maintained by the Company to ensure that information required to be disclosed in the Company’s publicly filed reports is recorded, processed, summarized and reported in a timely manner. Such information must be available to management, including the Chief Executive Officer (CEO) and Treasurer, to allow them to make timely decisions about required disclosures. Even a well-designed and maintained control system can provide only reasonable, not absolute, assurance that its objectives are achieved. Inherent limitations in any system of controls include flawed judgment, errors, omissions, or intentional circumvention of controls.

The Company’s management, including the CEO and Treasurer, performed an evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of September 30, 2010. Based on that evaluation, the Company’s management, including the CEO and Treasurer, has concluded that the Company’s disclosure controls and procedures are effective. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company’s internal control over financial reporting that have had or are reasonably likely to have a material effect on the Company’s internal control over financial reporting. As of September 30, 2010, the Company’s management, including the CEO and Treasurer, has concluded that the Company’s internal controls over financial reporting are effective.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Part II. Other Information

Item 1 Legal Proceedings
Not applicable

Item 1A Risk Factors
The Company and the Bank are subject to various types of risk during the normal conduct of business. There has been no material increase in any level of risk incurred by the Company or the Bank during the quarter covered by this report. Following are descriptions of the significant categories of risk most relevant to the Company.

Credit risk is the risk to the Company's earnings or capital from the potential of an obligor failing to fulfill its contractual commitment to the Company. Credit risk is most closely associated with the Company's lending activities.

Interest rate risk is the risk to earnings or capital from the potential movement in interest rates. It is the sensitivity of the Company's future earnings to interest rate changes.

Liquidity risk is the risk to earnings or capital from the Company's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

Market risk is the risk to earnings or capital from changes in the value of portfolios of financial instruments. For the Company, market risk is the risk of a decline in market value of its securities portfolio.

Transaction risk is the risk to earnings or capital arising from problems with service or product delivery. Transaction risk is the risk of a failure in the Company's operating processes, such as automation, employee integrity, or internal controls.

Compliance risk is the risk to earnings or capital from noncompliance with laws, rules, and regulations. Compliance risk is one of the greatest risks the Company faces.

Reputation risk is the risk to earnings or capital from negative public opinion. Customer and public relations are critical to the Company's success. Accordingly, the Company's reputation is extremely important and anything that would impair that reputation is a significant risk.

Strategic risk is the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

The Company publicly announced on August 14, 2003, that it would repurchase up to 10% of its outstanding equity stock at that time, which equated to a total of 324,000 common shares available for repurchase. As of January 1, 2005, and again on May 18, 2007, this plan was renewed by public announcement, making up to 10% of the Company's outstanding equity stock available for repurchase at the time of each renewal. On January 13, 2010, as part of its capital planning, the Board of Directors voted to suspend until June 30, 2010, the stock repurchase program. On June 9, 2010, the Board voted to extend the program suspension until December 31, 2010.

There is no final expiration date for this program. No other stock repurchase plan or program existed or exists simultaneously, nor has any other plan or program expired during the duration of this program. Common shares repurchased under this plan have been retired.

Item 3 Defaults Upon Senior Securities

Not applicable

Item 4 (Removed and Reserved)

Item 5 Other information

There is no information required to be disclosed in a report on Form 8-K during the period covered by this report, which has not been reported.

Item 6 Exhibits and Reports on Form 8-K

a) Exhibits

31. Certifications of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32. Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.1
Rule 13a-14(a) Certification of the Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Raymond M. Thompson, certify that:

I have reviewed this quarterly report on Form 10-Q of Calvin B. Taylor Bankshares, Inc.;

1. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

2. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

3. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal quarter that has or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

4. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2010

By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Exhibit 31.2
Rule 13a-14(a) Certification of the Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jennifer G. Hawkins, certify that:

I have reviewed this quarterly report on Form 10-Q of Calvin B. Taylor Bankshares, Inc.;

1. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

2. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

3. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal quarter that has or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

4. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2010

By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer (Principal Financial Officer and Principal Accounting Officer)

Exhibit 32
Certification - Pursuant to 18 U.S.C. 1350
(Section 906 of the Sarbanes-Oxley Act of 2002)

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended September 30, 2010, of Calvin B. Taylor Bankshares, Inc.:

(1) The referenced report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2010

By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer (Principal Financial Officer and Principal Accounting Officer)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2010

By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer (Principal Financial Officer and Principal Accounting Officer)