

TAYLOR CALVIN B BANKSHARES INC
Form 10-K
March 13, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2006
Commission File No. 000-50047

Calvin B. Taylor Bankshares, Inc.

(Exact name of registrant as specified in its Charter)

Maryland

(State of incorporation or organization)

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

Securities registered under Section 12(b) of the Act: None

Securities registered under Section 12(g) of the Act: Common Stock, par value \$1.00 per share

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [X] No ____

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ____ No [X]

Indicate by check mark whether the registrant has (1) 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] No ____

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (

§229.405 of this chapter) is not contained in this form, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large accelerated filer ____ Accelerated filer [X] Non-accelerated filer ____

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

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The aggregate market value of the Common Stock, all of which has voting rights, held by non-affiliates of the registrant on December 31, 2006, was \$98,432,775. This calculation is based upon the last price known to the registrant at which its Common Stock was sold as of the last business day of the registrant's most recently completed second fiscal quarter. As of June 30, 2006, the last known sale price was \$37.50 per share. There is not an active trading market for the Common Stock and it is not possible to identify precisely the market value of the Common Stock.

On February 28, 2007, 3,145,489 shares of the registrant's common stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Proxy Statement for Annual Meeting of Stockholders to be held on May 17, 2006, is incorporated by reference in this Form 10-K in Part III, Item 10, Item 11, Item 12, Item 13, and Item 14.

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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.

PART I

Item 1. Business

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 of Berlin, Maryland (Bank). The Bank is a commercial bank incorporated under the laws of the State of Maryland on December 17, 1907, with a main office located in Berlin, Maryland.

Location and Service Area

The Company, through the Bank, is engaged in a general commercial and retail banking business serving individuals, small- to medium-sized businesses, professional organizations, and governmental units. The Bank operates nine branches located throughout Worcester County, Maryland and one branch located in Sussex County, Delaware. The Bank draws most of its customer deposits and conducts most of its lending transactions within the communities in which these branches are located.

Much of the Bank's service area is located along the shores of the Atlantic Ocean and has grown as both a resort and a retirement community. The principal components of the economy are tourism and agriculture. Berlin has a strong component of health-care related businesses. The tourist businesses of Ocean City, Maryland and Bethany, Delaware and the health-care facilities in Berlin, Maryland (including Berlin Nursing Home and Atlantic General Hospital) are among the largest employers in the counties.

Banking Products and Services

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 accounts and time certificates are tailored to the Bank's principal market areas at rates competitive to those offered in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts. All deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the maximum amount allowed by law (generally, \$100,000 per depositor subject to aggregation rules). The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities.

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 also offers non-deposit products including retail repurchase agreements and discount brokerage services through a correspondent bank.

Competition

The Company and the Bank face strong competition in all areas of operations. The competition comes from entities operating in Worcester County, Maryland and Sussex County, Delaware and neighboring counties and includes branches of some of the largest banks in Maryland, Delaware, and Virginia. Its most direct competition for deposits historically has come from other commercial banks, savings banks, savings and loan associations, and credit unions operating in its service areas. The Bank also competes for deposits with money market mutual funds and corporate and government securities. The Bank competes for loans with the same banking entities, as well as mortgage banking companies and other institutional lenders. The competition for loans varies from time to time depending on certain factors. These factors include, among others, the general availability of lendable funds and credit, general and local economic conditions, current interest rate levels, conditions in the mortgage market, and other factors which are not readily predictable.

The Bank employs traditional marketing media including local newspapers and radio, to attract new customers. Bank officers, directors, and employees are active in numerous community organizations and participate in community-based events. These activities and referrals by satisfied customers result in new business.

Employees

As of December 31, 2006, the Bank employed 98 full-time equivalent employees. The Company's operations are conducted through the Bank. Consequently, the Company does not have separate employees. None of the employees of the Bank are represented by any collective bargaining unit. The Bank considers its relations with its employees to be good.

SUPERVISION AND REGULATION

The Company and the Bank are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on, and provide for general regulatory oversight with respect to, virtually all aspects of operations. These laws and regulations are generally intended to protect depositors, not stockholders. The following is a summary of certain statutes, rules, and regulations affecting the Company and the Bank. To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Proposed legislative changes and the policies of various regulatory authorities may affect the operations of the Company and the Bank and those effects may be material. The Company is unable to predict the nature or the extent of the effect on its business and earnings that fiscal or monetary policies, economic controls, or new federal or state legislation may have in the future.

The Company

Bank Holding Company Act of 1956

The Company is a bank holding company within the meaning of the federal Bank Holding Company Act of 1956 (BHCA). Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require. The Company's and the Bank's activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its Subsidiary, or engaging in any other activity that the Federal Reserve determines to be so closely related to banking or managing and controlling banks as to be a proper incident thereto.

Investments, Control, and Activities. With certain limited exceptions, the BHCA requires a bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring substantially all the assets of any bank, (ii) acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares), or (iii) merging or consolidating with another bank holding company.

In addition, and subject to certain exceptions, the BHCA and the Change in Bank Control Act, together with regulations thereunder, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring "control" of a bank holding company, such as the Company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Because the Company's Common Stock is registered under the Securities Exchange Act of 1934, under Federal Reserve regulations, control will be rebuttably presumed to exist if a person acquires at least 10% of the outstanding shares of any class of voting securities of the Company. The regulations provide a procedure for challenge of the rebuttable control presumption.

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Under the BHCA, the Company is generally prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in non-banking activities, unless the Federal Reserve, by order or regulation, has found those activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Source of Strength; Cross-Guarantee. Under Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which the Company might not otherwise do so. The Federal Reserve may require a bank holding company to terminate an activity or relinquish control of a nonbank subsidiary if the Federal Reserve determines that such activity or control poses serious risk to the financial soundness or stability of a subsidiary bank. Further, federal bank regulatory authorities have discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. The Bank may be required to indemnify, or cross-guarantee, the FDIC against losses it incurs with respect to any other bank controlled by the Company, which in effect makes the Company's equity investments in healthy bank subsidiaries available to the FDIC to assist any failing or failed bank subsidiary of the Company.

Gramm-Leach-Bliley Act

In November 1999, the Gramm-Leach-Bliley Act was signed into law. Among other things, the Act repeals the restriction, contained in the Glass-Steagall Act, on banks affiliating with securities firms. The Act permits bank holding companies to engage in a statutorily provided list of financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities. The Act also authorizes activities that are "complementary" to financial activities. The Act is intended to grant certain powers to community banks that larger institutions have accumulated on an ad hoc basis. The Act may have the result of increasing competition that the Company and the Bank face from larger institutions and other types of companies. It is not possible to predict the full effect that the Act will have on the Company and the Bank.

Securities Exchange Act of 1934

The Company's common stock is registered with the Securities and Exchange Commission (SEC) under Section 12(g) of the Securities Exchange Act of 1934 (the Act). The Company is, therefore, subject to periodic and ad hoc information reporting, proxy solicitation rules, restrictions on insider trading, and other requirements of the Act.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act (SOX) of 2002 imposed additional disclosure requirements in the Company's reports filed with SEC. SOX defines new standards of independence for insiders, provides guidance for certain Board committees including the composition of those committees, and establishes corporate governance requirements.

The Bank

General. The Bank operates as a state nonmember banking association incorporated under the laws of the State of Maryland. It is subject to examination by the FDIC and the state department of banking regulation for each state in which it has a branch. The States and FDIC regulate or monitor all areas of the Bank's operations, including security devices and procedures, adequacy of capitalization and loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees chargeable on loans, establishment of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The FDIC requires the Bank to maintain certain capital ratios and imposes limitations on the Bank's aggregate investment in real estate, bank premises, and furniture and fixtures. The Bank is required by the FDIC to prepare quarterly reports on the Bank's financial condition.

Under provisions of the FDICIA, all insured institutions must undergo periodic on-site examination by the appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the agency against each institution or affiliate, as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency (and state supervisor when applicable). FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

Transactions With Affiliates and Insiders

The Bank is subject to Section 23A of the Federal Reserve Act, which places limits on the amount of loans or extensions of credit to, or investment in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of the Bank's capital and surplus. In addition, each covered transaction must meet specific collateral requirements. The Bank is also subject to Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal stockholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Community Reinvestment Act

The Community Reinvestment Act requires that the Bank shall be evaluated by its primary federal regulator with respect to its record in meeting the credit needs of its local community, including low and moderate income neighborhoods, consistent with safe and sound operations. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. The Bank received a satisfactory rating in its most recent evaluation.

USA Patriot Act

In response to the terrorist attacks on September 11, 2001, Congress passed the Patriot Act. The Patriot Act requires that Banks prepare and retain additional records designed to assist the government in an effort to combat terrorism. The Act includes anti-money laundering and financial transparency provisions, and guidelines for verifying customer identification during account opening. The Act promotes cooperation between law enforcement, financial institutions, and financial regulators in identifying persons involved in illegal acts such as money laundering and terrorism.

Other Regulations

Interest and certain other charges collected or contracted for by the Bank are subject to state and federal laws concerning interest rates. The Bank's loan operations are also subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers, the Home Mortgage Disclosure Act of 1975 requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves, the Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed, or other prohibited bases in extending credit, the Fair Credit Reporting Act of 1978 governing the use and provision of information to credit reporting agencies, the Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies, and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank are also subject to the Right to Financial Privacy Act which imposes a duty to maintain confidentiality of customers' financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Fund Transfers Act as implemented by the Federal Reserve Board's Regulation E which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Deposit Insurance

The FDIC establishes rates for the payment of premiums by federally insured banks and thrifts for deposit insurance. Separate insurance funds are maintained for commercial banks (BIF) and thrifts (SAIF), with insurance premiums from the industry used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like the Bank have paid for deposit insurance under a risk-based premium system. The Federal Deposit Insurance Reform Act of 2005 creates a revised deposit insurance assessment rate structure, effective January 1, 2007. Under this system, assessment rates are based on Risk Categories as determined by a combination of CAMELS component ratings and financial ratios. Banks in Risk Category I, the lowest risk profile, will be assessed at a rate of 5 to 7 basis points. A One-time Assessment Credit for banks that were in existence on December 31, 1996, will be applied to offset assessments dollar-for-dollar until full benefit of the credit is received. In addition to the amount paid for deposit insurance, banks are assessed an additional amount to service the interest on the bond obligations of the Financial Corporation (FICO). Any increase in deposit insurance premiums for the Bank will increase the Bank's operating expenses, and there can be no assurance that such costs can be passed on to the Bank's customers.

Dividends

The principal source of the Company's cash revenues comes from dividends received from the Bank. The amount of dividends that may be paid by the Bank to the Company depends on the Bank's earnings and capital position and is limited by federal and state laws, regulations, and policies. The Federal Reserve has stated that bank holding companies should refrain from or limit dividend increases or reduce or eliminate dividends under circumstances in which the bank holding company fails to meet minimum capital requirements or in which earnings are impaired.

The Company's ability to pay any cash dividends to its stockholders in the future will depend primarily on the Bank's ability to pay dividends to the Company. In order to pay dividends to the Company, the Bank must comply with the requirements of all applicable laws and regulations. Under Maryland law, the Bank must pay a cash dividend only from the following, after providing for due or accrued expenses, losses, interest, and taxes: (i) its undivided profits, or (ii) with the prior approval of the Department of Financial Regulation, its surplus in excess of 100% of its required capital stock. Under FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. See "Capital Regulations" below. See Item 5 for a discussion of dividends paid by the Company in the past three years.

In addition to the availability of funds from the Bank, the future dividend policy of the Company is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash needs, and general business conditions. The amount of dividends that might be declared in the future presently cannot be estimated and it cannot be known whether such dividends would continue for future periods.

Capital Regulations

The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance sheet exposure, and minimize disincentives for holding liquid assets. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the regulators have noted that banks and bank holding companies contemplating significant expansion programs should not allow expansion to diminish their capital ratios and should maintain ratios well in excess of the minimums.

Current guidelines require bank holding companies and federally regulated banks to maintain a minimum ratio of total capital to risk-based assets equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common stockholders' equity before the unrealized gains and losses on securities available for sale, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles, and excludes the allowance for loan losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan losses up to 1.25% of risk-weighted assets. Total capital is the sum of Tier 1 plus Tier 2 capital. The federal bank regulatory authorities have also implemented a leverage ratio, which is Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk-based guidelines. The principal objective of the leverage ratio is to place a constraint on the maximum degree to which a bank holding company may leverage its equity capital base. The minimum required leverage ratio for top-rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points.

FDICIA established a new capital-based regulatory scheme designed to promote early intervention for troubled banks and requires the FDIC to choose the least expensive resolution of bank failures. The new capital-based regulatory framework contains five categories for compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." To qualify as a "well capitalized" institution, a bank must have a leverage ratio of no less than 5%, a Tier 1 risk-based ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2006, the Company and the Bank were qualified as "well capitalized." For further discussions, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Capital."

Recent Legislative Developments

Periodically, the federal and state legislatures consider bills with respect to the regulation of financial institutions. Some of these proposals could significantly change the regulation of banks and the financial services industry. The Company cannot predict if such proposals will be adopted or the affect to the Company.

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 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 1B. Unresolved Staff Comments

The registrant, an accelerated filer, has not received comments from the Commission staff which remain unresolved at the time of this filing.

Item 2. Properties

The Company has ten branch locations, all of which are owned by the Company or the Bank. The Bank leases the land on which the East Berlin branch is located. The locations are described as follows:

<u>Office</u>	<u>Location</u>	<u>Square Footage</u>
Main Office, Berlin	24 North Main Street, Berlin, Maryland 21811	24,229
East Berlin Office	10524 Old Ocean City Boulevard, Berlin, Maryland 21811	1,500
20 th Street Office	100 20 th Street, Ocean City, Maryland 21842	3,100
Ocean Pines Office	11003 Cathell Road, Berlin, Maryland 21811	2,420
Mid-Ocean City Office	9105 Coastal Highway, Ocean City, Maryland 21842	1,984
North Ocean City Office	14200 Coastal Highway, Ocean City, Maryland 21842	2,545
West Ocean City Office	9923 Golf Course Road, Ocean City, Maryland 21842	2,496
Pocomoke Office	2140 Old Snow Hill Road, Pocomoke, Maryland 21851	2,624
Snow Hill Office	108 West Market Street, Snow Hill, Maryland 21863	3,773
Ocean View, Delaware Office	50 Atlantic Avenue, Ocean View, Delaware 19970	4,900

The Berlin office is the centralized location for the Company and the Bank. Executive offices, loan processing, proof, bookkeeping, and the computer department are housed there.

Most branches have a manager who also serves as a loan officer. All offices participate in normal day-to-day banking operations. The Company operates automated teller machines in all branches and at one non-branch location in a local hospital.

Item 3. Legal Proceedings

- (a) There are no material pending legal proceedings to which the Company or the Bank or any of their properties are subject.
- (b) No proceedings were terminated during the fourth quarter of the fiscal year covered by this report.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of the stockholders of the Company during the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Articles of Incorporation, as amended, authorize it to issue up to 10,000,000 shares of common stock.

As of February 28, 2007 there were approximately 1,027 stockholders of record and 3,145,489 shares of Common Stock issued and outstanding. There is no established public trading market in the stock, and there is no likelihood that a trading market will develop in the near future. Transactions in the common stock are infrequent and are frequently negotiated privately between the persons involved in those transactions.

All outstanding shares of common stock of the Company are entitled to share equally in dividends from funds legally available, when, as, and if declared by the Board of Directors. The Company paid or declared dividends of \$.75 per share in 2006, \$2.10 per share in 2005, and \$.65 per share in 2004. Included is a special cash dividend of \$1.40 per share in 2005, which is not expected to be an annual event.

The following table presents information about the Company's repurchase of its equity securities during the calendar quarter ended on the date of this Form 10-K.

Period	(a) Total Number of shares	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of a Publicly Announced Program	(d) Maximum Number of Shares that may yet be Purchased Under the Program
October	-0-	N/A	-0-	269,053
November	2,340	\$36.00	2,340	266,713
December	4,987	\$36.00	4,987	261,726
Totals	7,327	\$36.00	7,327	

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. There was no expiration date for this program. No other stock repurchase plan or program existed simultaneously, nor had any other plan or program expired during the period covered by this table. Common shares repurchased under this plan were retired.

As of January 1, 2005, this plan was renewed, by public announcement, making up to 10% of the Company's outstanding equity stock at that time, which equates to a total of 320,848 common shares, available for repurchase. This renewal continues into 2007. Common shares repurchased under this plan are retired.

Item 6. Selected Financial Data

The following table presents selected financial data for the five years ended December 31, 2006.

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(Dollars in thousands, except for per share data)				
<u>At Year End</u>					
Total assets	\$ 367,532	\$ 389,075	\$ 393,333	\$ 386,486	\$ 369,243
Total deposits	\$ 290,325	\$ 310,858	\$ 319,772	\$ 317,946	\$ 301,495
Total loans, net of unearned income and allowance for loan losses	\$ 231,252	\$ 204,442	\$ 161,510	\$ 162,243	\$ 161,825
Total stockholders' equity	\$ 70,170	\$ 66,318	\$ 66,698	\$ 63,636	\$ 60,015
<u>For the Year</u>					
Net interest income	\$ 16,963	\$ 15,912	\$ 13,698	\$ 13,647	\$ 13,741
Net income	\$ 7,400	\$ 6,798	\$ 5,613	\$ 5,540	\$ 5,754
<u>Per share data</u>					
Book value	\$ 22.28	\$ 20.81	\$ 20.79	\$ 19.71	\$ 18.52
Net income	\$ 2.33	\$ 2.13	\$ 1.74	\$ 1.71	\$ 1.78
Cash dividends declared	\$.75	\$ 2.10	\$.65	\$.60	\$ 1.00

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Company's financial statements and related notes and other statistical information included in this report.

Overview

Consolidated income of the Company is derived primarily from operations of the Bank. Net income for 2006 was \$7,400,369 compared to \$6,797,638 for 2005 and \$5,613,187 for 2004. The Company had a return on average equity of 10.87% and return on average assets of 1.97% for 2006, compared to returns on average equity of 10.01% and 8.64%, and returns on average assets of 1.71% and 1.42%, for 2005 and 2004, respectively.

Results of Operations

The Company's net income of \$7,400,369, or \$2.33 per share, for the year ended December 31, 2006, was an increase of \$602,731 or 8.87%, from net income of \$6,797,638, or \$2.13 per share, for the year ended December 31, 2005. Contributing to this increase was a \$1,050,666 (6.60%) increase in net interest income. Noninterest revenue increased \$149,370 (8.30%) from 2005 to 2006, while noninterest expense increased \$195,005 (2.72%) during the same period.

The Company's net income of \$6,797,638, or \$2.13 per share, for the year ended December 31, 2005, was an increase of \$1,184,451 or 21.10%, from the net income of \$5,613,187, or \$1.74 per share, for the year ended December 31, 2004. Contributing to this increase was a \$2,213,985 (16.16%) increase in net interest income. Noninterest revenue increased \$49,577 (2.83%) from 2004 to in 2005, while noninterest expense increased \$351,211 (5.16%) during the same period.

The Company's net income of \$1,831,259 or \$.58 per share, for the quarter ended December 31, 2006, was an increase of \$127,316, or 7.47%, from the net income of \$1,703,943 or \$.53 per share, for the quarter ended December 31, 2005. Increased net interest income, the primary reason for the increase, was due to a second year of continued growth in the Bank's loan portfolio and higher earnings rates on the Bank's investments. Deposit interest expense increased due to rate increases targeted at deposit retention.

The Company's net income of \$1,703,943 or \$.53 per share, for the quarter ended December 31, 2005, was an increase of \$252,597, or 17.40%, from the net income of \$1,451,346 or \$.45 per share, for the quarter ended December 31, 2004. Increased net interest income, the primary reason for the increase, was due to growth in the Bank's loan portfolio and higher earnings rates on the Bank's investments. Deposit interest expense increased due to rate increases, but the effect on earnings was ameliorated by a reduction in the volume of time deposits.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between revenue on interest-earning assets, such as investment securities and loans, and interest incurred on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balance of interest-earning assets and the Company's funding sources and the various rate spreads between the interest-earning assets and funding sources. Changes in net interest income from period to period result from increases or decreases in the volume of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volume of interest-earning assets and interest-bearing liabilities is affected by the ability to manage the earning-asset portfolio, which includes loans, and the availability of particular sources of funds, such as noninterest-bearing deposits.

The key performance measure for net interest income is the "net margin on interest-earning assets," or net interest income divided by average interest-earning assets. The Company's net interest margin for 2006 on a non-GAAP tax-equivalent basis, was 5.02%, compared to 4.45% and 3.88% for 2005 and 2004, respectively. Because most of the Bank's loans are written with a demand feature, the income of the Bank should not change dramatically as interest rates change. Management of the Company expects to maintain the net margin on interest-earning assets. The net margin may decline, however, if competition increases, loan demand decreases, or the cost of funds rises faster than the return on loans and securities. Although such expectations are based on management's judgment, actual results will depend on a number of factors that cannot be predicted with certainty, and fulfillment of management's expectations cannot be assured.

The following tables present 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 these tables, 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.

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Average Balances, Interest, and Yields

(Dollars stated in thousands)

	For the Year Ended December 31, 2006			For the Year Ended December 31, 2005			For the Year Ended December 31, 2004		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets									
Federal funds sold	\$ 22,547	\$ 1,137	5.04%	\$ 34,233	\$ 1,078	3.15%	\$ 41,762	\$ 547	1.31%
Interest-bearing deposits	2,173	79	3.64%	2,175	56	2.56%	2,201	48	2.16%
Investment securities:									
U. S. Treasury	71,441	2,614	3.66%	105,456	2,881	2.73%	116,537	2,443	2.10%
U. S. Government Agency	13,378	398	2.98%	19,666	525	2.67%	18,844	503	2.67%
State and municipal	7,443	219	2.94%	16,618	388	2.34%	19,004	407	2.14%
Other	1,900	102	5.37%	1,882	90	4.80%	1,786	79	4.43%
Total investment securities	94,162	3,333	3.54%	143,622	3,884	2.70%	156,171	3,432	2.20%
Loans:									
Commercial	23,804	1,711	7.19%	19,134	1,322	6.91%	15,243	1,052	6.90%
Mortgage	200,588	14,020	6.99%	165,415	11,485	6.94%	146,121	10,289	7.04%
Consumer	2,491	206	8.27%	2,083	178	8.53%	2,305	201	8.73%
Total loans	226,883	15,937	7.02%	186,632	12,985	6.96%	163,669	11,542	7.05%
Allowance for loan losses	2,190			2,193			2,188		
Total loans, net of allowance	224,693	15,937	7.09%	184,439	12,985	7.04%	161,481	11,542	7.15%
Total interest-earning assets	343,575	\$ 20,486	5.96%	364,469	\$ 18,003	4.94%	361,615	\$ 15,569	4.31%
Noninterest-bearing cash	17,694			19,946			19,705		
Premises and equipment	6,605			6,757			6,968		
Other assets	7,358			6,194			6,428		
Total assets	\$375,232			\$397,366			\$394,716		
Interest-bearing deposits									
NOW	\$ 57,052	\$ 141	0.25%	\$ 67,452	\$ 101	0.15%	\$ 64,537	\$ 97	0.15%
Money market	41,810	335	0.80%	50,537	218	0.43%	49,733	198	0.40%
Savings	47,812	285	0.60%	54,988	218	0.40%	53,196	213	0.40%
Other time	68,359	2,414	3.53%	63,710	1,202	1.89%	72,621	1,028	1.42%
Total interest-bearing deposits	215,033	3,175	1.48%	236,687	1,739	0.73%	240,087	1,536	0.64%
Securities sold under agreements									
to repurchase	5,878	40	0.68%	6,325	22	0.34%	5,021	8	0.17%
Borrowed funds	145	8	5.52%	151	9	6.07%	171	10	6.06%
Total interest-bearing liabilities	221,056	3,223	1.46%	243,163	1,770	0.73%	245,279	1,554	0.63%
Noninterest-bearing deposits	84,380	-		85,526	-		83,498	-	
Other liabilities	305,436	\$ 3,223	1.06%	328,689	\$ 1,770	0.54%	328,777	\$ 1,554	0.47%
Other liabilities	1,739			750			990		
Stockholders' equity	68,057			67,927			64,949		
Total liabilities and stockholders' equity	\$375,232			\$397,366			\$394,716		
Net interest spread			4.50%			4.21%			3.68%
Net interest income		\$ 17,263			\$ 16,233			\$ 14,015	
Net margin on interest-earning assets			5.02%			4.45%			3.88%
Tax equivalent adjustment included in:									
Investment income		\$ 231			\$ 291			\$ 286	

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Loan income	\$ 69	\$ 27	\$ 31
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Analysis of Changes in Net Interest Income (Dollars stated in thousands)

	Year ended December 31, 2006 compared with 2005			Year ended December 31, 2005 compared with 2004		
	variance due to					
	Total	Rate	Volume	Total	Rate	Volume
Interest-earning assets						
Federal funds sold	59	427	(368)	531	630	(99)
Interest-bearing deposits	23	23	-	8	9	(1)
Investment securities:						
U. S. Treasury	(267)	662	(929)	438	670	(232)
U. S. Government Agency	(127)	41	(168)	22	-	22
State and municipals	(169)	45	(214)	(19)	32	(51)
Other	12	11	1	11	7	4
Loans:						
Commercial	389	66	323	270	1	269
Mortgage	2,535	93	2,442	1,196	(163)	1,359
Consumer	28	(7)	35	(23)	(4)	(19)
Total interest revenue	2,483	1,361	1,122	2,434	1,182	1,252
Interest-bearing liabilities						
NOW	40	56	(16)	4	-	4
Money market	117	155	(38)	20	17	3
Savings	67	95	(28)	5	(2)	7
Other time deposits	1,212	1,124	88	174	300	(126)
Other borrowed funds	17	19	(2)	13	12	1
Total interest expense	1,453	1,449	4	216	327	(111)
Net interest income	1,030	(88)	1,118	2,218	855	1,363

In the preceding table, the variance that is both rate and volume related is reported with the rate variance.

Composition of Loan Portfolio

Because loans are expected to produce higher yields than investment securities and other interest-earning assets (assuming that loan losses are not excessive), the absolute volume of loans and the volume as a percentage of total earning assets is an important determinant of net interest margin. Average loans, net of the allowance for loan losses, were \$224,693,000, \$184,439,000, and \$161,481,000 during 2006, 2005, and 2004, respectively, which constituted 65.40%, 50.60%, and 44.66% of average interest-earning assets for the periods. The Company's loan to deposit ratio was 79.65%, 65.77%, and 50.51% at December 31, 2006, 2005, and 2004, respectively. Average loans to average deposits were 75.04%, 57.24%, and 49.90% for 2006, 2005, and 2004. The increase in the loan to deposit ratio from 2005 to 2006 is attributable to 21.83% growth in the average loan portfolio accompanied by a 7.08% reduction in average deposits during 2006. Throughout 2005 and 2006, the Bank continued to enjoy increased loan opportunity due to steady demand and competitive pricing.

The Company extends loans primarily to customers located in and near Worcester County, Maryland and Sussex County, Delaware. There are no industry concentrations in the Company's loan portfolio. The Company does, however, have a substantial portion of its loans in real estate and performance will be influenced by the real estate market in the region.

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The following table sets forth the composition of the Company's loan portfolio as of December 31, 2006, 2005, and 2004, respectively.

Composition of the Loan Portfolio Stated in Dollars and Percentages

	2006	2005	2004	2003	2002
Real estate mortgages					
Construction, land, and land development	\$ 37,331,256	\$ 23,430,345	\$ 14,304,860	\$ 17,467,578	\$ 10,838,756
Residential 1 to 4 family	88,599,071	81,327,154	74,211,899	79,624,476	79,005,353
Second mortgages	2,395,178	2,094,749	1,900,559	1,353,800	553,316
Commercial properties	79,484,039	76,103,526	57,252,929	50,153,929	57,404,170
Commercial	23,264,997	21,461,593	14,007,430	13,199,879	12,765,723
Consumer	2,352,660	2,215,299	2,010,406	2,630,623	3,438,494
Total loans	233,427,201	206,632,666	163,688,083	164,430,285	164,005,812
Less allowance for loan losses	2,175,418	2,190,709	2,177,926	2,187,277	2,181,135
Loans, net	\$ 231,251,783	\$ 204,441,957	\$ 161,510,157	\$ 162,243,008	\$ 161,824,677

	2006	2005	2004	2003	2002
Real estate mortgages					
Construction, land, and land development	15.99%	11.34%	8.74%	10.62%	6.61%
Residential 1 to 4 family	37.95%	39.36%	45.33%	48.43%	48.17%
Second mortgages	1.03%	1.01%	1.16%	0.82%	0.34%
Commercial properties	34.05%	36.83%	34.98%	30.50%	35.00%
Commercial	9.97%	10.39%	8.56%	8.03%	7.78%
Consumer	1.01%	1.07%	1.23%	1.60%	2.10%
Total loans	100.00%	100.00%	100.00%	100.00%	100.00%

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The following table sets forth the maturity distribution, classified according to sensitivity to changes in interest rates, for selected components of the Company's loan portfolio as of December 31, 2006.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

December 31, 2006

	Over one through		Over five		Total
	One year or less	five years	years	years	
Real estate mortgages					
Construction, land, and land development	\$ 37,209,747	\$ 62,518	\$ 58,991	\$ 37,331,256	
Residential 1 to 4 family	88,318,586	51,749	228,736	88,599,071	
Second mortgages	2,395,178	-	-	2,395,178	
Commercial properties	79,165,424	53,191	265,424	79,484,039	
Commercial	20,443,065	2,203,607	618,325	23,264,997	
Consumer	1,075,144	1,125,642	151,874	2,352,660	
	\$ 228,607,144	\$ 3,496,707	\$ 1,323,350	\$ 233,427,201	
Fixed interest rate	\$ 1,432,234	\$ 3,496,707	\$ 1,323,350	\$ 6,252,291	
Variable interest rate (or demand)	227,174,910	-	-	227,174,910	
Total	\$ 228,607,144	\$ 3,496,707	\$ 1,323,350	\$ 233,427,201	

As of December 31, 2006, \$227,174,910 or 97.32%, of the total loans were either variable rate loans or loans written on demand.

The Company has the following commitments, lines of credit, and letters of credit outstanding as of December 31, 2006, 2005, and 2004, respectively.

	2006	2005	2004
Construction and land development loans	\$ 18,866,083	\$ 21,845,161	\$ 7,294,592
Other loan commitments	21,557,185	24,252,637	21,276,025
Standby letters of credit	1,682,942	1,272,000	1,535,210
Total	\$ 42,106,210	\$ 47,369,798	\$ 30,105,827

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments may have interest fixed at current rates, fixed expiration dates, and may require the payment of a fee. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company's exposure to loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment.

Loan Quality

The allowance for loan losses represents an allowance for potential losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on non-accruing, past due, and other loans that management believes require attention. The determination of the allowance rests upon management's judgment about factors affecting loan quality and assumptions about the economy. Management considers the year-end allowance appropriate and adequate to cover possible losses in the loan portfolio; however, management's judgment is based upon a number of assumptions about future events, which are believed to be reasonable, but which may or may not prove valid. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan loss or that additional increases in the loan loss allowance will not be required.

It is the Company's policy to evaluate loan portfolio risk for the purpose of establishing an adequate allowance. The allowance may include reserves for specific loans identified as substandard during management's loan review. For significant problem loans, management's review consists of evaluation of the financial strengths of the borrowers and guarantors, the related collateral, and the effects of economic conditions. The overall evaluation of the adequacy of the total allowance for loan losses is based on an analysis of historical loan losses ratios, loan charge-offs, delinquency trends, and previous collection experience, along with an assessment of the effects of external economic conditions. The recent 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 provision for loan losses is a charge to earnings in the current period to replenish the allowance and maintain it at a level management has determined to be adequate. No provision for loan losses was made in 2006, 2005, or 2004 due to low levels of delinquencies. Generally, the Company will not require a negative provision to reduce the allowance as a result of either net recoveries, or a decrease in loans.

Substantially all of the balance of the allowance as of December 31 2006, 2005, and 2004, is "general" in nature, that is, it cannot be specifically allocated among the major categories of loans in any meaningful manner. Management believes that this is consistent with the Company's history of conservative underwriting, high asset quality, low levels of delinquency, and minimal loan losses. As of December 31, 2006, the allowance for loan losses was .93% of outstanding loans, down from 1.06% at December 31, 2005, and 1.33% at December 31, 2004.

Allowance for Loan Losses

	2006	2005	2004	2003	2002
Balance at beginning of year	\$ 2,190,709	\$ 2,177,926	\$ 2,187,277	\$ 2,181,135	\$ 2,195,922
Loan losses:					
Commercial	5,357	-	-	-	6,816
Mortgages	-	-	-	-	-
Consumer	10,029	8,131	13,874	3,423	41,954
Total loan losses	15,386	8,131	13,874	3,423	48,770
Recoveries on loans previously charged off:					
Commercial	-	-	2,577	533	1,000
Mortgages	-	15,263	-	-	-
Consumer	95	5,651	1,946	9,032	7,983
Total loan recoveries	95	20,914	4,523	9,565	8,983
Net loan losses (recoveries)	15,291	(12,783)	9,351	(6,142)	39,787
Provision for loan losses charged to expense	-	-	-	-	25,000
Balance at end of year	\$ 2,175,418	\$ 2,190,709	\$ 2,177,926	\$ 2,187,277	\$ 2,181,135

Allowance for loan losses to loans

outstanding at end of year	0.93%	1.06%	1.33%	1.33%	1.33%
Net charge-offs to average loans	0.01%	-0.01%	0.01%	0.00%	0.02%

As a result of management's ongoing review of the loan portfolio, loans are classified as nonaccrual when it is not reasonable to expect collection of interest under the original terms. These loans are classified as nonaccrual even though the presence of collateral or the borrower's financial strength may be sufficient to provide for ultimate repayment. Interest payments received on nonaccrual loans are recognized as a reduction of principal. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. When a loan is placed in nonaccrual status, all interest that has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

Nonperforming loans are loans past due 90 or more days and still accruing plus nonaccrual loans. When real estate acquired in foreclosure and held for sale is included with nonperforming loans, the result comprises nonperforming assets. There were no nonperforming assets other than nonperforming loans as of December 31, 2006, 2005, 2004, 2003, or 2002, as shown in the following table.

	2006	2005	2004	2003	2002
Loans 90 days or more past due					
and still accruing	\$ 239,620	\$ 131,717	\$ 391,676	\$ 315,395	\$ 282,856
Nonaccruing loans	-	-	-	-	2,222
Total nonperforming loans	\$ 239,620	\$ 131,717	\$ 391,676	\$ 315,395	\$ 285,078

Loans are classified as impaired when the collection of contractual obligations, including principal and interest, is doubtful. Management has identified no significant impaired loans as of December 31, 2006, 2005, or 2004.

Liquidity and 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.

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. Average liquid assets (cash and amounts due from banks, interest-bearing deposits in other banks, federal funds sold, and investment securities) were 45.61% of average deposits for 2006, compared to 62.06% and 67.94% for 2005 and 2004, respectively.

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As of December 31, 2006, \$48,945,961, or 68.93% of the investment debt securities mature in one year or less, of which, \$11,919,970 are classified as "available-for-sale." Federal funds sold provide additional liquidity. Other sources of liquidity include letters of credit, overnight federal funds, and reverse repurchase agreements available from correspondent banks. The total lines and letters of credit available from correspondent banks were \$21,000,000 as of December 31, 2006, and \$19,000,000 as of December 31, 2005 and 2004.

Investment Securities Maturity Distribution and Yields

	December 31, 2006		December 31, 2005		December 31, 2004	
	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Treasury						
One year or less	\$ 37,408,625	4.04%	\$ 57,192,124	2.66%	\$ 58,255,488	1.71%
Over one through five years	18,479,455	4.69%	27,462,872	3.48%	58,361,766	2.57%
Over ten years	2,524,375	7.28%	2,587,187	7.28%	2,554,687	7.28%
Total U.S. Treasury securities	58,412,455	4.38%	87,242,183	3.05%	119,171,941	2.25%
U.S. Government Agencies						
One year or less	8,749,280	3.11%	9,999,514	2.31%	3,250,000	2.20%
Over one through five years	-	-	7,746,483	3.13%	16,741,938	2.61%
Total U. S. Government Agencies	8,749,280	3.11%	17,745,997	2.67%	19,991,938	2.55%
State, county, and municipal						
One year or less	2,788,056	2.43%	6,822,528	1.59%	11,399,926	1.34%
Over one through five years	1,062,744	2.82%	3,551,782	2.32%	8,121,361	1.60%
Total state, county, and municipal	3,850,800	2.54%	10,374,310	1.84%	19,521,287	1.45%
Total debt securities						
One year or less	48,945,961	3.78%	74,014,166	2.51%	72,905,414	1.67%
Over one through five years	19,542,199	4.59%	38,761,137	3.30%	83,225,065	2.48%
Over ten years	2,524,375	7.28%	2,587,187	7.28%	2,554,687	7.28%
Total debt securities	71,012,535	4.13%	115,362,490	2.89%	158,685,166	2.19%
Equity securities	4,113,288	3.72%	3,721,950	2.95%	3,265,566	2.72%
Total securities	\$ 75,125,823	4.11%	\$ 119,084,440	2.89%	\$ 161,950,732	2.20%

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 maturity distribution desired. 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.

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As of December 31, 2006, 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.

Interest Sensitivity Analysis

December 31, 2006

	Within three months	After three but within twelve months	After one but within five years	After five years	Total
Assets					
Earning assets					
Federal funds sold	\$ 24,616,735	\$ -	\$ -	\$ -	\$ 24,616,735
Interest-bearing deposits	215,278	1,349,411	491,000	-	2,055,689
Investment debt securities	23,779,618	25,166,343	19,542,199	2,524,375	71,012,535
Loans	227,578,213	1,028,931	3,496,707	1,323,350	233,427,201
Total earning assets	\$ 276,189,844	\$ 27,544,685	\$ 23,529,906	\$ 3,847,725	\$ 331,112,160
Liabilities					
Interest-bearing deposits					
NOW	\$ 54,458,814	\$ -	\$ -	\$ -	\$ 54,458,814
Money market	36,413,676	-	-	-	36,413,676
Savings	45,844,558	-	-	-	45,844,558
Certificates \$100,000 and over	10,632,910	16,438,142	890,730	-	27,961,782
Certificates under \$100,000	16,631,525	24,070,763	5,317,789	-	46,020,077
Securities sold under agreements to repurchase	5,624,048	-	-	-	5,624,048
Note payable	5,535	17,112	98,090	-	120,737
Total interest-bearing liabilities	\$ 169,611,066	\$ 40,526,017	\$ 6,306,609	\$ -	\$ 216,443,692
Period gap	\$ 106,578,778	\$ (12,981,332)	\$ 17,223,297	\$ 3,847,725	\$ 114,668,468
Cumulative gap	\$ 106,578,778	\$ 93,597,446	\$ 110,820,743	\$ 114,668,468	
Ratio of cumulative gap to total earning assets	32.19%	28.27%	33.47%	34.63%	

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities decreased \$22,107,000, or 9.09%, to \$221,056,000 in 2006, from \$243,163,000 in 2005. Average interest-bearing deposits decreased \$21,654,000, or 9.15%, to \$215,033,000 in 2006 from \$236,687,000 in 2005, while average noninterest-bearing demand deposits decreased \$1,146,000, or 1.34% to \$84,380,000 in 2006 from \$85,526,000 in 2005. At December 31, 2006, total deposits were \$290,324,760, compared to \$310,857,607 at December 31, 2005, a decrease of 6.60%.

Average interest-bearing liabilities decreased \$2,116,000, or .86%, from \$245,279,000 in 2004, to \$243,163,000 in 2005. Average interest-bearing deposits decreased \$3,400,000, or 1.42%, from \$240,087,000 in 2004 to \$236,687,000 in 2005, while average noninterest-bearing demand deposits increased \$2,028,000, or 2.43% from \$83,498,000 in 2004 to \$85,526,000 in 2005. At December 31, 2005, total deposits were \$310,857,607, compared to \$319,772,358 at December 31, 2004, a decrease of 2.79%.

Management believes that decreasing deposit volume through 2005 and 2006 is indicative of a return by investors to non-deposit investment products and strong competition for deposits in the local market. Management monitors deposit decreases closely and implements counter-measures as needed, including but not limited to rate increases on existing products and the development of new products.

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The following table sets forth the deposits of the Company by category as of December 31, 2006, 2005, and 2004, respectively.

	December 31, 2006		2005		2004	
	Amount	Percent of deposits	Amount	Percent of deposits	Amount	Percent of deposits
Demand deposit accounts	\$ 79,625,853	27.43%	\$ 88,236,133	28.39%	\$ 78,542,414	24.56%
NOW accounts	54,458,814	18.76%	62,601,973	20.14%	68,892,269	21.55%
Money market	36,413,676	12.54%	46,464,340	14.95%	49,362,532	15.44%
Savings accounts	45,844,558	15.79%	51,648,088	16.61%	53,667,019	16.78%
Time deposits less than \$100,000	46,020,077	15.85%	44,028,847	14.16%	50,683,867	15.85%
Time deposits of \$100,000 or more	27,961,782	9.63%	17,878,226	5.75%	18,624,257	5.82%
Total deposits	\$ 290,324,760	100.00%	\$ 310,857,607	100.00%	\$ 319,772,358	100.00%

Core deposits, which exclude certificates of deposit of \$100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits decreased \$30,616,403 during 2006 and \$8,168,720 during 2005. Management attributes this decrease to more aggressive competition for time deposits in the rising rate environment of 2006 and 2005. Rate increases implemented to retain deposits have caused a shift of funds from core deposits into time deposits of \$100,000 or more. During this period, as in the previous year, management believes there has been a reversal of some of the 2001 through 2004 migration of funds from the stock market into insured deposits.

Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet both its short-term and long-term liquidity needs. Management anticipates that while such deposits will continue to be the Company's primary source of funding in the future, continued reductions in deposit levels, if coupled with growth in the Company's loan portfolio, could require periodic borrowing of funds. In this event, it is likely that Management would liquidate investment securities from the available for sale portfolio or purchase overnight federal funds as needed.

The maturity distribution of the Company's time deposits of \$100,000 or more at December 31, 2006, is shown in the following table.

Maturities of Certificates of Deposit and Other Time Deposits of \$100,000 or More

December 31, 2006

	Within three <u>months</u>	Through <u>six months</u>	After three through twelve <u>months</u>	After six through twelve <u>months</u>	After twelve <u>months</u>	<u>Total</u>
Time of deposits of \$100,000 or more	<u>\$ 10,632,910</u>	<u>\$ 10,796,797</u>	<u>\$ 5,641,345</u>	<u>\$ 890,730</u>	<u>\$ 27,961,782</u>	

Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Some financial institutions partially fund their balance sheets using large certificates of deposit obtained through brokers. These brokered deposits are generally expensive and are unreliable as long-term funding sources. Accordingly, the Company does not accept brokered deposits.

Noninterest revenue

Noninterest revenue for 2006 increased \$149,370, or 8.30% from the previous year. Service charges on deposit accounts increased \$65,715, or 6.24%, due to fee increases effective in early January 2006. ATM and debit card revenue increased \$75,776, or 20.35%, due to a combination of fee increases and card usage.

Noninterest revenue for 2005 increased \$49,577, or 2.83% from the previous year. Of this, \$49,710, representing a 15.40% line item increase, is attributable to revenues from ATM and VISA debit card usage.

The following table presents the principal components of noninterest revenue for the years ended December 31, 2006, 2005, and 2004, respectively.

	2006	2005	2004
Service charges on deposit accounts	\$ 1,119,158	\$ 1,053,443	\$ 1,050,504
ATM and debit card revenue	448,202	372,426	322,716
Miscellaneous revenue	381,384	373,505	376,577
Total noninterest revenue	\$ 1,948,744	\$ 1,799,374	\$ 1,749,797
Noninterest revenue as a percentage of average total assets	0.52%	0.45%	0.44%

Noninterest Expense

Noninterest expense increased \$195,005, or 2.72%, from 2005 to 2006. Increased personnel costs of \$159,652 include a \$48,300 cash bonus paid in February 2006, and a \$28,197 increase in expense related to the Bank's employee retirement plan. Occupancy expense increased \$69,284 which includes a \$29,430, or 24.93%, increase in utility costs. Furniture and equipment expense are down \$12,404, which is attributable to lower depreciation expense. Other operating expense decreased \$21,527, as the net result of several increases and decreases. Increased directors' fees resulted from a fee increase, an additional Board seat, and one additional meeting in 2006 as compared to 2005. Postage costs are down by \$30,200 due to the timing of as-needed meter replenishment, and the Company's efforts to reduce unnecessary mailings. Professional fees in 2005 included non-recurring consulting fees of \$19,052.

Noninterest expense increased \$351,211, or 5.16%, from 2004 to 2005. Increased personnel costs of \$194,255 include a \$37,487 increase in expense related to the Bank's employee retirement plan and the accrual of a 10-year commitment, valued at \$107,409, to provide long-term care insurance to the Chairman of the Board. Occupancy expense increased \$46,860 due to routine increases in costs of utilities, real property taxes, and insurance, in addition to several significant repairs. Furniture and equipment expense are down \$60,766, of which \$26,769 is reduced depreciation expense, and \$21,944 is lower cost of service contracts and repairs. Other operating expense increased \$170,862, including a \$29,452 increase in telephone and network telecommunications.

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The following table presents the principal components of noninterest expense for the years ended December 31, 2006, 2005, and 2004, respectively.

	2006	2005	2004
	\$	\$	\$
Salaries and employee benefits	4,257,185	4,097,533	3,903,278
Occupancy expense	709,619	640,335	593,475
Furniture and equipment expense	478,551	490,955	551,721
Advertising	166,441	147,541	145,583
Armored car service	52,513	76,068	60,829
ATM and debit card	234,409	234,732	232,353
Business and product development	79,623	78,399	70,720
Computer software amortization	111,765	121,982	117,191
Computer software maintenance	111,777	101,875	82,514
Courier service	108,961	105,148	103,922
Deposit insurance	36,275	42,098	45,403
Director fees	140,200	99,900	89,375
Dues, donations, and subscriptions	88,255	94,385	81,328
Liability insurance	39,402	40,380	41,556
Postage	149,262	179,462	169,569
Professional fees	41,337	65,090	22,745
Stationery and supplies	123,652	111,593	135,269
Telephone	170,960	152,464	123,012
Miscellaneous	254,500	279,742	238,628
Total noninterest expense	\$ 7,354,687	\$ 7,159,682	\$ 6,808,471
Noninterest expense as a percentage of average total assets	1.96%	1.80%	1.73%

Capital

Under capital guidelines adopted by the Federal Reserve Board and the FDIC, the Company and the 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 common stockholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. 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.

At December 31, 2006, 2005, and 2004, the Company and the Bank were well-capitalized, exceeding all minimum requirements, as set forth in the following table.

	Analysis of Capital			
	Consolidated Company	Bank	To be well capitalized	Required minimums
2006				
Total risk-based capital ratio	33.7%	32.1%	10.0%	8.0%
Tier I risk-based capital ratio	32.2%	31.0%	6.0%	4.0%
Tier I leverage ratio	18.4%	17.5%	5.0%	4.0%
2005				
Total risk-based capital ratio	35.2%	32.9%	10.0%	8.0%
Tier I risk-based capital ratio	33.5%	31.7%	6.0%	4.0%
Tier I leverage ratio	16.2%	15.4%	5.0%	4.0%
2004				
Total risk-based capital ratio	43.3%	41.3%	10.0%	8.0%
Tier I risk-based capital ratio	41.7%	40.1%	6.0%	4.0%
Tier I leverage ratio	16.0%	15.3%	5.0%	4.0%

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. **Accounting Rule Changes**

The following accounting pronouncements have been approved by the Financial Accounting Standards Board but have not become effective as of December 31, 2006. These pronouncements would apply to the Company if the Company or the Bank entered into an applicable activity.

FASB Statement No. 156, "Accounting for Servicing of Financial Assets" amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in each of several specific situations. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and permits an entity to choose either of two accepted measurement methods for each class of separately recognized servicing assets and servicing liabilities. The Statement permits, at its initial adoption, a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights. Lastly, the Statement requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006. Management does not expect the adoption of this Statement to have a material impact on the Company's consolidated financial statements.

FASB Statement No. 157, "Fair Value Measurements" defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management does not expect SFAS No. 157 to have a material impact on the Company's consolidated financial statements.

FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" requires companies to recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. The effective date of the recognition and disclosure provisions for calendar-year public companies is for calendar years ending after December 15, 2006. Management does not expect SFAS No. 158 to have a material impact on the Company's consolidated financial statements since the Company does not currently have any defined benefit plans.

FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a recognition and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management does not expect FIN No. 48 to have a material impact on the Company's consolidated financial statements.

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.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Impact of Inflation

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 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. See "Liquidity and Interest Rate Sensitivity" above.

Item 8. Financial Statements and Supplementary Data

In response to this Item, the information included on pages 1 through 21 of the Company's Annual Report to Stockholders for the year ended December 31, 2006, is incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

There have been no changes in or disagreements with accountants on accounting or financial disclosure during the fiscal year covered by this report.

Item 9A. Controls and Procedures

Evaluation of disclosure 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 December 31, 2006. 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.

Internal Control Over Financial Reporting

Management Report on Internal Control over Financial Reporting

Calvin B. Taylor Bankshares, Inc. maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation of reliable published financial statements. The system includes an organizational structure and division of responsibility, established policies and procedures including a code of conduct to foster a strong ethical climate, and the careful selection, training and development of our staff. The system contains self-monitoring mechanisms, and an internal auditor monitors the operation of the internal control system and reports findings and recommendations to management and the board of directors. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The board, operating through its audit committee, which is composed entirely of directors who are not officers or employees of the Company, provides oversight to the financial reporting process.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system may vary over time and with circumstances.

The Company assessed its internal control system as of December 31, 2006 in relation to criteria for effective internal control over financial reporting as described in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Company believes that, as of December 31, 2006, its system of internal control over financial reporting met those criteria.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date:

January 31, 2007 By: Raymond M. Thompson
Chief Executive Officer

Date: January 31, 2007 By: Jennifer G. Hawkins
Treasurer / Principal Financial Officer

Attestation Report of the Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Calvin B. Taylor Bankshares, Inc.
Berlin, Maryland

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting, that Calvin B. Taylor Bankshares, Inc. and Subsidiary maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Calvin B. Taylor Bankshares, Inc. and Subsidiary maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Calvin B. Taylor Bankshares, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America, the balance sheets and the related statements of income, changes in stockholders' equity and cash flows of Calvin B. Taylor Bankshares, Inc. and Subsidiary, and our report dated February 2, 2007, expressed an unqualified opinion.

/s/ Rowles & Company, LLP

Baltimore, Maryland
February 2, 2007

Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company's internal controls 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 December 31, 2006, the Company's management, including the CEO and Treasurer, has concluded that the Company's internal controls over financial reporting are effective.

Audit Committee and Financial Expert

The Board of Directors has adopted a written Audit Policy, which serves as a charter for the Audit Committee. The Audit Committee is comprised of eight independent directors, including Chairman James R. Bergey, Jr. who serves as the financial expert. The Audit Committee is scheduled to meet quarterly and held six meetings in 2006.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2007 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2007 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2007 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2007 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2007 Annual Meeting of Stockholders, and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Exhibits

(a)(1),(2) Annual Report to Stockholders for the year ended December 31, 2006.

3.1 Articles of Incorporation of the Company, incorporated by reference to Exhibit 3.1 of Registration Statement Form S-4, File No. 33-99762.

3.2 Bylaws of the Company, incorporated by reference to Exhibit 3.2 of Registration Statement Form S-4, File No. 33-99762.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.
(Registrant)

Date: March 8, 2007 By: Raymond M. Thompson
Chief Executive Officer

Date: March 8, 2007 By: Jennifer G. Hawkins
Treasurer / Principal Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March , 2007 By: /s/ James R. Bergey, Jr., Director

Date: March , 2007 By: /s/ John H. Burbage, Jr., Director

Date: March , 2007 By: /s/ Todd E. Burbage, Director

Date: March , 2007 By: /s/ Charlotte K. Cathell, Director

Date: March , 2007 By: /s/ Reese F. Cropper, Jr.
Chairman of the Board of Directors

Date: March , 2007 By: /s/ Reese F. Cropper, III, Director

Date: March , 2007 By: /s/ Hale Harrison, Director

Date: March , 2007 By: /s/ Gerald T. Mason, Director

Date: March , 2007 By: /s/ William H. Mitchell, Director
Vice President

Date: March , 2007 By: /s/ Joseph E. Moore, Director

Date: March , 2007 By:

/s/ Michael L. Quillin, Sr., Director

Date: March , 2007 By: /s/ D. Bruce Rogers, Director

Date: March , 2007 By: /s/ Raymond M. Thompson, Director
President and Chief Executive Officer

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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 Annual Report on Form 10-K for the period ended December 31, 2005 of the Registrant (the "Report"):

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

(Registrant)

Date: March 8, 2007 By: /s/ Raymond M. Thompson
Chief Executive Officer

Date: March 8, 2007 By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer

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Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Raymond M. Thompson, certify that:

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

..Based on my knowledge, this annual 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 annual report;

..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;

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

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:

- 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:

March 8, 2007

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

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jennifer G. Hawkins, certify that:

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

..Based on my knowledge, this annual 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 annual report;

..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;

..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 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 evaluations; and

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

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:

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: March 8, 2007

By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer