TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
November 09, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2009
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]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ____ Accelerated filer [X]
Non- accelerated filer ____ (Do not check if a smaller reporting company) Smaller reporting company ____

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

On October 31, 2009, 3,004,716 shares of the registrant's common stock were issued and outstanding.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
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Part I - Financial Information, Item 1 Financial Statements

Calvin B. Taylor Bankshares, Inc. and Subsidiary

Consolidated Balance Sheets

	(unaudited) September 30 2009	December 31, 2008
Assets		
Cash and due from banks	$ 19,438,917	$ 8,769,784
Federal funds sold	34,442,376	26,460,842
Interest-bearing deposits	12,310,219	15,517,115
Investment securities available for sale	49,905,705	33,975,271
Investment securities held to maturity (approximate fair value of $40,031,510 and $33,523,422)	39,616,443	32,621,797
Loans, less allowance for loan losses of $625,604 and $707,152	235,193,981	241,430,914
Premises and equipment	6,655,172	6,326,312
Other real estate owned	829,500	-
Accrued interest receivable	1,244,480	1,704,260
Computer software	146,567	156,372
Bank owned life insurance	5,044,862	4,914,810
Other assets	389,408	725,034
	$ 405,217,630	$ 372,602,511
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	$ 88,284,486	$ 70,652,032
Interest-bearing	233,733,590	221,807,181
	322,018,076	292,459,213
Securities sold under agreements to repurchase	7,545,718	5,742,765
Note payable	55,044	74,046
Accrued interest payable	205,286	359,673
Deferred income taxes	1,075,423	1,437,813
Other liabilities	185,416	245,507
	331,084,963	300,319,017
Stockholders' equity		
Common stock, par value $1 per share authorized 10,000,000 shares, issued and outstanding 3,005,916 shares at September 30, 2009, and 3,048,397 shares at December 31, 2008	3,005,916	3,048,397
Additional paid-in capital	8,908,384	10,406,403
Retained earnings	60,571,428	56,569,913
	72,485,728	70,024,713
Accumulated other comprehensive income	1,646,939	2,258,781
	74,132,667	72,283,494
	$ 405,217,630	$ 372,602,511

See accompanying Notes to Consolidated Financial Statements

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

	For the three months ended September 30 2009	2008
Interest and dividend revenue		
Loans, including fees	$ 3,978,452	$ 4,140,888
U.S. Treasury and government agency securities	391,920	545,844
State and municipal securities	12,672	10,857
Federal funds sold	18,085	221,938
Interest-bearing deposits	26,100	87,138
Equity securities	10,081	9,908
Total interest and dividend revenue	4,437,310	5,016,573
Interest expense		
Deposits	591,775	905,011
Borrowings	10,648	25,538
Total interest expense	602,423	930,549
Net interest income	3,834,887	4,086,024
Provision for loan losses	(132,550)	(1,478)
Net interest income after provision for loan losses	3,967,437	4,087,502
Noninterest revenue		
Service charges on deposit accounts	243,108	280,280
ATM and debit card	147,965	146,784
Bank owned life insurance	43,962	51,510
Miscellaneous revenue	77,776	47,062
Total noninterest revenue	512,811	525,636
Noninterest expenses		
Salaries	902,057	878,244
Employee benefits	201,225	200,211
Occupancy	182,149	188,860
Furniture and equipment	103,669	111,778
Data proccessing	73,915	67,847
ATM and debit card	43,820	81,713
Deposit insurance premiums	151,637	-
Other operating	413,627	395,843
Total noninterest expenses	2,072,099	1,924,496
Income before income taxes	2,408,149	2,688,642
Income taxes	896,500	982,500
Net income	$ 1,511,649	$ 1,706,142
Earnings per common share – basic and diluted	$ 0.50	$ 0.56
Dividend per common share	$ -	$ 1.30

See accompanying Notes to Consolidated Financial Statements

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

	For the nine months ended September 30 2009	2008
Interest and dividend revenue		
Loans, including fees	$ 12,005,793	$ 12,520,143
U.S. Treasury and government agency securities	1,237,332	1,683,837
State and municipal securities	34,070	31,657
Federal funds sold	51,272	669,832
Interest-bearing deposits	132,880	209,076
Equity securities	50,150	56,944
Total interest and dividend revenue	13,511,497	15,171,489
Interest expense		
Deposits	1,951,112	3,054,918
Borrowings	26,682	40,627
Total interest expense	1,977,794	3,095,545
Net interest income	11,533,703	12,075,944
Provision for loan losses	497,050	75,015
Net interest income after provision for loan losses	11,036,653	12,000,929
Noninterest revenue		
Service charges on deposit accounts	743,186	803,242
ATM and debit card	400,557	395,601
Bank owned life insurance	130,052	150,059
Miscellaneous revenue	200,051	181,251
Total noninterest revenue	1,473,846	1,530,153
Noninterest expenses		
Salaries	2,705,716	2,637,949
Employee benefits	631,275	644,978
Occupancy	560,586	560,180
Furniture and equipment	340,636	352,240
Data proccessing	215,049	207,865
ATM and debit card	192,472	221,891
Deposit insurance premiums	417,034	30,731
Other operating	1,172,716	1,066,470
Total noninterest expenses	6,235,484	5,722,304
Income before income taxes	6,275,015	7,808,778
Income taxes	2,273,500	2,837,500
Net income	$ 4,001,515	$ 4,971,278
Earnings per common share – basic and diluted	$ 1.32	$ 1.61
Dividend per common share	$ -	$ 1.30

See accompanying Notes to Consolidated Financial Statements

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

	For the nine months ended September 30, 2009	2008
Cash flows from operating activities		
Interest and dividends received	$ 14,029,927	$ 15,369,050
Fees and commissions received	1,344,516	1,383,262
Interest paid	(2,132,182)	(3,246,537)
Cash paid to suppliers and employees	(5,894,557)	(5,439,087)
Income taxes paid	(1,944,434)	(2,748,015)
	5,403,270	5,318,673
Cash flows from investing activities		
Certificates of deposit purchased, net of maturities	3,315,503	(9,910,482)
Proceeds from maturities of investments available for sale	17,200,000	23,360,000
Purchase of investments available for sale	(34,149,247)	(13,438,682)
Proceeds from maturities of investments held to maturity	23,765,000	17,000,000
Purchase of investments held to maturity	(30,773,647)	(25,000,000)
Loans made, net of principal reductions	4,885,851	2,881,941
Proceeds from sale of repossessed loan collateral	39,510	-
Purchases of premises, equipment, and computer software	(750,181)	(239,230)
Proceeds from sale of equipment	20,900	-
	(16,446,311)	(5,346,453)
Cash flows from financing activities		
Net increase (decrease) in		
Time deposits	(795,649)	5,355,891
Other deposits	30,354,512	9,093,559
Securities sold under agreements to repurchase	1,802,953	2,619,801
Payments on note payable	(19,002)	(17,898)
Common shares repurchased	(1,540,500)	(1,775,540)
Dividends Paid	-	(3,972,268)
	29,802,314	11,303,545
Net increase in cash and cash equivalents	18,759,273	11,275,765
Cash and cash equivalents at beginning of period	35,270,664	40,568,264
Cash and cash equivalents at end of period	$ 54,029,937	$ 51,844,029

See accompanying Notes to Consolidated Financial Statements

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

	For the nine months ended September 30, 2009	2008
Reconciliation of net income to net cash provided by operating activities		
Net income	$ 4,001,515	$ 4,971,278
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	497,050	75,015
(Gain) loss on sale of repossessed loan collateral	(1,203)	-
(Gain) loss on sale of equipment and computer software	(3,593)	-
Amortization of premiums and accretion of discount, net	58,582	(115,289)
Depreciation and amortization	413,818	431,401
Decrease (increase) in		
Accrued interest receivable	459,780	312,799
Cash surrender value of bank owned life insurance	(130,052)	(150,060)
Other assets	321,851	72,547
Increase (decrease) in		
Accrued interest payable	(154,387)	(150,992)
Accrued income taxes	2,708	-
Other liabilities	(62,799)	(128,026)
	$ 5,403,270	$ 5,318,673
Composition of cash and cash equivalents		
Cash and due from banks	$ 19,438,917	$ 12,103,008
Federal funds sold	34,442,376	39,722,207
Interest-bearing deposits, except for time deposits	148,644	18,814
	$ 54,029,937	$ 51,844,029
Supplemental cash flows information:		
Non-cash transfers from loans to other real estate owned	$ 845,000	$ -

See accompanying Notes to Consolidated Financial Statements

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements conform with accounting principles generally accepted in the United States of America and to the instructions to Form 10-Q. Interim financial statements do not include all the information and footnotes required for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of financial position and results of operations for these interim periods have been made. These adjustments are of a normal recurring nature. Results of operations for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected in any other interim period or for the year ending December 31, 2009. 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, 2008.

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:

	2009	2008
Three months ended September 30	3,011,098	3,063,966
Nine months ended September 30	3,025,271	3,084,485

2. Comprehensive Income

Comprehensive income consists of:

	For the nine months ended September 30, 2009	2008
Net income	$ 4,001,515	$ 4,971,278
Unrealized gain (loss) on investment securities available for sale, net of income taxes	(611,842)	72,926
Comprehensive income	$ 3,389,673	$ 5,044,204

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

3. Investment Securities

Investment securities are summarized as follows:

	Amortized cost	Unrealized gains	Unrealized losses	Fair value
September 30, 2009				
Available for sale				
U.S. Treasury	$ 45,219,489	$ 1,109,541	$ -	$ 46,329,030
State and municipal	395,000	5,811	1,878	398,933
Equity	1,691,841	1,500,143	14,242	3,177,742
	$ 47,306,330	$ 2,615,495	$ 16,120	$ 49,905,705
Held to maturity				
U.S. Treasury	$ 23,499,804	$ 360,743	$ -	$ 23,860,547
U.S. Government agency	13,000,269	41,664	640	13,041,293
State and municipal	3,116,370	13,368	68	3,129,670
	$ 39,616,443	$ 415,775	$ 708	$ 40,031,510
December 31, 2008				
Available for sale				
U.S. Treasury	$ 28,309,823	$ 1,408,794	$ -	$ 29,718,617
State and municipal	400,000	5,220	590	404,630
Equity	1,691,841	2,160,183	-	3,852,024
	$ 30,401,664	$ 3,574,197	$ 590	$ 33,975,271
Held to maturity				
U.S. Treasury	$ 24,519,603	$ 861,569	$ -	$ 25,381,172
U.S. Government agency	6,999,443	32,657	1,016	7,031,084
State and municipal	1,102,751	8,415	-	1,111,166
	$ 32,621,797	$ 902,641	$ 1,016	$ 33,523,422

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

3. Investment Securities (Continued)
The table below shows the gross unrealized losses and fair value of securities that are in an unrealized loss position as of September 30, 2009, 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. Government Agency	$ 99,360	$ 640	$ -	$ -	$ 99,360	$ 640
State and municipal	328,123	1,946	-	-	328,123	1,946
Equity	294,962	14,242	-	-	294,962	14,242
	$ 722,445	$ 16,828	$ -	$ -	$ 722,445	$ 16,828

The debt securities for which an unrealized loss is recorded are issues of 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 security for which an unrealized loss is recorded is issued by a local community bank holding company. Management believes that these fluctuations in fair value reflect market conditions, and are not indicative of other-than-temporary impairment of the investments.

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

	September 30, 2009		December 31, 2008	
	Amortized cost	Fair value	Amortized cost	Fair value
Available for sale				
Within one year	$ 22,095,198	$ 22,138,688	$ 17,159,259	$ 17,201,296
After one year through five years	21,523,010	21,898,650	9,554,499	9,960,076
After ten years	1,996,281	2,690,625	1,996,065	2,961,875
	$ 45,614,489	$ 46,727,963	$ 28,709,823	$ 30,123,247
Held to maturity				
Within one year	$ 21,041,568	$ 21,382,307	$ 13,766,474	$ 14,027,311
After one year through five years	18,574,875	18,649,203	18,855,323	19,496,111
	$ 39,616,443	$ 40,031,510	$ 32,621,797	$ 33,523,422
Pledged securities	$ 25,747,735	$ 26,758,790	$ 25,023,730	$ 26,891,914

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

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

4. Loan commitments

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

	September 30, 2009		December 31, 2008	
Loan commitments and lines of credit				
Construction and land development	$	10,453,391	$	15,218,812
Other		21,810,385		22,245,089
	$	32,263,776	$	37,463,901
Standby letters of credit	$	2,172,566	$	1,921,878

5. Assets Measured at Fair Value

The Company values investment securities classified as available for sale and other real estate acquired through foreclosure at fair value on a recurring basis. The fair value hierarchy established in the financial accounting standards board accounting standards codification topic 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 basis that are valued under Level 3 criteria. At September 30, 2009, values for available for sale investment securities were established as follows:

	Total		Level 1 Inputs		Level 2 Inputs
Investment securities available for sale	$ 49,905,705	$	46,638,438	$	3,267,267
Other real estate owned	829,500		829,500		-
	$ 50,735,205	$	47,467,938	$	3,267,267

The Company does not have the intent to sell any of these securities; and deems that it is more likely than not, that it will not have to sell any of these securities before recovery of their individual cost basis.

Estimated fair values of the Company's financial instruments, including cash, interest-bearing deposits, investment securities, loans, and interest-bearing deposit liabilities are detailed in the Company's 2008 Form 10-K. It is not practicable for the Company to disclose this information for interim periods.

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

New authoritative accounting guidance

On July 1, 2009, the Accounting Standards Codification (ASC) became the Financial Accounting Standards Board's (FASB) officially recognized source of authoritative U.S. generally accepted accounting principles applicable to all public and non-public non-governmental entities, superseding existing FASB, AICPA, EITF and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the away companies refer to U.S. GAAP in financial statements and accounting policies.

The following accounting guidance has been approved by the Financial Accounting Standards Board and would apply to the Company if the Company or the Bank entered into an applicable activity.

FASB ASC Topic 715, "Compensation - Retirement Benefits" provides guidance related to an employer's disclosures about plan assets of defined benefit pension or other post-retirement benefit plans. Under ASC Topic 715, disclosures should provide users of financial statements with an understanding of how investment allocation decisions are made, the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets. Adoption of the disclosure requirements of ASC topic 715 will be effective beginning with the financial statements for the year-ended December 31, 2009 and is not expected to have a significant impact on the Company's financial statements.

Accounting Standards Update No. 2009-5, under FASB ASC Topic 820, "Fair Value Measurement and Disclosures,"ot; provides authoritative guidance for measuring the fair value of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. In such a case, the reporting company must measure must measure fair value utilizing a valuation technique that uses (i) the quoted price of the identical liability when traded as an asset, (ii) quoted prices for similar liabilities or similar liabilities when traded as assets, or (iii) another valuation technique that is consistent with the existing principles of ASC Topic 820, such as an income approach or market approach. The new authoritative accounting guidance also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The new authoritative accounting guidance under ASC Topic 820 will be effective for the Company's financial statements beginning October 31, 2009, and is not expected to have a significant impact on the Company's financial statements.

FASB ASC Topic 855, "Subsequent Events" establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC Topic 855 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. ASC Topic 855 became effective for periods ending after June 15, 2009, and did not have a significant impact on the Company's financial statements.

FASB ASC Topic 860, "Transfers and Servicing" enhances reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. This new guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. It also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. ASC Topic 860 will be effective January 1, 2010 and is not expected to have a significant impact on the Company's financial statements.

The accounting policies adopted by management are consistent with authoritative U.S. generally accepted accounting principles and are consistent with those followed by peer Banks.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
Part I. Financial Information
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

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

General

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

The Company currently engages in no business other than owning and managing the Bank. The Bank employed 89 full time equivalent employees as of September 30, 2009. The Bank hires seasonal employees during the summer. The Company has no employees other than those hired by the Bank.

Critical Accounting Policies

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

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

Financial Condition

Total assets of the Company increased $32.6 million (8.75%) from December 31, 2008 to September 30, 2009. Combined deposits and customer repurchase agreements increased $31.4 million (10.52%) during the same period. Management believes that some of the recent growth in deposit balances results from market instability that is part of a continuing general economic recession. Consumers often seek the safety of conservatively run community banks when the stock market has a significant and prolonged downturn. For further discussion of seasonal activity that affects deposit levels, see the section titled Liquidity.

Average total assets and average total deposits increased $23.3 million and $24.6 million, respectively, from third quarter 2008 to third quarter 2009. Management carefully monitors deposit increases and reductions and the resulting effect on liquidity. Funds generated by recent deposit growth have been invested in interest-bearing deposits in banks and in debt securities.

Loan Portfolio

During the first three quarters of 2009, the Bank's gross loan portfolio decreased $6.3 million (2.61%). This decrease in loans, coupled with increased deposits has resulted in the Bank investing higher balances in debt securities. This shift from higher earning loans to lower yielding debt securities has a negative effect on earnings. There is no adverse impact on the Company's ability to meet liquidity demands resulting from decreases in the loan portfolio or increased investment in short-term debt instruments, most of which are classified as available for sale.

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. Throughout 2008 and 2009, the local and regional economies have been adversely affected by a recession of national and international reach.

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, applied to the current portfolio. This formulation 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 ongoing 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. In recent months, 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.

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 through 2008 and 2009, the Bank has increased 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 September 30, 2009, management reserved 85 bp against unsecured loans, and consumer loans secured by other than real estate. Both of these reserves were increased during the first, second and third quarters of this year in recognition of the prolonged economic challenges to regional, national, and global economies. Additionally, management reserved 10.0% against overdrawn checking accounts which are a distinct high risk category of unsecured loan.

The depth and length of the current recession has resulted in unusual stress to the Bank’s real estate secured portfolio as well. Rising delinquencies and falling collateral values have caused the Bank to suffer historically high losses in real estate secured loans. The Bank continually evaluates loss potential in the mortgage portfolio and provides specific reserves at the time a potential loss is identified.

Historically, the absence or improper execution of a document has not resulted in a loss to the Bank, however, management recognizes that the Bank’s loss exposure is increased until a critical contract or collateral documentation exception is cured. At September 30, 2009, management reserved 10 bp against the outstanding balances of loans identified as having critical documentation exceptions.

The provision for loan losses is a charge to earnings in the current period to maintain the allowance at a level management has determined to be appropriate. The allowance is increased by current period provisions and by recoveries of amounts previously charged-off. The allowance is decreased when loans are charged-off as losses, which occurs when they are deemed to be uncollectible. Adjustments made to bring the balance in the allowance to the level established by management may result in an increase or decrease to expense. Provisions for loan losses of ($132,550) and $497,050 were made for the third quarter of 2009 and year-to-date, respectively. This compares to provisions for loan losses of ($1,478) and $75,015 for the comparable periods in 2008. The increased year-to-date 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 increases. As Management identifies loans with heightened loss potential, a provision for those losses is recorded. Management believes that loan losses are a lagging indicator of economic distress and that losses may continue after improvement is noted in the economy at large.

Year-to-date the level of the ALLL has fallen slightly from $707,152 at December 31, 2008 to $625,604 at September 30, 2009. This results from increases due to additional loss provisions and decreases as troubled loans are charged off. Management considers the September 30, 2009 allowance appropriate and adequate to absorb identified and inherent losses in the loan portfolio. However, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required. As of September 30, 2009, management has identified two loans with balances totaling $539,637 which are anticipated to be wholly charged-off within the next 12 months. One of these loans is 80% guaranteed by a US government agency. The anticipated loss on these loans totals $119,877 and has been fully reserved in the ALLL.

The following is a schedule of transactions in the allowance for loan losses. The Bank experienced net charge-offs of $121,101 in the third quarter of 2009 and $578,599 in the current year to date. As described earlier, management attributes the increased loan losses to the effects of the current economic recession on some of the Bank's customers and, subsequently, on the Bank.

Allowance for Loan Losses

	For nine months ended		For the year ended
	September 30		December 31
	2009	2008	2008
Balance at beginning of year	$ 707,152	$ 195,525	$ 195,525
Loans charged-off:			
Real estate - construction and land	75,000	-	-
Real estate - mortgage	399,704	-	-
Commercial	83,105	59,199	76,383
Consumer	38,120	12,216	34,532
Total loan losses	595,929	71,415	110,915
Recoveries on loans previously charged off:			
Real estate - construction	-	-	-
Real estate - mortgage	669	-	-
Commercial	276	-	3,785
Consumer	16,386	350	1,231
Total loan recoveries	17,331	350	5,016
Net loan charge-offs (recoveries)	578,598	71,065	105,899
Provision for loan losses charged to expense	497,050	75,015	617,526
Balance at end of period	$ 625,604	$ 199,475	$ 707,152
Average loans outstanding during the period	$ 239,930,765	$ 238,446,661	$ 238,873,590
Annualized net charge-offs as a percentage of average loans outstanding during the period	0.32%	0.04%	0.04%
Gross loans outstanding at the end of the period	$ 235,819,585	$ 235,318,797	$ 242,138,066
Allowance for loan losses to gross loans outstanding at the end of the period	0.27%	0.08%	0.29%

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

Nonperforming loans are loans past due 90 or more days and still accruing plus nonaccrual loans. Nonperforming assets are comprised of nonperforming loans combined with real estate acquired in foreclosure and held for sale (other real estate owned). The following table details the composition of nonperforming assets as of September 30, 2009 or December 31, 2008.

	September 30, 2009	December 31, 2008
Loans 90 days or more past due and still accruing		
Real estate	$ 990,869	$ 4,602,365
Commercial	-	40,000
Consumer	4,420	5,427
	995,289	4,647,792
Nonaccruing loans	1,450,876	199,724
Total nonperforming loans	2,446,165	4,847,516
Other real estate owned	829,500	-
Total nonperforming assets	$ 3,275,665	$ 4,847,516
Interest not accrued on nonaccruing loans	$ 55,698	$ 6,797
Interest included in net income on nonaccruing loans, year-to-date	$ 24,307	$ -

A loan with a principal balance of $4,500,000 is included in amounts past due 90 days or more and still accruing at December 31, 2008. 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 lien. 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. As of September 30, 2009, interest on this loan was current. The Bank’s claim with the title company has not yet been settled.

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

Impaired loans including nonaccruing loans totaled $3,853,923 and $8,888,200, at September 30, 2009, and December 31, 2008, respectively. Principal balances of impaired loans include $419,770 which is guaranteed by a government agency at both September 30, 2009, and December 31, 2008.

	September 30, 2009	December 31, 2008
Impaired loans with valuation allowances,		
including nonaccruing loans	$ 1,755,304	$ 4,328,618
Valuation allowances on impaired loans	$ 432,721	$ 605,405
Impaired loans with no valuation allowances	$ 2,098,619	$ 4,559,582
Total impaired loans	$ 3,853,923	$ 8,888,200

Liquidity

September 30, 2009 December 31, 2008 Impaired loans with valuation allowances, including nonaccruing loans $1,755,304 $4,328,618 Valuation allowances on impaired loans $432,721 $605,405 Impaired loans with no valuation allowances $2,098,619 $4,559,582 Total impaired loans $3,853,923 $8,888,200 September 30, 2009 December 31, 2008 Impaired loans with valuation allowances, including nonaccruing loans $1,755,304 $4,328,618 Valuation allowances on impaired loans $432,721 $605,405 Impaired loans with no valuation allowances $2,098,619 $4,559,582 Total impaired loans $3,853,923 $8,888,200 retail repurchase agreements were 45.16% for the third quarter of 2009 compared to 41.92% for the same quarter of 2008.

The Company has available lines of credit, including overnight federal funds and reverse repurchase agreements, totaling $28,000,000 as of September 30, 2009.

Average net loans to average deposits were 74.36% versus 80.19% as of September 30, 2009 and 2008, respectively. Average net loans increased by a modest .41% while average deposits grew by 8.28%. Funding for loan growth was provided by deposit increases. Because loans earn higher average rates than the Bank’s cost of funds, this results in a positive effect on earnings. Average deposit balance increases occurred in all categories of deposits, but were particularly notable in time deposits. Neither changes in deposit portfolio composition nor the increase in outstanding loan balances has a negative impact on the Company’s ability to meet liquidity demands.

Interest Rate Sensitivity

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

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

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

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

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

As of September 30, 2009, the Company was cumulatively asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Results of Operations

Net income for the three months ended September 30, 2009*,* was $1,511,649 or $.50 per share, compared to $1,706,142 or $.56 per share for the third quarter of 2008. This represents a decrease of $194,493 or 11.40% from the prior year. Year to date net income has decreased $969,763 or $.29 per share from $4,971,278 ($1.61 per share) in 2008 to $4,001,515 ($1.32 per share) in 2009. The key components of net income are discussed in the following paragraphs.

For the first nine months of 2009 compared to 2008, net interest income decreased $542,241 (4.49%). Net interest income decreased $251,137 (6.15%) in the third quarter of 2009 compared to the same period of 2008. The decrease in interest and dividend revenue is primarily attributable to market rate reductions which have resulted in the dramatic downward repricing of overnight federal funds and slower but steady downward repricing of interest-bearing deposits in banks and debt securities. Interest expense decreased in the third quarter of 2009 by $328,126 (35.26%) relative to the comparable period last year due to lower rates on all deposits, but particularly time deposits. For the year to date, interest expense is down $1,117,751 (36.11%) relative to the previous year to date.

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 92 basis points from 5.75% for third quarter 2008 to 4.83% in 2009. The quarterly yield on interest-bearing liabilities decreased by 70 basis points from 1.70% in 2008 to 1.00% in 2009. In combination, these shifts contribute to a decrease in net margin on interest-earning assets of 51 basis points.

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

Average Balances, Interest, and Yields

	For the quarter ended September 30, 2009			For the quarter ended September 30, 2008		
	Average balance	Interest	Yield	Average balance	Interest	Yield
Assets						
Federal funds sold	$ 37,585,106	$ 18,085	0.19%	$ 43,752,965	$ 221,938	2.02%
Interest-bearing deposits	12,284,308	26,100	0.84%	10,899,809	87,138	3.18%
Investment securities	81,079,391	446,496	2.18%	60,345,351	608,017	4.01%
Loans, net of allowance	239,223,663	4,019,226	6.67%	238,243,801	4,186,781	6.99%
Total interest-earning assets	370,172,468	4,509,907	4.83%	353,241,926	5,103,874	5.75%
Noninterest-bearing cash	17,849,768			12,096,712		
Other assets	14,254,239			13,641,588		
Total assets	$ 402,276,475			$ 378,980,226		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
NOW	$ 51,424,450	37,201	0.29%	$ 48,928,744	56,726	0.46%
Money market	36,663,323	45,981	0.50%	32,345,651	77,261	0.95%
Savings	45,026,198	56,096	0.49%	41,724,294	77,858	0.74%
Other time	98,448,988	452,497	1.82%	88,782,767	693,166	3.11%
Total interest-bearing deposits	231,562,959	591,775	1.01%	211,781,456	905,011	1.70%
Securities sold under agreements to repurchase & federal funds purchased	7,777,915	9,758	0.50%	6,102,057	24,274	1.58%
Borrowed funds	57,311	890	6.16%	82,283	1,264	6.11%
Total interest-bearing liabilities	239,398,185	602,423	1.00%	217,965,796	930,549	1.70%
Noninterest-bearing deposits	90,127,491			85,319,024		
	329,525,676	602,423	0.73%	303,284,820	930,549	1.22%
Other liabilities	1,304,113			1,509,882		
Stockholders' equity	71,446,686			74,185,524		
Total liabilities and stockholders' equity	$ 402,276,475			$ 378,980,226		
Net interest spread			3.83%			4.05%
Net interest income		$ 3,907,484			$ 4,173,325	
Net margin on interest-earning assets			4.19%			4.70%
Tax equivalent adjustment in:						
Investment income		$ 31,823			$ 41,408	
Loan income		$ 40,774			$ 45,893	

Provisions for loan losses of ($132,550) and $497,050 were recorded during the three and nine months periods ended September 2009, respectively. Net loans charged-off were $578,598 and $71,065 during the first three quarters of 2009 and 2008, 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 third quarter of 2009 is $12,825 (2.44%) lower than the comparable period last year. Noninterest revenue for the year-to-date is $56,307 (3.68%) less than last year. For both the quarter and the year-to-date, results are largely due to decreased service charges on deposit accounts and the reduced rate of growth in cash surrender value of bank owned life insurance abated by increased miscellaneous revenues. Most of the increase is miscellaneous revenues is attributable to increased fees for placement of brokered certificates of deposit in the Certificate of Deposit Account Registry Services® network.

Noninterest expense for the third quarter of 2009 is $147,603 (7.67%) more than last year of which $151,637 is due to increased FDIC premiums. Noninterest expense year-to-date is $513,180 (8.97%) more than last year of which $386,303 is due to FDIC premium increases. FDIC insurance premiums have jumped dramatically due to increased rates and assessable balances, the expiration of the one-time insurance premium credit, and the accrual of a special assessment to restore the deposit insurance fund to target levels.

Income taxes for the nine months ended September 30, 2009 are $564,000 (19.88%) lower than the same period last year, on a pre-tax income decrease of $1,533,763 (19.64%). 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. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities.

All deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the maximum amount allowed by law. FDIC deposit insurance has been temporarily increased from $100,000 to $250,000 per depositor through December 31, 2013. The Bank offers individual customers up to $50 million in FDIC insured deposits through the Certificate of Deposit Account Registry Services® network.

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

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

Capital Resources and Adequacy

Total stockholders' equity increased $1,849,173 from December 31, 2008 to September 30, 2009. This increase is attributable to comprehensive income recorded during the period, as detailed in Note 2 of the Notes to Financial Statements, reduced by $1,540,500 used to repurchase and retire 42,481 shares of common stock.

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

Tier one risk-based capital ratios of the Company as of September 30, 2009 and December 31, 2008 were 32.95% and 31.8%, 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), which, in combination with temporary deposit insurance limit increases, provide the security of additional insurance to depositors. These actions have contributed to an increase in deposits in the Bank as investors seek the safety of insured deposits in community banks. Deposit insurance premiums will increase as a result of the higher deposit balances, the higher insurance limits, participation in TLG, and higher insurance rates. Management does not expect to pass all of the additional insurance premium costs on to customers.

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 2009 to bring lower interest revenues and higher fees associated with loan collection and increased deposit insurance premiums. The full impact of the dramatic developments of 2008 on future results of operation of the Company and the Bank, are uncertain.

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. This can be clearly seen in the table of Average Balances, Interest, and Yields presented in the section Results of Operation. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management monitors and seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

At September 30, 2009, the Company’s interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 24.38%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. The Bank has classified its demand mortgage and commercial loans as immediately repriceable. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans and change the rates rests with management.

Item 4. Controls and procedures

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

The Company’s management, including the CEO and Treasurer, performed an evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of September 30, 2009. Based on that evaluation, the Company’s management, including the CEO and Treasurer, has concluded that the Company’s disclosure controls and procedures are effective. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company’s internal control over financial reporting that have had or are reasonably likely to have a material effect on the Company’s internal control over financial reporting. As of September 30, 2009, 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

(c) The following table presents information about the Company's repurchase of its equity securities during the calendar quarter ended on the date of this report.

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
July	7,772	35.00	7,772	187,222
August	7,756	35.15	7,756	179,466
August**				293,883
September	200	35.00	200	293,683
Totals	15,728	35.07	15,728	

** Additional shares made available by Board resolution.

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. This plan has been renewed by public announcement as of January 1, 2005, May 18, 2007, and August 13, 2009. As of August 13, 2009, a total of 301,539 common shares were available for repurchase.

There is no 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 period covered by this table. Common shares repurchased under this plan are retired.

Item 3 Defaults Upon Senior Securities

Not applicable

Item 4 Submission of Matters to a Vote of Security Holders

There have been no matters submitted to a vote of security holders during the period covered by this report.

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

31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of 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
Certification - 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 officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the most recent fiscal quarter that has or is reasonably likely to materially affect the registrant’s internal control over financial reporting; and
4. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent function):
a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2009   By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Exhibit 31.2

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

I, Jennifer G. Hawkins, certify that:

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

1. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
2. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
3. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal quarter that has or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
4. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2009

By: /s/ Jennifer G. Hawkins

Jennifer G. Hawkins

Treasurer (Principal Financial Officer)

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

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended September 30, 2009, of the Registrant (the "Report"):

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

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

Calvin B. Taylor Bankshares, Inc.

Date: November 5, 2009 By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Date: November 5, 2009 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: November 5, 2009	By:	/s/ Raymond M. Thompson
		Raymond M. Thompson
		Chief Executive Officer
Date: November 5, 2009	By:	/s/ Jennifer G. Hawkins
		Jennifer G. Hawkins
		Treasurer (Principal Financial Officer)