

AMES NATIONAL CORP  
Form 10-Q  
August 06, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]

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

For the quarterly period ended June 30, 2010

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-32637

AMES NATIONAL CORPORATION  
(Exact Name of Registrant as Specified in Its Charter)

IOWA  
(State or Other Jurisdiction of  
Incorporation or Organization)

42-1039071  
(I. R. S. Employer  
Identification Number)

405 FIFTH STREET  
AMES, IOWA 50010  
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (515) 232-6251

NOT APPLICABLE  
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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  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 (Section 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated

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filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

COMMON STOCK, \$2.00 PAR VALUE  
(Class)

9,432,915  
(Shares Outstanding at July 30, 2010)

## AMES NATIONAL CORPORATION

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(unaudited)

ASSETS	June 30, 2010	December 31, 2009
Cash and due from banks	\$16,671,320	\$18,796,664
Interest bearing deposits in financial institutions	25,357,030	24,776,088
Securities available-for-sale	436,928,802	418,655,018
Loans receivable, net	410,432,696	415,434,236
Loans held for sale	2,510,258	1,023,200
Bank premises and equipment, net	11,666,390	11,909,404
Accrued income receivable	5,918,291	5,710,226
Deferred income taxes	2,513,174	3,867,523
Other real estate owned	10,630,371	10,480,449
Other assets	4,350,105	4,916,991
<b>Total assets</b>	<b>\$926,978,437</b>	<b>\$915,569,799</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
<b>Deposits</b>		
Demand, noninterest bearing	\$91,706,784	\$99,918,848
NOW accounts	208,779,142	197,393,459
Savings and money market	179,879,101	184,631,343
Time, \$100,000 and over	86,614,339	87,054,194
Other time	148,225,335	153,166,105
<b>Total deposits</b>	<b>715,204,701</b>	<b>722,163,949</b>
Federal funds purchased and securities sold under agreements to repurchase	50,279,602	40,489,505
Short-term borrowings	6,819	138,874
FHLB advances and other long-term borrowings	38,500,000	36,500,000
Dividend payable	1,037,620	943,292
Accrued expenses and other liabilities	3,251,797	2,994,291
<b>Total liabilities</b>	<b>808,280,539</b>	<b>803,229,911</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$2 par value, authorized 18,000,000 shares; 9,432,915 shares issued and outstanding	18,865,830	18,865,830
Additional paid-in capital	22,651,222	22,651,222
Retained earnings	72,024,066	67,703,701
Accumulated other comprehensive income-net unrealized gain on securities available-for-sale	5,156,780	3,119,135
<b>Total stockholders' equity</b>	<b>118,697,898</b>	<b>112,339,888</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$926,978,437</b>	<b>\$915,569,799</b>

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income  
(unaudited)

	Three Months Ended June 30,		Six Month Ended June 30,	
	2010	2009	2010	2009
Interest and dividend income:				
Loans, including fees	\$6,023,730	\$6,389,627	\$12,123,209	\$13,000,802
Securities:				
Taxable	1,770,707	2,055,441	3,598,228	4,166,936
Tax-exempt	1,429,568	1,291,796	2,795,150	2,570,452
Federal funds sold	-	8,253	-	19,328
Interest bearing deposits	129,198	81,151	259,311	186,222
Total interest and dividend income	9,353,203	9,826,268	18,775,898	19,943,740
Interest expense:				
Deposits	1,563,610	2,183,150	3,225,964	4,624,680
Other borrowed funds	402,304	476,498	805,462	944,882
Total interest expense	1,965,914	2,659,648	4,031,426	5,569,562
Net interest income	7,387,289	7,166,620	14,744,472	14,374,178
Provision for loan losses	170,416	326,670	494,214	556,324
Net interest income after provision for loan losses	7,216,873	6,839,950	14,250,258	13,817,854
Noninterest income:				
Trust department income	465,298	390,882	996,014	773,434
Service fees	435,365	449,382	835,188	870,832
Securities gains (losses), net	134,830	255,088	671,813	(95,587)
Gain on loans held for sale	171,453	256,776	324,989	519,682
Merchant and ATM fees	195,137	153,159	360,524	299,169
Other	209,460	223,337	380,780	367,066
Total noninterest income	1,611,543	1,728,624	3,569,308	2,734,596
Noninterest expense:				
Salaries and employee benefits	2,706,545	2,703,106	5,304,584	5,049,865
Data processing	494,681	541,678	945,645	1,020,313
Occupancy expenses	364,955	302,240	766,109	695,044
FDIC insurance assessments	278,109	557,091	591,466	1,037,002
Other real estate owned	62,954	727,793	119,307	1,154,637
Other operating expenses	728,405	705,236	1,441,477	1,406,703

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Total noninterest expense	4,635,649	5,537,144	9,168,588	10,363,564
Income before income taxes	4,192,767	3,031,430	8,650,978	6,188,886
Provision for income taxes	1,066,761	622,525	2,255,372	1,338,841
Net income	\$3,126,006	\$2,408,905	\$6,395,606	\$4,850,045
Basic and diluted earnings per share	\$0.33	\$0.26	\$0.68	\$0.51
Declared dividends per share	\$0.11	\$0.10	\$0.22	\$0.20
Comprehensive income	\$4,413,196	\$4,360,628	\$8,433,251	\$5,406,674

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

	Six Months Ended June 30,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$6,395,606	\$4,850,045
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	494,214	556,324
Provision (credit) for off-balance sheet commitments	13,000	(5,000 )
Amortization and (accretion), net	1,389,789	184,623
Depreciation	381,534	432,738
Provision for deferred taxes	157,636	1,316,262
Securities losses (gains), net	(671,813 )	95,587
Other-than-temporary impairment of investment securities	-	29,565
Impairment of other real estate owned	14,900	931,533
(Gain) loss on sale of other real estate owned	(35,922 )	1,096
Change in assets and liabilities:		
Increase in loans held for sale	(1,487,058 )	(1,505,549 )
(Increase) decrease in accrued income receivable	(208,065 )	1,171,957
Decrease in other assets	560,326	449,373
Increase in accrued expenses and other liabilities	244,506	427,866
Net cash provided by operating activities	7,248,653	8,936,420
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of securities available-for-sale	(109,570,798)	(136,151,556)
Proceeds from sale of securities available-for-sale	16,353,562	33,751,830
Proceeds from maturities and calls of securities available-for-sale	77,459,834	46,069,180
Net increase in interest bearing deposits in financial institutions	(580,942 )	(26,902,623 )
Net decrease in federal funds sold	-	16,533,000
Net decrease in loans	3,805,797	28,563,420
Net proceeds for the sale of other real estate owned	571,028	702,137
Purchase of bank premises and equipment, net	(131,960 )	(65,221 )
Improvements in other real estate owned	1,601	2,250
Net cash used in investing activities	(12,091,878 )	(37,497,583 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase (decrease) in deposits	(6,959,248 )	19,326,615
Increase in federal funds purchased and securities sold under agreements to repurchase	9,790,097	7,951,847
Payments on short-term borrowings, net	(132,055 )	(738,587 )
Proceeds from FHLB advances	2,500,000	2,500,000
Payments on FHLB advances	(500,000 )	(5,500,000 )
Dividends paid	(1,980,913 )	(3,584,507 )
Net cash provided by financing activities	2,717,881	19,955,368



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Net decrease in cash and cash equivalents	(2,125,344 )	(8,605,795 )
<b>CASH AND DUE FROM BANKS</b>		
Beginning	18,796,664	24,697,591
Ending	\$16,671,320	\$16,091,796

Continued

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AMES NATIONAL CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)  
 (unaudited)

Six Months Ended  
 June 30,  
 2010                      2009

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments (receipt) for:

Interest	\$4,128,891	\$5,809,507
Income taxes	2,107,614	(566,065 )

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES

Transfer of loans to other real estate owned	\$701,529	\$1,499,411
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See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

1. Significant Accounting Policies

The consolidated financial statements for the three and six month periods ended June 30, 2010 and 2009 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 (the "Annual Report"). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the "Banks"). All significant intercompany balances and transactions have been eliminated in consolidation. Certain immaterial reclassifications have been made to previously presented financial statements to conform to the 2010 presentation.

**Fair value of financial instruments:** The following methods and assumptions were used by the Company in estimating fair value disclosures:

**Cash and due from banks and interest bearing deposits in financial institutions:** The recorded amount of these assets approximates fair value.

**Securities available-for-sale:** Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the securities credit rating, prepayment assumptions and other factors such as credit loss assumptions.

**Loans receivable:** The fair value of loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates, which reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the historical experience, with repayments for each loan classification modified, as required, by an estimate of the effect of current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate.

**Loans held for sale:** The fair value of loans held for sale is based on prevailing market prices.

**Deposit liabilities:** Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, are equal to the amount payable on demand as of the respective balance sheet date. Fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

**Federal funds purchased and securities sold under agreements to repurchase:** The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximate fair value because of the generally short-term nature of the instruments.



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Short-term borrowings: The carrying amounts of short-term borrowings approximate fair value because of the generally short-term nature of the instruments.

FHLB advances and other long-term borrowings: Fair values of FHLB advances and other long-term borrowings are estimated using discounted cash flow analysis based on interest rates currently being offered with similar terms.

Accrued income receivable and accrued interest payable: The carrying amounts of accrued income receivable and interest payable approximate fair value.

New Accounting Pronouncements

On December 23, 2009 the FASB issued guidance which modifies certain aspects contained in the Transfers and Servicing topic of FASB ASC 860. This standard enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. This standard was effective for the Company as of January 1, 2010 with adoption applied prospectively for transfers that occur on or after that date. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

In January, 2010, the FASB issued guidance which modifies certain aspects contained in the Fair Value Measurements and Disclosure topic of FAS ASC 820. This standard enhances information reported to users of the financial statements by providing additional and enhanced disclosures about the fair value measurements. This standard was effective for the company as of January 1, 2010; except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which will be effective on January 1, 2011. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

In July, 2010, the FASB issued Accounting Standards Update 2010-20, Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The new guidance will increase disclosures made about the credit quality of loans and the allowance for credit losses. The disclosures will provide additional information about the nature of credit risk inherent in the Company's loans, how credit risk is analyzed and assessed, and the reasons for the change in the allowance for loan losses. The requirements will be effective for the Company's year ending December 31, 2010. The company has not yet determined the impact the requirements will have on the consolidated financial statements.

2. Dividends

On May 12, 2010, the Company declared a cash dividend on its common stock, payable on August 16, 2010 to stockholders of record as of August 2, 2010, equal to \$0.11 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three and six months ended June 30, 2010 and 2009 were 9,432,915. The Company had no potentially dilutive securities outstanding during the periods presented.

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## 4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company's off-balance sheet arrangements have occurred since December 31, 2009.

## 5. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments (as described in Note 1) were as follows:

	June 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$16,671,320	\$16,671,000	\$18,796,664	\$18,797,000
Interest-bearing deposits	25,357,030	25,357,000	24,776,088	24,766,000
Securities available-for-sale	436,928,802	436,929,000	418,655,018	418,655,000
Loans receivable, net	410,432,696	413,659,000	415,434,236	411,344,000
Loans held for sale	2,510,258	2,510,000	1,023,200	1,023,000
Accrued income receivable	5,918,291	5,918,000	5,710,226	5,710,000
Financial liabilities:				
Deposits	\$715,204,701	\$717,737,000	\$722,163,949	\$725,840,000
Federal funds purchased and securities sold under agreements to repurchase	50,279,602	50,280,000	40,489,505	40,490,000
Other short-term borrowings	6,819	7,000	138,874	139,000
Long-term borrowings	38,500,000	41,902,000	36,500,000	41,504,000
Accrued interest payable	994,726	995,000	1,092,191	1,092,000

The methodology used to determine fair value as of June 30, 2010 did not change from the methodology used in the Annual Report.

## 6. Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

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Level 1 inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; Level 2 inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following table presents the balances of assets measured at fair value on a recurring basis by level as of June 30, 2010 and December 31, 2009:

Description	Total	Quoted Prices in Active markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2010				
U.S. treasury	\$515,000	\$515,000	\$-	\$ -
U.S. government agencies	104,562,000	-	104,562,000	-
U.S. government mortgage-backed securities	102,376,000	-	102,376,000	-
State and political subdivisions	201,881,000	-	201,881,000	-
Corporate bonds	20,822,000	-	20,822,000	-
Equity securities, financial industry common stock	2,310,000	2,310,000	-	-
Equity securities, other	4,463,000	1,230,000	3,233,000	-
	\$436,929,000	\$4,055,000	\$432,874,000	\$ -
December 31, 2009				
U.S. treasury	\$525,000	\$525,000	\$-	\$ -
U.S. government agencies	106,640,000	-	106,640,000	-
U.S. government mortgage-backed securities	101,589,000	-	101,589,000	-
State and political subdivisions	178,052,000	-	178,052,000	-
Corporate bonds	24,300,000	-	24,300,000	-
Equity securities, financial industry common stock	2,347,000	2,347,000	-	-
Equity securities, other	5,202,000	2,023,000	3,179,000	-
	\$418,655,000	\$4,895,000	\$413,760,000	\$ -

(a) Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the securities credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1

securities include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include U.S. government agency securities, mortgage-backed securities (including pools and collateralized mortgage obligations), municipal bonds, and corporate debt securities. There were no transfers between level one and two classifications. The Company's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.



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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level with the required valuation hierarchy as of June 30, 2010 and December 31, 2009:

Description	Total	Quoted Prices in Active markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2010				
Loans	\$4,380,000	\$-	\$-	\$ 4,380,000
Other real estate owned	10,630,000	-	-	10,630,000
Total	\$ 15,010,000	\$-	\$-	\$ 15,010,000
December 31, 2009				
Loans	\$4,807,000	\$-	\$-	\$ 4,807,000
Other real estate owned	10,480,000	-	-	10,480,000
Total	\$ 15,287,000	\$-	\$-	\$ 15,287,000

Loans in the tables above consist of impaired credits held for investment. Impaired loans are valued by management based on collateral values underlying the loans. Management uses original appraised values and adjusts for trends observed in the market to determine the value of impaired loans. Other real estate owned in the table above consists of real estate obtained through foreclosure. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned.

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## 7. Debt and Equity Securities

The amortized cost of securities available for sale and their approximate fair values are summarized below:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2010:				
U.S. treasury	\$499,420	\$15,594	\$-	\$515,014
U.S. government agencies	102,844,632	1,759,112	(41,529 )	104,562,215
U.S. government mortgage-backed securities	99,300,541	3,123,017	(47,661 )	102,375,897
State and political subdivisions	198,372,229	3,739,900	(231,582 )	201,880,547
Corporate bonds	19,600,975	1,235,709	(14,269 )	20,822,415
Equity securities, financial industry common stock	3,402,389	-	(1,092,388)	2,310,001
Equity securities, other	4,723,251	2,300	(262,838 )	4,462,713
	\$428,743,437	\$9,875,632	\$(1,690,267)	\$436,928,802

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2009:				
U.S. treasury	\$498,972	\$26,219	\$-	\$525,191
U.S. government agencies	105,903,470	969,583	(233,169 )	106,639,884
U.S. government mortgage-backed securities	100,106,597	1,724,922	(242,033 )	101,589,486
State and political subdivisions	175,298,674	3,109,322	(355,571 )	178,052,425
Corporate bonds	23,094,417	1,253,157	(47,880 )	24,299,694
Equity securities, financial industry common stock	3,402,389	-	(1,056,088)	2,346,301
Equity securities, other	5,399,493	58,400	(255,856 )	5,202,037
	\$413,704,012	\$7,141,603	\$(2,190,597)	\$418,655,018

Non-interest income for the three months ended June 30, 2010 and 2009 was primarily impacted by net security gains of approximately \$135,000 and \$255,000, respectively. Non-interest income for the six months ended June 30, 2010 and 2009 was primarily impacted by net security gains (losses) of approximately \$672,000 and (\$96,000), respectively.

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Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2010 and December 31, 2009, are summarized as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2010:						
Securities available for sale:						
U.S. government agencies	\$4,659,087	\$(31,899 )	\$436,904	\$(9,630 )	\$5,095,991	\$(41,529 )
U.S. government mortgage-backed securities	2,996,377	(47,661 )	-	-	2,996,377	(47,661 )
State and political subdivisions	22,887,523	(207,528 )	2,230,126	(24,054 )	25,117,649	(231,582 )
Corporate obligations	993,971	(5,269 )	743,243	(9,000 )	1,737,214	(14,269 )
Equity securities, financial industry common stock	-	-	2,310,001	(1,092,388)	2,310,001	(1,092,388)
Equity securities, other	-	-	1,230,114	(262,838 )	1,230,114	(262,838 )
	\$31,536,958	\$(292,357 )	\$6,950,388	\$(1,397,910)	\$38,487,346	\$(1,690,267)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2009:						
Securities available for sale:						
U.S. government agencies	\$20,945,895	\$(221,061 )	\$493,118	\$(12,108 )	\$21,439,013	\$(233,169 )
U.S. government mortgage-backed securities	35,520,408	(242,033 )	-	-	35,520,408	(242,033 )
State and political subdivisions	25,536,025	(292,017 )	2,701,961	(63,554 )	28,237,986	(355,571 )
Corporate obligations	998,971	(764 )	2,687,426	(47,116 )	3,686,397	(47,880 )
Equity securities, financial industry common stock	-	-	2,346,301	(1,056,088)	2,346,301	(1,056,088)
Equity securities, other	-	-	1,932,636	(255,856 )	1,932,636	(255,856 )
	\$83,001,299	\$(755,875 )	\$10,161,442	\$(1,434,722)	\$93,162,741	\$(2,190,597)

At June 30, 2010, debt securities have unrealized losses of \$335,041. These losses are generally due to changes in interest rates or general market conditions. In analyzing an issuers' financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond ratings agencies have occurred and industry analysts' reports. Unrealized losses on equity securities totaled \$1,355,226 as of June 30, 2010. Management analyzed the financial condition of the equity issuers and considered the general market conditions and other factors in concluding that the unrealized losses on equity securities were not other-than-temporary. Due to potential changes in conditions, it is at least reasonably possible changes in fair values and management's assessments will occur in the near term and that such changes could lead to additional impairment charges, thereby materially affecting the amounts reported in the Company's financial statements.



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## 8. Impaired Loans and Allowance for Loan Losses

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment. Impairment of \$892,000 and \$999,000 is included in the allowance for loan losses as of June 30, 2010 and December 31, 2009, respectively. The following is a recap of impaired loans at June 30, 2010 and December 31, 2009:

	June 30, 2010	December 31, 2009
Impaired loans without a valuation allowance	\$2,454,000	\$4,381,000
Impaired loans with a valuation allowance	5,272,000	5,806,000
Total impaired loans	\$7,726,000	\$10,187,000
Valuation related to impaired loans	\$892,000	\$999,000
Total nonaccrual loans	\$7,754,000	\$10,187,000
Total loans past due ninety days or more and still accruing	\$7,000	\$121,000

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Average investments in impaired loans	\$7,898,000	\$9,402,000	\$8,661,000	\$8,438,000
Interest income that would have been recognized on impaired loans	\$108,000	\$56,000	\$226,000	\$192,000
Interest income recorded on impaired loans	\$9,000	\$34,000	\$107,000	\$55,000

Changes in the allowance for loan losses were as follows for the three and six months ended June 30, 2010 and 2009:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Balance, beginning	\$ 7,682,000	\$ 6,932,000	\$ 7,652,000	\$ 6,779,000
Loans charged-off	(27,000 )	(582,000 )	(342,000 )	(679,000 )
Recoveries of loans charged-off	25,000	11,000	46,000	32,000
Net charge offs	(2,000 )	(571,000 )	(296,000 )	(647,000 )
Provision for loan losses	170,000	327,000	494,000	556,000
Balance, ending	\$ 7,850,000	\$ 6,688,000	\$ 7,850,000	\$ 6,688,000



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9. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. There were no significant events or transactions occurring after June 30, 2010, but prior to August 6, 2010 that provided additional evidence about conditions that existed at June 30, 2010. There were no events or transactions that provided evidence about conditions that did not exist at June 30, 2010.

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

Overview

Ames National Corporation (the "Company") is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa (the "Banks"). The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Randall-Story State Bank (Randall-Story Bank) and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and trust services. The Banks also offer investment services through a third-party broker dealer. The Company employs eleven individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 184 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cash flow are: (i) interest and fees earned on loans made by the Banks; (ii) service charges on deposit accounts maintained at the Banks; (iii) interest on fixed income investments held by the Banks; (iv) fees on trust services provided by those Banks exercising trust powers and (v) securities gains. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs associated with maintaining the Banks' loan and deposit functions; (iv) occupancy expenses for maintaining the Banks' facilities; and (v) FDIC insurance assessments. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company had net income of \$3,126,000, or \$0.33 per share, for the three months ended June 30, 2010, compared to net income of \$2,409,000, or \$0.26 per share, for the three months ended June 30, 2009. Total equity capital as of June 30, 2010 totaled \$118.7 million or 12.8% of total assets.

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The Company's earnings for the second quarter increased \$717,000 from the \$2,409,000 earned a year ago. The higher quarterly earnings can be primarily attributed to lower other real estate owned expenses, lower FDIC insurance assessments and higher net interest income. The decrease in other real estate costs of \$665,000 is due primarily to write downs in 2009, with no significant write downs in 2010. The decrease in the FDIC insurance assessments of \$279,000 is due primarily to lower quarterly deposit assessments. FDIC insurance assessments are expected to negatively impact future operating results if bank failures continue to erode the FDIC insurance fund. Through June 30, 2010, 89 banks have failed compared to 140 bank failures for the year ended December 31, 2009.

Net loan charge-offs for the quarter totaled \$2,000, compared to net charge-offs of \$571,000 in the second quarter of 2009. The provision for loan losses for the second quarter of 2010 totaled \$170,000 compared to the provision for loan losses of \$327,000 for the same period in 2009. This decrease in the provision for loan losses was due primarily to a decrease in outstanding loans, lower net charge offs and improving asset quality.

The Company had net income of \$6,396,000, or \$0.68 per share, for the six months ended June 30, 2010, compared to net income of \$4,850,000, or \$0.51 per share, for the six months ended June 30, 2009.

The Company's earnings for the six months ended June 30, 2010 increased \$1,546,000 from the \$4,850,000 earned a year ago. The higher year-to-date earnings can be primarily attributed to increased securities gains, lower other real estate owned expenses, lower FDIC insurance assessments and higher net interest income. For the six months ended June 30, 2010, securities gains were \$672,000 as compared to securities losses of \$96,000 for the six month ended June 30, 2009. The decrease in other real estate costs of \$1,035,000 is due primarily to write downs in 2009, with no significant write downs in 2010. The decrease in the FDIC insurance assessments of \$446,000 is due primarily to lower quarterly deposit assessments.

Net loan charge-offs for the six months ended June 30, 2010 totaled \$296,000, compared to net charge-offs of \$647,000 for the six months ended June 30, 2009. The provision for loan losses for the six months ended June 30, 2010 totaled \$494,000 compared to the provision for loan losses of \$556,000 for the same period in 2009. This decrease in the provision for loan losses was due primarily to a decrease in outstanding loans, lower net charge offs and improving asset quality.

The following management discussion and analysis will provide a review of important items relating to:

- Challenges
- Key Performance Indicators and Industry Results
- Critical Accounting Policies
- Income Statement Review
- Balance Sheet Review
- Asset Quality and Credit Risk Management
- Liquidity and Capital Resources
- Forward-Looking Statements and Business Risks

Challenges

Management has identified certain challenges that may negatively impact the Company's revenues in the future and is attempting to position the Company to best respond to those challenges.



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- In March of 2009, the OCC imposed individual minimum capital ratios requiring First National to maintain, on an ongoing basis, Tier One Leverage Capital of 9% of Adjusted Total Assets and Total Risk Based Capital of 11% of Risk Weighted Assets. As of June 30, 2010, First National exceeded these capital ratios. Failure to maintain the individual minimum capital ratios could result in additional regulatory action against First National.
- Interest rates are likely to increase as the economy continues its gradual recovery and an increasing interest rate environment may present a challenge to the Company. Increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense may increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.
- The Company's market in central Iowa has numerous banks, credit unions, and investment and insurance companies competing for similar business opportunities. This competitive environment will continue to put downward pressure on the Banks' net interest margins and thus affect profitability. Strategic planning efforts at the Company and Banks continue to focus on capitalizing on the Banks' strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.
- The Company's equity securities portfolio (held at the holding company level and excluding equity holdings by the Banks) is \$3.5 million as of June 30, 2010. The Company invests a portion of its' capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks. The Company has focused on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market. The strategy, however, did not prove successful in 2010 and 2009 as problems due to the national recession caused a significant decline in the market value and dividend rates of the Company's equity securities. Unrealized losses in the Company's equity portfolio totaled \$1,355,000 and \$1,312,000 (at the holding company level on an unconsolidated basis) as of June 30, 2010 and December 31, 2009, respectively. The Company had realized gains of \$3,000 in its equity portfolio during the six months ended June 30, 2010, compared to realized losses of \$55,000 during the six months ended June 30, 2009 (at the holding company level on an unconsolidated basis). Additionally, the Company recognized no impairment losses in the equity portfolio during the six months ended June 30, 2010 and 2009. It is possible that the Company may incur impairment losses in the remainder of 2010 which would have a negative impact on the Company's earnings for the year.
- Loans amounted to \$410.4 million and \$415.4 million as of June 30, 2010 and December 31, 2009, respectively. The loan portfolio decreased 1.2% during the six months ended June 30, 2010. The decline in the loan portfolio is primarily due to the decrease in loan volume due to a weakening of loan demand as payments and prepayments exceeded originations. The declines in the loan portfolio occurred primarily in the commercial real estate and commercial operating loan portfolios, offset in part by increases in one-to-four family real estate, agricultural operating and agricultural real estate loan portfolios.
- The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated in recent years and significantly contributed to the Company's increased level of non-performing loans, other real estate owned and related costs since 2007. The Company has \$8,880,000 in other real estate owned in the Des Moines market. The Company has \$3.4 million in impaired loans with two Des Moines development companies with specific reserves totaling \$338,000. The Company has additional customer relationships with real estate developers in the Des Moines area that may become impaired in the future if economic conditions do not improve or become worse. The Company has a limited number of such credits and is actively engaged with the customers to

minimize credit risk.

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- Other real estate owned amounted to \$10.6 million and \$10.5 million as of June 30, 2010 and December 31, 2009, respectively. Other real estate owned costs amounted to \$119,000 and \$1,155,000 for the six months ended June 30, 2010 and 2009, respectively. Management obtains independent appraisals or performs evaluations to determine that these properties are carried at the lower of the new cost basis or fair value less cost to sell. It is at least reasonably possible that change in fair values will occur in the near term and that such changes could have a negative impact on the Company's earnings.
- The FDIC imposes an assessment against all depository institutions for deposit insurance. Notably, the FDIC has the authority to increase insurance assessments. FDIC insurance assessments amounted to \$591,000 and \$1,037,000 for the six months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010, 89 banks failed as compared 140 bank failures for the year ended December 31, 2009. In 2011, the FDIC has a scheduled assessment increase for all FDIC insured institutions. An increase in FDIC deposit assessments will have a negative impact on the Company's earnings.
- The Company operates in a highly regulated environment and is subject to extensive regulation, supervision and examination. Applicable laws and regulations may change, and there is no assurance that such changes will not adversely affect the Company's business. In this respect potentially landscape-changing legislative proposals have been introduced in Congress and by regulatory agencies with respect to their respective regulatory powers. Such regulation and supervision govern the activities in which an institution may engage and are intended primarily for the protection of the Bank, its depositors and the FDIC. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, or legislation, including but not limited to changes in the regulations governing banks, could have a material impact on the Company's operations. In particular, the Dodd-Frank Wall Street Reform and Consumer Protection Act was recently signed into law by the President. The effect of this new law on the banking industry and on the Company is uncertain at the present time given that many of the changes will be implemented through regulatory rules that have yet to be proposed or adopted.

Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 7,932 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

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## Selected Indicators for the Company and the Industry

	June 30, 2010		March 31, 2010				Year Ended December 31,				
	3 Months Ended	6 Months Ended	3 Months Ended		Industry *		2009		2008		
	Company	Company	Company	Company	Company	Company	Industry	Company	Industry	Company	Industry
Return on average assets	1.35 %	1.39 %	1.43 %	0.54 %	1.02 %	0.09 %	0.74 %	0.12 %			
Return on average equity	10.73 %	11.09 %	11.46 %	4.96 %	8.31 %	0.90 %	5.89 %	1.24 %			
Net interest margin	3.73 %	3.76 %	3.78 %	3.83 %	3.78 %	3.47 %	3.94 %	3.18 %			
Efficiency ratio	51.51 %	50.06 %	48.66 %	54.39 %	63.87 %	55.53 %	67.40 %	59.02 %			
Capital ratio	12.56 %	12.54 %	12.51 %	8.57 %	12.32 %	8.65 %	12.57 %	7.49 %			

\*Latest available data

Key performances indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.35% and 1.08%, respectively, for the three month periods ending June 30, 2010 and 2009. The increase in this ratio in 2010 from the previous period is primarily the result of higher net income, offset in part by an increase in average assets.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was 10.73% and 9.09%, respectively for the three month periods ending June 30, 2010 and 2009. The increase in this ratio in 2010 from the previous period is primarily the result of higher net income, offset in part by an increase in average equity.

- Net Interest Margin

The net interest margin for the three months ended June 30, 2010 and 2009 was 3.73%. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings. Although no change in the net interest margin occurred, higher interest earning assets and lower cost of funds on interest bearing deposits were offset by higher interest bearing liabilities and higher yields on interest earning assets. The lower yields and cost of funds were due primarily to lower market interest rates as interest earning assets

and interest-bearing liabilities are repricing.

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- Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 51.51% and 62.25% for the three months ended June 30, 2010 and 2009, respectively. The improvement in the efficiency ratio in 2010 from the previous period is primarily the result of decreased expenses related to other real estate owned and FDIC insurance assessments.

- Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio is significantly higher than the industry average.

## Industry Results

The FDIC Quarterly Banking Profile reported the following results for the first quarter of 2010:

### Earnings Post Significant Increase

First quarter results for insured commercial banks and savings institutions contained positive signs of recovery for the industry. While new accounting rules had a major effect on several components of the industry's balance sheet and income statement, there was clear improvement in certain performance indicators. Lower provisions for loan losses and reduced expenses for goodwill impairment lifted the earnings of FDIC-insured commercial banks and savings institutions to \$18.0 billion. While still low by historical standards, first quarter earnings represented a significant improvement from the \$5.6 billion the industry earned in first quarter 2009 and are the highest quarterly total since first quarter 2008. The largest year-over-year increases occurred at the biggest banks, but a majority of institutions (52.2%) reported net income growth. This is the highest percentage of institutions reporting increased quarterly earnings in more than three years (since third quarter 2006).

### Reduced Loan-Loss Provisions Help Drive Earnings Improvement

Insured institutions set aside \$51.3 billion in provisions for loan and lease losses in the first quarter, a \$10.2 billion (16.6%) decline from a year earlier. However, only about one-third of insured institutions reported year-over-year declines in loss provisions, with much of the overall reduction concentrated among a few of the largest banks. Another positive factor in the earnings improvement at larger institutions was a \$2.2 billion (2.3%) decline in noninterest expenses that was caused by lower goodwill impairment losses. Total noninterest income was \$6.6 billion (9.7%) lower than a year earlier because of the declines in securitization and servicing income and a \$1.5 billion (15.1%) reduction in trading revenue. The average return on assets (ROA) rose to 0.54%, compared to 0.16% in first quarter 2009. This is the highest quarterly ROA for the industry since first quarter 2008. Almost half of all institutions—48.1%—reported improved ROAs.

### Rise in Average Margin Reflects Impact of New Rules

The sharp increase in net interest income caused by adoption of the new accounting rules significantly boosted the industry's net interest margin (NIM). The average margin increased to a seven-year high of 3.83%, from 3.53% in fourth quarter 2009 and 3.41% in first quarter 2009. Most of the improvement occurred at a few large credit card lenders; only 40.7% of institutions reported higher NIMs compared to the fourth quarter, although 57.8% reported

year-over-year improvement.

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C&I Charge-Offs Decline for First Time in Four Years

Loan losses posted a year-over-year increase for a 13th consecutive quarter. Net charge-offs totaled \$52.4 billion, an increase of \$14.5 billion (38.4%) from a year earlier. Credit cards accounted for almost three quarters (\$10.4 billion) of the growth in charge-offs, reflecting the securitized receivables brought back onto balance sheets by the new accounting rules. Charge-offs were up from a year ago in most major loan categories, although the increases were smaller than in recent quarters. Most non-consumer loan categories were not affected by the new accounting rules. A notable exception to the rising trend was loans to commercial and industrial (C&I) borrowers, where charge-offs fell for the first time since first quarter 2006, declining by \$675 million (10.2%). Net charge-offs of real estate loans secured by nonfarm nonresidential real estate properties increased by \$1.6 billion (155.5%). Charge-offs of residential mortgage loans were \$1.6 billion (22.9%) higher than a year earlier, while charged-off home equity loans rose by \$1.2 billion (29.9%).

Increase in Noncurrent Loans Is Smallest in Three Years

The amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) increased for a 16th consecutive quarter, rising by \$17.4 billion (4.4%) from the level at the end of 2009. This is the smallest quarterly increase in noncurrent loans since third quarter 2007, and all of the increase consisted of loans and leases 90 days or more past due. Loans and leases in nonaccrual status fell for the first time in four years, declining by \$65 million. Noncurrent credit card loans increased during the quarter by \$7.6 billion (51.9%), reflecting the inclusion of securitized credit card receivables. Noncurrent residential mortgage loans rose by \$12.9 billion (7.2%), and noncurrent nonfarm nonresidential real estate loans increased by \$3.7 billion (8.8%). In contrast, noncurrent C&I loans declined by \$5.1 billion (12.2%), and noncurrent real estate construction and development loans fell by \$1.8 billion (2.5%). It was the second consecutive quarterly decline in noncurrent levels for both loan categories.

Internal Capital Generation Turns Positive for First Time in Two Years

Total equity capital increased by \$15.1 billion (1.0%) in the first quarter. The increase would have been larger, but institutions reported almost \$22 billion in reductions in equity capital stemming from the application of FAS 167. More than three-quarters of all institutions (76.6%) increased their equity capital by a combined total of \$30 billion during the quarter, but these increases were partially offset by the accounting related equity declines noted above. Retained earnings were positive for the first time since first quarter 2008, as net income exceeded dividends by \$13.6 billion. Insured institutions paid \$4.4 billion in dividends in the first quarter, down \$2.9 billion (39.4%) from a year earlier.

Securitized Consumer Loans Return to Balance Sheets

The increase in loan balances was mirrored by declines in loans securitized and sold. Securitized credit card receivables declined by \$347.4 billion (95.6%) during the quarter, while securitized other consumer loans fell by \$25.7 billion (80.5%), and securitized home equity lines of credit dropped by \$5.8 billion (97.2%). In all, securitized assets posted a \$403.1 billion (22.2%) decline in the first quarter.



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Secured Borrowings Register Sharp Increase

A substantial amount of short-term secured borrowings accompanied securitized loans onto bank balance sheets in the first quarter. Total deposits fell for the first time in a year, declining by \$28.6 billion (0.3%). Nondeposit liabilities increased by \$262.9 billion (10.9%). Federal Home Loan Bank advances fell for a sixth consecutive quarter, declining by \$52.9 billion (9.9%), while other nondeposit borrowings increased by \$294.3 billion (52.8%).

“Problem List” Continues to Grow

The number of institutions reporting quarterly financial results declined by 80 in the first quarter of 2010, from 8,012 to 7,932. Forty-one FDIC-insured institutions failed during the quarter, while 37 institutions were merged into other charters. Only three new charters were added during the quarter, and all three were charters formed to acquire failed banks. The number of insured commercial banks and savings institutions on the FDIC’s “Problem List” increased from 702 to 775 during the quarter, and total assets of “problem” institutions increased from \$403 billion to \$431 billion.

Critical Accounting Policies

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company’s audited consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company’s significant accounting policies are described in the “Notes to Consolidated Financial Statements” contained in the Company’s Annual Report. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified its most critical accounting policies to be those related to the allowance for loan losses, valuation of other real estate owned and the assessment of other-than-temporary impairment of certain financial instruments.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company’s historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include the general economic environment in the Company’s market area. To the extent actual results differ from forecasts and management’s judgment, the allowance for loan losses may be greater or lesser than future charge-offs. Due to potential changes in conditions, it is at least reasonably possible that change in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company’s financial statements.

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Other Real Estate Owned

Real estate properties acquired through or in lieu of foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Impairment losses are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. The portion of interest costs relating to development of real estate is capitalized. Independent appraisals or evaluations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost basis or fair value less cost to sell. These appraisals or evaluations are inherently subjective and require estimates that are susceptible to significant revisions as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

Other-Than-Temporary Impairment of Investment Securities

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are generally reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the intent to sell the investment securities and the more likely than not requirement that the Company will be required to sell the investment securities prior to recovery (2) the length of time and the extent to which the fair value has been less than cost and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that change in management's assessment of other-than-temporary impairment will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

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## Income Statement Review for the Three Months ended June 30, 2010

The following highlights a comparative discussion of the major components of net income and their impact for the three month periods ended June 30, 2010 and 2009:

## AVERAGE BALANCES AND INTEREST RATES

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

## AVERAGE BALANCE SHEETS AND INTEREST RATES

Three Months ended June 30,

	2010			2009		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>ASSETS</b>						
(dollars in thousands)						
Interest-earning assets						
Loans 1						
Commercial	\$ 69,555	\$ 926	5.32 %	\$ 70,798	\$ 919	5.19 %
Agricultural	42,852	625	5.83 %	34,907	526	6.02 %
Real estate	285,482	4,157	5.82 %	308,549	4,587	5.95 %
Consumer and other	22,981	316	5.50 %	25,121	358	5.70 %
Total loans (including fees)	420,870	6,024	5.73 %	439,375	6,390	5.82 %
Investment securities						
Taxable	236,131	1,771	3.00 %	207,743	2,055	3.96 %
Tax-exempt 2	181,940	2,195	4.83 %	149,303	1,980	5.31 %
Total investment securities	418,071	3,966	3.79 %	357,046	4,036	4.52 %
Interest bearing deposits with banks						
Federal funds sold	35,692	129	1.45 %	25,908	81	1.25 %
	-	-	0.00 %	18,910	8	0.17 %
Total interest-earning assets	874,633	\$ 10,119	4.63 %	841,239	\$ 10,515	4.99 %
Noninterest-earning assets	52,670					