

TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
May 11, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2010
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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). N/A (not required at this time)

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

Large accelerated filer _____

Accelerated filer [X]

Non-accelerated filer _____ (Do not check if a smaller reporting company)

Smaller reporting company _____

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

On April 30, 2010, 3,000,508 shares of the registrant's common stock were issued and outstanding.

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Calvin B. Taylor Bankshares, Inc. and Subsidiary

Form 10-Q

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Part I - Financial Information, Item 1 Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary

Consolidated Balance Sheets

| | (unaudited) | |
|---|-------------------|----------------------|
| | March 31, 2010 | December 31, 2009 |
| Assets | | |
| Cash and due from banks | \$ 17,549,372 | \$ 15,117,190 |
| Federal funds sold | 31,988,106 | 28,222,472 |
| Interest-bearing deposits | 8,639,741 | 12,494,003 |
| Investment securities available for sale | 29,771,513 | 42,767,578 |
| Investment securities held to maturity (approximate fair value of \$39,358,455 and \$38,897,082) | 39,166,248 | 38,597,942 |
| Loans, less allowance for loan losses of \$688,350 and \$637,761 | 247,312,213 | 240,061,869 |
| Premises and equipment | 6,495,964 | 6,594,757 |
| Other real estate owned | 1,378,500 | 1,433,000 |
| Accrued interest receivable | 1,345,788 | 1,292,604 |
| Computer software | 124,175 | 135,831 |
| Bank owned life insurance | 5,131,166 | 5,089,278 |
| Other assets | 1,314,920 | 1,721,772 |
| | \$ 390,217,706 | \$ 393,528,296 |
| Liabilities and Stockholders' Equity | | |
| Deposits | | |
| Noninterest-bearing | \$ 68,206,655 | \$ 72,431,731 |
| Interest-bearing | 240,850,526 | 240,215,888 |
| | 309,057,181 | 312,647,619 |
| Securities sold under agreements to repurchase | 6,235,265 | 7,048,176 |
| Note payable | 41,894 | 48,519 |
| Accrued interest payable | 176,419 | 192,621 |
| Deferred income taxes | 1,041,864 | 1,026,786 |
| Other liabilities | 100,129 | 287,282 |
| | 316,652,752 | 321,251,003 |
| Stockholders' equity | | |
| Common stock, par value \$1 per share authorized 10,000,000 shares, issued and outstanding 3,000,508 shares at March 31, 2010 and December 31, 2009 | 3,000,508 | 3,000,508 |
| Additional paid-in capital | 8,733,438 | 8,733,438 |
| Retained earnings | 60,240,657 | 58,975,278 |
| | 71,974,603 | 70,709,224 |
| Accumulated other comprehensive income | 1,590,351 | 1,568,069 |
| | 73,564,954 | 72,277,293 |
| | \$ 390,217,706 | \$ 393,528,296 |

See accompanying Notes to Consolidated Financial Statements

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

| | For the three months ended | |
|---|----------------------------|--------------|
| | March 31, | |
| | 2010 | 2009 |
| Interest and dividend revenue | | |
| Loans, including fees | \$ 3,960,170 | \$ 4,063,046 |
| U.S. Treasury and government agency securities | 345,052 | 449,164 |
| State and municipal securities | 12,325 | 10,313 |
| Federal funds sold | 11,956 | 16,231 |
| Interest-bearing deposits | 19,496 | 78,764 |
| Equity securities | 18,844 | 26,140 |
| Total interest and dividend revenue | 4,367,843 | 4,643,658 |
| Interest expense | | |
| Deposits | 499,860 | 717,546 |
| Borrowings | 8,846 | 7,922 |
| Total interest expense | 508,706 | 725,468 |
| Net interest income | 3,859,137 | 3,918,190 |
| Provision for loan losses | 421,000 | 333,100 |
| Net interest income after provision for loan losses | 3,438,137 | 3,585,090 |
| Noninterest revenue | | |
| Service charges on deposit accounts | 224,735 | 248,062 |
| ATM and debit card | 121,647 | 117,679 |
| Bank owned life insurance | 41,888 | 43,164 |
| Gain (loss) on sale of assets | 148,236 | (1,275) |
| Miscellaneous revenue | 101,686 | 53,190 |
| Total noninterest revenue | 638,192 | 460,820 |
| Noninterest expenses | | |
| Salaries | 866,847 | 895,730 |
| Employee benefits | 250,829 | 219,203 |
| Occupancy | 228,842 | 197,704 |
| Furniture and equipment | 124,670 | 125,645 |
| Data processing | 73,226 | 71,807 |
| ATM and debit card | 63,647 | 78,702 |
| Deposit insurance premiums | 78,455 | 12,554 |
| Other operating | 406,934 | 361,875 |
| Total noninterest expenses | 2,093,450 | 1,963,220 |
| Income before income taxes | 1,982,879 | 2,082,690 |
| Income taxes | 717,500 | 744,000 |
| Net income | \$ 1,265,379 | \$ 1,338,690 |
| Earnings per common share - basic and diluted | \$ 0.42 | \$ 0.44 |

See accompanying Notes to Consolidated Financial Statements

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

| | For the three months ended | |
|--|----------------------------|---------------|
| | March 31, | |
| | 2010 | 2009 |
| Cash flows from operating activities | | |
| Interest and dividends received | \$ 4,354,052 | \$ 4,704,538 |
| Fees and commissions received | 525,329 | 400,203 |
| Interest paid | (524,908) | (817,478) |
| Cash paid to suppliers and employees | (1,999,269) | (1,761,175) |
| Income taxes paid | (435,956) | (3,728) |
| | 1,919,248 | 2,522,360 |
| Cash flows from investing activities | | |
| Certificates of deposit purchased, net of maturities | 3,830,680 | 7,296,255 |
| Proceeds from maturities of investments available for sale | 13,005,000 | 14,000,000 |
| Purchase of investments available for sale | - | (4,997,075) |
| Proceeds from maturities of investments held to maturity | 5,190,000 | 6,100,000 |
| Purchase of investments held to maturity | (5,769,273) | (8,037,148) |
| Loans made, net of principal reductions | (7,671,344) | (3,506,412) |
| Proceeds from sale of repossessed loan collateral, net of cost of sale | 59,420 | 12,500 |
| Purchases of premises, equipment, and computer software | (51,625) | (252,835) |
| Proceeds from sale of premises | 72,100 | - |
| | 8,664,958 | 10,615,285 |
| Cash flows from financing activities | | |
| Net increase (decrease) in | | |
| Time deposits | 1,452,960 | 3,004,895 |
| Other deposits | (5,043,398) | 1,653,171 |
| Securities sold under agreements to repurchase | (812,911) | (514,268) |
| Payments on note payable | (6,625) | (6,240) |
| Common shares repurchased | - | (720,276) |
| | (4,409,974) | 3,417,282 |
| Net increase in cash and cash equivalents | 6,174,232 | 16,554,927 |
| Cash and cash equivalents at beginning of period | 43,489,772 | 35,270,664 |
| Cash and cash equivalents at end of period | \$ 49,664,004 | \$ 51,825,591 |

See accompanying Notes to Consolidated Financial Statements

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

| | For the three months ended | |
|--|----------------------------|---------------|
| | March 31, | |
| | 2010 | 2009 |
| Reconciliation of net income to net cash provided by operating activities | | |
| Net income | \$ 1,265,379 | \$ 1,338,690 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Provision for loan losses | 421,000 | 333,100 |
| (Gain) loss on sale of repossessed loan collateral | (4,920) | 1,275 |
| Amortization of premiums and accretion of discount, net | 39,392 | (2,824) |
| Depreciation and amortization | 145,034 | 138,273 |
| Gain on sale of real property | (55,061) | - |
| Decrease (increase) in | | |
| Accrued interest receivable | (53,184) | 63,637 |
| Cash surrender value of bank owned life insurance | (41,888) | (43,164) |
| Other assets | 406,851 | 491,084 |
| Increase (decrease) in | | |
| Accrued interest payable | (16,202) | (92,010) |
| Accrued income taxes | 34,374 | 365,032 |
| Other liabilities | (221,527) | (70,733) |
| | \$ 1,919,248 | \$ 2,522,360 |
| Composition of cash and cash equivalents | | |
| Cash and due from banks | \$ 17,549,372 | \$ 13,657,389 |
| Federal funds sold | 31,988,106 | 38,151,879 |
| Interest-bearing deposits, except for time deposits | 126,528 | 16,323 |
| | \$ 49,664,006 | \$ 51,825,591 |

See accompanying Notes to Consolidated Financial Statements

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

1. Basis of Presentation

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

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

Cash Flows

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

Per share data

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

| | 2010 | 2009 |
|-----------------------------|-----------|-----------|
| Three months ended March 31 | 3,000,508 | 3,039,978 |

2. Comprehensive Income

Comprehensive income consists of:

| | For the three months ended March 31, | |
|--|---|--------------|
| | 2010 | 2009 |
| Net income | \$ 1,265,379 | \$ 1,338,690 |
| Unrealized gain (loss) on investment securities available for sale, net of income taxes | 22,282 | (183,516) |
| Comprehensive income | \$ 1,287,661 | \$ 1,155,174 |

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

3. Investment Securities

Investment securities are summarized as follows:

| | Amortized cost | Unrealized gains | Unrealized losses | Fair value |
|------------------------|-------------------|---------------------|----------------------|---------------|
| March 31, 2010 | | | | |
| Available for sale | | | | |
| U.S. Treasury | \$ 25,169,546 | \$ 935,454 | \$ - | \$ 26,105,000 |
| State and municipal | 390,000 | 6,043 | 4 | 396,039 |
| Equity | 1,691,841 | 1,657,667 | 79,034 | 3,270,474 |
| | \$ 27,251,387 | \$ 2,599,164 | \$ 79,038 | \$ 29,771,513 |
| Held to maturity | | | | |
| U.S. Treasury | \$ 27,495,164 | \$ 174,465 | \$ 18,692 | \$ 27,650,937 |
| U.S. Government agency | 8,001,290 | 21,177 | 2,240 | 8,020,227 |
| State and municipal | 3,669,794 | 18,443 | 946 | 3,687,291 |
| | \$ 39,166,248 | \$ 214,085 | \$ 21,878 | \$ 39,358,455 |
| December 31, 2009 | | | | |
| Available for sale | | | | |
| U.S. Treasury | \$ 38,197,971 | \$ 950,429 | \$ - | \$ 39,148,400 |
| State and municipal | 395,000 | 5,392 | 270 | 400,122 |
| Equity | 1,691,841 | 1,571,962 | 44,747 | 3,219,056 |
| | \$ 40,284,812 | \$ 2,527,783 | \$ 45,017 | \$ 42,767,578 |
| Held to maturity | | | | |
| U.S. Treasury | \$ 25,498,390 | \$ 254,672 | \$ 8,999 | \$ 25,744,063 |
| U.S. Government agency | 10,000,000 | 30,808 | 650 | 10,030,158 |
| State and municipal | 3,099,552 | 23,309 | - | 3,122,861 |
| | \$ 38,597,942 | \$ 308,789 | \$ 9,649 | \$ 38,897,082 |

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

3. Investment Securities (Continued)

The table below shows the gross unrealized losses and fair value of securities that are in an unrealized loss position as of March 31, 2010, aggregated by length of time that individual securities have been in a continuous unrealized loss position.

| | Less than 12 months | | 12 months or more | | Total | |
|-------------------------|---------------------|-------------------|-------------------|-------------------|--------------|-------------------|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| U. S. Treasury | \$ 3,976,250 | \$ 18,692 | \$ - | \$ - | \$ 3,976,250 | \$ 18,692 |
| U. S. Government Agency | 2,999,050 | 2,240 | - | - | 2,999,050 | 2,240 |
| State and municipal | 624,321 | 950 | - | - | 624,321 | 950 |
| Equity securities | 586,001 | 79,034 | - | - | 586,001 | 79,034 |
| | \$ 8,185,622 | \$ 100,916 | \$ - | \$ - | \$ 8,185,622 | \$ 100,916 |

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

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

| | March 31, 2010 | | December 31, 2009 | |
|-----------------------------------|----------------|---------------|-------------------|---------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| Available for sale | | | | |
| Within one year | \$ 7,203,500 | \$ 7,244,693 | \$ 15,106,388 | \$ 15,136,254 |
| After one year through five years | 16,359,621 | 16,672,596 | 21,490,230 | 21,822,893 |
| After ten years | 1,996,425 | 2,583,750 | 1,996,353 | 2,589,375 |
| | \$ 25,559,546 | \$ 26,501,039 | \$ 38,592,971 | \$ 39,548,522 |
| Held to maturity | | | | |
| Within one year | \$ 17,918,951 | \$ 18,045,468 | \$ 16,042,286 | \$ 16,273,130 |
| After one year through five years | 21,247,297 | 21,312,987 | 22,555,656 | 22,623,952 |
| | \$ 39,166,248 | \$ 39,358,455 | \$ 38,597,942 | \$ 38,897,082 |
| Pledged securities | \$ 26,244,888 | \$ 27,130,239 | \$ 26,269,854 | \$ 27,142,948 |

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

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

4. Loan commitments

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

| | March 31, 2010 | December 31, 2009 |
|---------------------------|----------------|-------------------|
| Loan commitments | \$ 29,973,065 | \$ 29,270,217 |
| Standby letters of credit | \$ 1,901,531 | \$ 1,907,736 |

5. Assets Measured at Fair Value on a Recurring Basis

The Company values investment securities classified as available for sale on a recurring basis and other real estate acquired through foreclosure at fair value on a non-recurring basis. The fair value hierarchy established in the Financial Accounting Standards Board Codification Topic 820 titled *Fair Value Measurements* defines three input levels for fair value measurement. Level 1 is based on quoted market prices in active markets for identical assets. Level 2 is based on significant observable inputs other than those in Level 1. Level 3 is based on significant unobservable inputs. The Company values US Treasury securities, government agency securities, and an equity investment in an actively traded public utility under Level 1. Municipal debt securities, equity investments in community banks, and other real estate acquired through foreclosure are valued under Level 2. The Company has no assets measured at fair value on a recurring or non-recurring basis that are valued under Level 3 criteria. At March 31, 2010, values for available for sale investment securities and other real estate owned were established as follows:

| | Total | Level 1 Inputs | Level 2 Inputs |
|--|---------------|----------------|----------------|
| Investment securities available for sale (recurring) | \$ 29,771,513 | \$ 26,437,288 | \$ 3,334,225 |
| Other real estate owned (non-recurring) | 1,378,500 | - | 1,378,500 |
| | \$ 31,150,013 | \$ 26,437,288 | \$ 4,712,725 |

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

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

New accounting standards

The following accounting pronouncements have been approved by the Financial Accounting Standards Board but had not become effective as of March 31, 2010. These pronouncements would apply to the Company if the Company or the Bank entered into an applicable activity.

ASU No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures About Fair Value Measurements."

ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. Disclosures related to the gross presentation of Level 3 purchases, sales, issuances and settlements of assets and liabilities will be required for the Corporation beginning January 1, 2011.

ASU No. 2010-11, "Derivatives and Hedging (Topic 815) - Scope Exception Related to Embedded Credit Derivatives."

ASU 2010-11 clarifies that the only form of an embedded credit derivative that is exempt from embedded derivative bifurcation requirements are those that relate to the subordination of one financial instrument to another. Entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. The provisions of ASU 2010-11 will be effective for the Company on July 1, 2010 and are not expected to have a significant impact on the Corporation's 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.

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

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

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

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

General

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

The Company currently engages in no business other than owning and managing the Bank. The Bank employed 92 full time equivalent employees as of March 31, 2010. The Bank hires seasonal employees during the summer. The Company has no employees other than those hired by the Bank.

Use of estimates

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

Critical Accounting Policies

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

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

Financial Condition

Total assets of the Company decreased \$3.3 million (.084%) from December 31, 2009 to March 31, 2010. Combined deposits and customer repurchase agreements decreased \$4.4 million during the same period. Average total assets and average total deposits increased \$17.1 million and \$15.4 million, respectively, from first quarter 2009 to first quarter 2010. Throughout 2009, deposits and total assets grew as a result of market instability that was part of a continuing general economic recession. At such times, many consumers seek the safety of conservatively run community banks. The first quarter of 2010 conforms more to the historical pattern in which the Bank sees a decrease in deposits during the first quarter of the year as business customers in the resort area purchase inventory for the upcoming summer season. For further discussion of seasonal activity that affects deposit levels, see the section titled Liquidity.

Loan Portfolio

From December 31, 2009 to March 31, 2010 the gross loan portfolio has grown \$7.3 million (3.03%). Growth in the loan portfolio has been funded by reductions in the investment portfolio. Because loans earn at higher average rates than investments, this shift has a positive effect on earnings. There is no adverse impact on the Company's ability to meet liquidity demands resulting from recent increases in the loan portfolio.

The Company makes loans to customers located primarily in the Delmarva region. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

Loan Quality and the Allowance for Loan Losses

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

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

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

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

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

Management believes that in a general economic downturn, such as the region has experienced since mid-2008, the Bank's greatest likelihood of loss is in unsecured loans - commercial and consumer, and in secured consumer loans. Reserves for these segments of the portfolio are included in the formula-based portion of the ALLL. As of March 31, 2010, management reserved 110 bp against unsecured loans, and consumer loans secured by other than real estate. Both of these reserves were increased during the first quarter of this year in recognition of the prolonged economic challenges to regional, national, and global economies. Additionally, management reserved 10% against overdrawn checking accounts which are a distinct high risk category of unsecured loan.

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

Historically, the absence or improper execution of a document has not resulted in a loss to the Bank, however, management recognizes that the Bank's loss exposure is increased until a critical contract or collateral documentation exception is cured. At March 31, 2010, management reserved 10 bp against the outstanding balances of loans identified as having critical documentation exceptions.

The provision for loan losses is a charge to earnings in the current period to maintain the allowance at a level management has determined to be appropriate. The allowance is increased by current period provisions and by recoveries of amounts previously charged-off. The allowance is decreased when loans are charged-off as losses, which occurs when they are deemed to be uncollectible. Adjustments made to bring the balance in the allowance to the level established by management may result in an increase or decrease to expense. A provision of \$421,000 was made in the first quarter of 2010. A provision of \$333,100 was made in the comparable period in 2009. The year-to-year increase in the level of the ALLL and the provision for loan loss reflects the consequences of the current economy. As the recession continues and borrowers' suffer personal and professional financial hardship, the likelihood of loss on previously performing loans has increased. As Management identifies loans with heightened loss potential, a provision for those losses is recorded.

Management considers the March 31, 2010 allowance appropriate and adequate to absorb identified and inherent losses in the loan portfolio. As of March 31, 2010, management has not identified any loans which are anticipated to be wholly charged-off within the next 12 months. However, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required.

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The following is a schedule of transactions in the allowance for loan losses. The Bank experienced net charge-offs of \$73,499 in the first quarter of 2009 and \$370,411 in the current year to date. A loss of \$347,214 was attributable to a single unsecured commercial line of credit. Management attributes the increased loan losses to the effects of the current economic recession on some of the Bank's customers and, subsequently, on the Bank.

| Allowance for Loan Losses | For three months ended | | For the year |
|---|------------------------|----------------|---------------------|
| | March 31 | | ended |
| | 2010 | 2009 | December 31 2009 |
| Balance at beginning of year | \$ 637,761 | \$ 707,152 | \$ 707,152 |
| Loans charged-off: | | | |
| Real estate - construction and land | - | - | 75,000 |
| Real estate - mortgage | - | - | 656,191 |
| Commercial | 347,872 | 64,226 | 200,357 |
| Consumer | 27,981 | 20,311 | 47,321 |
| Total loan losses | 375,853 | 84,537 | 978,869 |
| Recoveries on loans previously charged off: | | | |
| Real estate - construction | - | - | - |
| Real estate - mortgage | - | - | 669 |
| Commercial | 78 | 10,850 | 40,364 |
| Consumer | 5,364 | 188 | 18,445 |
| Total loan recoveries | 5,442 | 11,038 | 59,478 |
| Net loan charge-offs (recoveries) | 370,411 | 73,499 | 919,391 |
| Provision for loan losses charged to expense | 421,000 | 333,100 | 850,000 |
| Balance at end of period | \$ 688,350 | \$ 966,753 | \$ 637,761 |
| Gross loans outstanding at the end of the period | \$ 248,000,563 | \$ 245,561,947 | \$ 240,699,630 |
| Allowance for loan losses to gross loans outstanding at the end of the period | 0.28% | 0.39% | 0.26% |
| Average loans outstanding during the period | \$ 243,850,884 | \$ 245,525,433 | \$ 242,095,000 |
| Annualized net charge-offs as a percentage of average loans outstanding during the period | 0.62% | 0.12% | 0.38% |

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

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

| | March 31, 2010 | March 31, 2009 | December 31, 2009 |
|---|-------------------|-------------------|----------------------|
| Loans 90 days or more past due and still accruing | | | |
| Real estate | \$ 1,170,391 | \$ 8,127,230 | \$ 787,580 |
| Commercial | 24,032 | - | - |
| Consumer | 883 | - | - |
| | 1,195,306 | 8,127,230 | 787,580 |
| Nonaccruing loans | 974,083 | 1,046,952 | 1,023,083 |
| Total nonperforming loans | 2,169,389 | 9,174,182 | 1,810,663 |
| Other real estate owned | 1,378,500 | - | 1,433,000 |
| Total nonperforming assets | \$ 3,547,889 | \$ 9,174,182 | \$ 3,243,663 |
| Interest not accrued on nonaccruing loans | \$ 38,552 | \$ 57,667 | \$ 46,467 |

Interest included in net income on nonaccruing loans,

| | | | |
|--------------|----------|-------|-----------|
| year-to-date | \$ 4,517 | \$ 61 | \$ 30,492 |
|--------------|----------|-------|-----------|

Included in amounts past due 90 days or more and still accruing at March 31, 2009 was a loan with a principal balance of \$4,500,000. As of March 31, 2010 and December 31, 2009, this loan was 51 and 53 days past due, respectively. It continues to accrue as the Bank continues collection efforts. Late in 2008, the Bank was notified that there is a lien on the property securing this loan that is superior to the Bank's liens. The Bank was not aware of this lien at the time the loan was originated, and the Bank's settlement agent did not discover the lien during the title examination process. The Bank has filed a claim with the title company that has insured its title and lien priority. The Bank believes the title company will indemnify the Bank for any losses resulting from the superior lien, although there is no guarantee that this will be the case. Management reviews the accrual status of this loan quarterly. As of March 31, 2010, there is \$33,915 of accrued interest on this loan.

Also included in amounts past due 90 days or more and still accruing at March 31, 2009, was a loan with a principal balance of \$2,755,000. In May 2009, interest was brought current and a principal reduction occurred. By agreement with the borrower, Management restructured the remaining balance of this loan which is current at March 31, 2010 and December 31, 2009.

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

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Impaired loans including nonaccruing loans totaled \$2,881,097 and \$2,901,859, at March 31, 2010, and December 31, 2009, respectively.

| | March 31, 2010 | December 31, 2009 |
|--|----------------|-------------------|
| Impaired loans with valuation allowances, including nonaccruing loans | \$ 637,803 | \$ 799,834 |
| Valuation allowances on impaired loans | \$ 127,561 | \$ 258,869 |
| Impaired loans with no valuation allowances | \$ 2,244,104 | \$ 2,102,025 |
| Total impaired loans | \$ 2,881,907 | \$ 2,901,859 |

Liquidity

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

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

Average liquid assets (cash and amounts due from banks, interest-bearing deposits in other banks, federal funds sold, and investment securities) compared to average deposits and retail repurchase agreements were 40.21% for the first quarter of 2010 compared to 36.92% for the same quarter of 2009.

The Company has available lines of credit, including overnight federal funds and reverse repurchase agreements, totaling \$28,000,000 as of March 31, 2010.

Average net loans to average deposits were 79.47% versus 84.21% as of March 31, 2010 and 2009, respectively. Average net loans decreased by .64% while average deposits grew by 5.30%. Deposit increases were generally reinvested in overnight federal funds sold and investment securities. Most average deposit balance increases occurred in interest-bearing transaction and savings accounts. Resulting changes in deposit portfolio composition do not have a negative impact on the Company's ability to meet liquidity demands.

Interest Rate Sensitivity

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

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

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

On the liability side, deposit products are structured to offer incentives to attain the 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.

As of March 31, 2010, the Company was cumulatively asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Results of Operations

Net income for the three months ended March 31, 2010, was \$1,265,379 or \$.42 per share, compared to \$1,338,690 or \$.44 per share for the first quarter of 2009. This represents a decrease of \$73,311 or 5.48% from the prior year. The key components of net income are discussed in the following paragraphs.

For the first quarter of 2010 compared to 2009, net interest income decreased \$59,053 (1.51%). The decrease in interest and dividend revenue is primarily attributable to market rate reductions which continue to cause gradual downward repricing of interest-bearing balances in banks and investment securities. The impact of lower rates on federal funds sold, which reprice immediately, was felt in 2009. Interest expense was \$216,762 (29.88%) less than in the comparable period last year primarily due to lower rates on time deposits. Most of the Bank's time deposits have fixed rates resulting in more gradual repricing than the Bank's other deposit products which are immediately repricable.

The Company's net interest income is one of the most important factors in evaluating its financial performance. Management uses interest rate sensitivity analysis to determine the effect of rate changes. Net interest income is projected over a one-year period to determine the effect of an increase or decrease in the prime rate of 100 basis points. If prime were to decrease one hundred basis points, and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience a decrease of approximately 5.3% in net interest income. Conversely, if prime were to increase one hundred basis points, and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience an increase in net interest income of the same percentage. The sensitivity analysis does not consider the likelihood of these rate changes nor whether management's reaction to this rate change would be to reprice its loans or deposits or both.

The tax-equivalent quarterly yield on interest-earning assets decreased by 48 basis points from 5.57% for first

quarter 2009 to 5.09% in 2010. The quarterly yield on interest-bearing liabilities decreased by 44 basis points from 1.28% in 2009 to .84% in 2010. In combination, these shifts contribute to a decrease in net margin on interest-earning assets of 22 basis points.

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

Average Balances, Interest, and Yields

| | For the quarter ended March 31, 2010 | | | For the quarter ended March 31, 2009 | | |
|---|---|--------------|-------|---|--------------|-------|
| | Average balance | Interest | Yield | Average balance | Interest | Yield |
| Assets | | | | | | |
| Federal funds sold | \$ 29,389,496 | \$ 11,956 | 0.16% | \$ 27,175,261 | \$ 16,231 | 0.24% |
| Interest-bearing deposits | 9,956,179 | 19,496 | 0.79% | 13,461,275 | 78,764 | 2.37% |
| Investment securities | 71,006,973 | 411,297 | 2.35% | 58,933,601 | 529,043 | 3.64% |
| Loans, net of allowance | 243,207,854 | 3,992,843 | 6.66% | 244,771,789 | 4,107,055 | 6.80% |
| Total interest-earning assets | 353,560,502 | 4,435,592 | 5.09% | 344,341,926 | 4,731,093 | 5.57% |
| Noninterest-bearing cash | 15,383,108 | | | 9,795,677 | | |
| Other assets | 15,924,931 | | | 13,581,611 | | |
| Total assets | \$ 384,868,541 | | | \$ 367,719,214 | | |
| Liabilities and Stockholders' Equity | | | | | | |
| Interest-bearing deposits | | | | | | |
| NOW | \$ 54,539,056 | 49,383 | 0.37% | \$ 47,094,101 | 27,298 | 0.24% |
| Money market | 36,294,849 | 44,647 | 0.50% | 32,873,887 | 55,338 | 0.68% |
| Savings | 47,316,166 | 57,861 | 0.50% | 42,965,104 | 52,487 | 0.50% |
| Other time | 99,652,437 | 347,969 | 1.42% | 100,387,945 | 582,423 | 2.35% |
| Total interest-bearing deposits | 237,802,508 | 499,860 | 0.85% | 223,321,037 | 717,546 | 1.30% |
| Securities sold under agreements to repurchase & federal funds purchased | | | | | | |
| Borrowed funds | 44,159 | 695 | 6.38% | 69,962 | 1,079 | 6.25% |
| Total interest-bearing liabilities | 244,498,758 | 508,707 | 0.84% | 228,975,751 | 725,468 | 1.28% |
| Noninterest-bearing deposits | | | | | | |
| | 68,253,940 | | | 67,334,614 | | |
| | 312,752,698 | 508,707 | 0.66% | 296,310,365 | 725,468 | 0.99% |
| Other liabilities | | | | | | |
| | 504,585 | | | 675,759 | | |
| Stockholders' equity | | | | | | |
| | 71,611,258 | | | 70,733,090 | | |
| Total liabilities and stockholders' equity | \$ 384,868,541 | | | \$ 367,719,214 | | |
| Net interest spread | | | 4.25% | | | 4.29% |
| Net interest income | | \$ 3,926,885 | | | \$ 4,005,625 | |
| Net margin on interest-earning assets | | | 4.50% | | | 4.72% |
| Tax equivalent adjustment in: | | | | | | |
| Investment income | | \$ 35,075 | | | \$ 43,425 | |
| Loan income | | \$ 32,673 | | | \$ 44,010 | |

Provisions for loan losses of \$421,000 and \$333,100 were recorded during the three months ended March 31, 2010 and 2009, respectively. Net loans charged-off were \$370,411 and \$73,499 during the first quarters of 2010 and 2009, respectively. Management attributes the increased loan losses to the generally poor state of the economy which has had an adverse effect on certain borrowing customers. See Loan Quality and the Allowance for Loan Losses for a discussion of the provision for loan losses.

Noninterest revenue for the first quarter of 2010 is \$177,372 (38.49%) higher than the comparable period last year. Gains on sale of assets account for most of this increase. The Bank is in the process of liquidating an inventory of old coin much of which has high precious metal content. Also, in the first quarter of 2010, the Delaware Department of Transportation purchased a portion of the Company's property in Ocean View for expansion of the adjacent highway. Gains on these two transactions comprise \$143,315 of that increase. Included in miscellaneous revenue in 2010 are proceeds totaling \$45,000 from the granting of easements related to the Ocean View roadway expansion. Service charges on deposit accounts are down primarily due to lower assessment of funds for insufficient items.

Noninterest expense for the first quarter of 2010 is \$130,230 (6.63%), more than last year. Although salaries are down due to staff attrition, employee benefits are higher due to a higher unemployment tax rate and higher medical claims under the group insurance program. The increase in occupancy expense reflects the consequences of an extremely harsh winter – higher utility costs and the costs of clearing snow. ATM and debit card expenses have dropped due to the favorable renegotiation of a debit card processing contract. Deposit insurance premiums are higher primarily due to the expiration of the one-time insurance premium credit in 2009. For the year of 2010, management expects deposit insurance premiums to be lower than those assessed in 2009, assuming there is no need for another special assessment like the one paid in 2009 to restore the deposit insurance fund. Other operating expenses include increased legal fees related to loan collections and costs to maintain other real estate owned.

Income taxes for the quarter ended March 31, 2010 are \$26,500 lower than the same period last year, on a pre-tax income decrease of \$99,811. This is consistent with the Company's effective tax rate of approximately 36.0%.

Plans of Operation

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

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

Other bank services include cash management services, 24-hour ATMs, debit cards, safe deposit boxes, travelers' checks, direct deposit of payroll and social security funds, and automatic drafts for various accounts. The Bank offers bank-by-phone and Internet banking services, including electronic bill-payment, to both commercial and retail customers. The Bank offers a remote capture service that enables commercial customers to electronically capture check images and make on-line deposits. The Bank also offers non-deposit investment products including retail repurchase agreements.

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Capital Resources and Adequacy

Total stockholders' equity increased \$1,287,661 from December 31, 2009 to March 31, 2010. This increase is attributable to comprehensive income recorded during the period, as detailed in Note 2 of the Notes to Financial Statements.

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

Tier one risk-based capital ratios of the Company as of March 31, 2010 and December 31, 2009 were 31.4% and 31.6%, respectively. Both are substantially in excess of regulatory minimum requirements.

The Company and the Bank did not seek assistance under the federally funded Troubled Asset Relief Program (TARP) developed in the last quarter of 2008. Neither the Company nor the Bank will benefit directly from TARP funds. The Bank has not engaged in subprime mortgage lending, and has no investments in mortgage backed securities.

Late in 2008, the Company and the Bank elected to participate in the Temporary Liquidity Guarantee Program (TLG). A component of TLG, the Transaction Account Guarantee Program (TAG), provides additional insurance protection to holders of transaction accounts with rates not exceeding .50%. The Company's participation in this program may have contributed to an increase in deposits in the Bank as investors seek the safety of insured deposits in community banks. Deposit insurance premiums have increased as a result of the higher deposit balances, the higher insurance limits, participation in TAG, and higher insurance rates. Management does not expect to pass all of the additional insurance premium costs on to customers. Effective July 1, 2010, the Bank will no longer participate in TAG due to the rate limitations (maximum .25%) imposed on banks that do extend their participation and the term (up to 18 months) over which rate restrictions might apply. Deposits will continue to be insured up to the limits provided under standard FDIC deposit insurance rules. Management does not expect withdrawal from the TAG program to have a significant effect on deposit balances.

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

Website Access to SEC Reports

The Bank maintains an Internet website at

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

At March 31, 2010, the Company's interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 21.20%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. The Bank has classified its demand mortgage and commercial loans as immediately repricable. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans or change the rates rests with management.

Item 4. Controls and procedures

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

The Company's management, including the CEO and Treasurer, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2010. Based on that evaluation, the Company's management, including the CEO and Treasurer, has concluded that the Company's disclosure controls and procedures are effective. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company's internal control over financial reporting that have had or are reasonably likely to have a material effect on the Company's internal control over financial reporting. As of March 31, 2010, the Company's management, including the CEO and Treasurer, has concluded that the Company's internal controls over financial reporting are effective.

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

Item 1 Legal Proceedings

Not applicable

Item 1A Risk Factors

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

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

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

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

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

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

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

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

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

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

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

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

Item 3 Defaults Upon Senior Securities

Not applicable

Item 4 (Removed and Reserved)

Item 5 Other information

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

Item 6 Exhibits and Reports on Form 8-K

a) Exhibits

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

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

Exhibit 31.1

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

I, Raymond M. Thompson, certify that:

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

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

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

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

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

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

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

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

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

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

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

Calvin B. Taylor Bankshares, Inc.

Date: May 5, 2010

By: /s/ Raymond M. Thompson

Raymond M. Thompson

Chief Executive Officer

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Exhibit 31.2

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

I, Jennifer G. Hawkins, certify that:

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

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

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

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

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

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

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

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

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

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

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

Calvin B. Taylor Bankshares, Inc.

Date: May 5, 2010

By: /s/ Jennifer G. Hawkins

Jennifer G. Hawkins

Treasurer (Principal Financial Officer)

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Exhibit 32

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

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended March 31, 2010, of Calvin B. Taylor Bankshares, Inc:

- (1) The referenced report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Calvin B. Taylor Bankshares, Inc.

Date: May 5, 2010

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

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

SIGNATURES

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

Calvin B. Taylor Bankshares, Inc.

Date: May 5, 2010

By: /s/ Raymond M. Thompson

Raymond M. Thompson

Chief Executive Officer

By: /s/ Jennifer G. Hawkins

Jennifer G. Hawkins

Treasurer (Principal Financial Officer)