AMES NATIONAL CORP
Form 10-K
March 17, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2007. 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 No.)
405 FIFTH STREET, AMES, IOWA (Address of principal executive offices)	50010 (Zip Code)

(515) 232-6251
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act:

COMMON STOCK, $2.00 PAR VALUE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 definition of "accelerated filer, large accelerated filer, and a smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x 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 x

As of June 30, 2007, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sale price for the registrant's common stock in the NASDAQ Capital Market, was $190,747,798. Shares of common stock beneficially owned by each executive officer and director of the Company and by each person who beneficially owns 5% or more of the outstanding common stock have been excluded on the basis that such persons may be deemed to be an affiliate of the registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

The number of shares outstanding of the registrant's common stock on February 29, 2008, was 9,429,580.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement, as filed with the Securities and Exchange Commission on March 19, 2008, are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

General

Ames National Corporation (the "Company") is an Iowa corporation and bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company owns 100% of the stock of five banking subsidiaries consisting of two national banks and three state-chartered banks, as described below. All of the Company's operations are conducted in the State of Iowa and primarily within the central Iowa counties of Boone, Marshall, Polk and Story where the Company's banking subsidiaries are located. The Company does not engage in any material business activities apart from its ownership of its banking subsidiaries. The principal executive offices of the Company are located at 405 Fifth Street, Ames, Iowa 50010 and its telephone number is (515) 232-6251.

The Company was organized and incorporated on January 21, 1975 under the laws of the State of Iowa to serve as a holding company for its principal banking subsidiary, First National Bank, Ames, Iowa ("First National") located in Ames, Iowa. In 1983, the Company acquired the stock of the State Bank & Trust Co. ("State Bank") located in Nevada, Iowa; in 1991, the Company, through a newly-chartered state bank known as Boone Bank & Trust Co. ("Boone Bank"), acquired certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company located in Boone, Iowa; in 1995, the Company acquired the stock of the Randall-Story State Bank ("Randall-Story Bank") located in Story City, Iowa; and in 2002, the Company chartered and commenced operations of a new national banking organization, United Bank & Trust NA ("United Bank"), located in Marshalltown, Iowa. First National, State Bank, Boone Bank, Randall-Story Bank and United Bank are each operated as a wholly owned subsidiary of the Company. These five financial institutions are referred to in this Form 10-K collectively as the "Banks" and individually as a "Bank".

The principal sources of Company revenue 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 and dividends on equity investments held by the Company and the Banks.

The Banks' lending activities consist primarily of short-term and medium-term commercial and residential real estate loans, agricultural and business operating loans and lines of credit, equipment loans, vehicle loans, personal loans and lines of credit, home improvement loans and secondary mortgage loan origination. The Banks also offer a variety of demand, savings and time deposits, cash management services, merchant credit card processing, safe deposit boxes, wire transfers, direct deposit of payroll and social security checks and automated teller machine access. Four of the five Banks also offer trust services.

The Company provides various services to the Banks which include, but are not limited to, management assistance, internal auditing services, human resources services and administration, compliance management, marketing assistance and coordination, loan review and assistance with respect to computer systems and procedures.

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Banking Subsidiaries

First National Bank, Ames, Iowa. First National is a nationally-chartered, commercial bank insured by the Federal Deposit Insurance Corporation (the “FDIC”). It was organized in 1903 and became a wholly owned subsidiary of the Company in 1975 through a bank holding company reorganization whereby the then shareholders of First National exchanged all of their First National stock for stock in the Company. First National provides full-service banking to businesses and residents within the Ames community and surrounding area. It provides a variety of products and services designed to meet the needs of the market it serves. It has an experienced staff of bank officers including many who have spent the majority of their banking careers with First National and who emphasize long-term customer relationships. First National conducts business out of three full-service offices and one super market location, all located in the city of Ames and a new full-service office built in Ankeny, Iowa that opened in April of 2007.

As of December 31, 2007, First National had capital of $41,394,000 and 95 full-time equivalent employees. Full-time equivalents represent the number of people a business would employ if all its employees were employed on a full-time basis. It is calculated by dividing the total number of hours worked by all full and part-time employees by the number of hours a full-time individual would work for a given period of time. First National had net income of $5,887,000 in 2007, $5,938,000 in 2006 and $6,417,000 in 2005. Total assets as of December 31, 2007, 2006 and 2005 were $466,908,000, $423,517,000 and $413,412,000, respectively.

State Bank & Trust Co., Nevada, Iowa. State Bank is an Iowa, state-chartered, FDIC insured commercial bank. State Bank was acquired by the Company in 1983 through a stock transaction whereby the then shareholders of State Bank exchanged all their State Bank stock for stock in the Company. State Bank was organized in 1939 and provides full-serve banking to businesses and residents within the Nevada area from its main Nevada location and two offices, one in McCallsburg, Iowa and the other in Colo, Iowa. It is strong in agricultural, commercial and residential real estate lending.

As of December 31, 2007, State Bank had capital of $11,689,000 and 23 full-time equivalent employees. It had net income of $1,352,000 in 2007, $1,310,000 in 2006 and $1,401,000 in 2005. Total assets as of December 31, 2007, 2006 and 2005 were $107,585,000, $114,266,000 and $112,626,000, respectively.

Boone Bank & Trust Co., Boone, Iowa. Boone Bank is an Iowa, state-chartered, FDIC insured commercial bank. Boone Bank was organized in 1992 by the Company under a new state charter in connection with a purchase and assumption transaction whereby Boone Bank purchased certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company in exchange for a cash payment. It provides full service banking to businesses and residents within the Boone community and surrounding area. It is actively engaged in agricultural, consumer and commercial lending, including real estate, operating and equipment loans. It conducts business from its main office and a full service branch office, both located in Boone.

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As of December 31, 2007, Boone Bank had capital of $12,541,000 and 26 full-time equivalent employees. It had net income of $1,586,000 in 2007, $1,636,000 in 2006 and $1,849,000 in 2005. Total assets as of December 31, 2007, 2006 and 2005 were $97,574,000, $103,225,000 and $108,780,000, respectively.

Randall-Story State Bank, Story City, Iowa. Randall-Story Bank is an Iowa, state-chartered, FDIC insured commercial bank. Randall-Story Bank was acquired by the Company in 1995 through a stock transaction whereby the then shareholders of Randall-Story Bank exchanged all their Randall-Story Bank stock for stock in the Company. Randall-Story Bank was organized in 1928 and provides full-service banking to Story City and the surrounding area. While its primary emphasis is in agricultural lending, Randall-Story Bank also provides the traditional lending services typically offered by community banks. The bank closed its office in Randall, Iowa in 2006 as the result of the community's declining population base.

As of December 31, 2007, Randall-Story Bank had capital of $8,148,000 and 14 full-time equivalent employees. It had net income of $969,000 in 2007, $902,000 in 2006 and $869,000 in 2005. Total assets as of December 31, 2007, 2006 and 2005 were $72,762,000, $73,777,000 and $70,371,000, respectively.

United Bank & Trust NA, Marshalltown, Iowa. United Bank is a nationally-chartered, commercial bank insured by the FDIC. It was newly chartered in June of 2002 and offers a broad range of deposit and loan products, as well as Internet banking and trust services to customers located in the Marshalltown and surrounding Marshall County area.

As of December 31, 2007, United Bank had capital of $8,588,000 and 22 full-time equivalent employees. United Bank had net income of $104,000 in 2007, a loss of in 2006 of $58,000, and net income in 2005 of $124,000. Total assets as of December 31, 2007, 2006 and 2005 were $106,736,000, $100,511,000 and $94,684,000, respectively.

Business Strategy and Operations

As a locally owned, multi-bank holding company, the Company emphasizes strong personal relationships to provide products and services that meet the needs of the Banks' customers. The Company seeks to achieve growth and maintain a strong return on equity. To accomplish these goals, the Banks focus on small to medium size businesses that traditionally wish to develop an exclusive relationship with a single bank. The Banks, individually and collectively, have the size to give the personal attention required by business owners, in addition to the credit expertise to help businesses meet their goals.

The Banks offer a full range of deposit services that are typically available in most financial institutions, including checking accounts, savings accounts and time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. One major goal in developing the Banks' product mix is to keep the product offerings as simple as possible, both in terms of the number of products and the features and benefits of the individual services. The transaction accounts and time certificates are tailored to each Bank's principal market area at rates competitive in that Bank's market. In addition, retirement accounts such as IRAs (Individual Retirement Accounts) are available. The FDIC insures all deposit accounts up to the maximum amount. The Banks solicit these accounts from small-to-medium sized businesses in their respective primary trade areas, and from individuals who live and/or work within these areas. No material portion of the Banks' deposits has been obtained from a single person or from a few persons. Therefore, the Company does not believe that the loss of the deposits of any person or of a few persons would have an adverse effect on the Banks' operations or erode their deposit base.

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Loans are provided to creditworthy borrowers regardless of their race, color, national origin, religion, sex, age, marital status, disability, receipt of public assistance or any other basis prohibited by law. The Banks intend to fulfill this commitment while maintaining prudent credit standards. In the course of fulfilling this obligation to meet the credit needs of the communities which they serve, the Banks give consideration to each credit application regardless of the fact that the applicant may reside in a low to moderate income neighborhood, and without regard to the geographic location of the residence, property or business within their market areas.

The Banks provide innovative, quality financial products, such as Internet banking and trust services that meet the banking needs of their customers and communities. The loan programs and acceptance of certain loans may vary from time-to-time depending on the funds available and regulations governing the banking industry. The Banks offer all basic types of credit to their local communities and surrounding rural areas, including commercial, agricultural and consumer loans. The types of loans within these categories are as follows:

Commercial Loans. Commercial loans are typically made to sole proprietors, partnerships, corporations and other business entities such as municipalities and individuals where the loan is to be used primarily for business purposes. These loans are typically secured by assets owned by the borrower and often times involve personal guarantees given by the owners of the business. The types of loans the Banks offer include:

- financing guaranteed under Small Business Administration programs
- operating and working capital loans
- loans to finance equipment and other capital purchases
- commercial real estate loans
- business lines of credit
- term loans
- loans to professionals
- letters of credit

Agricultural Loans. The Banks, by nature of their location in central Iowa, are directly and indirectly involved in agriculture and agri-business lending. This includes short-term seasonal lending associated with cyclical crop and livestock production, intermediate term lending for machinery, equipment and breeding stock acquisition and long-term real estate lending. These loans are typically secured by the crops, livestock, equipment or real estate being financed. The basic tenet of the Banks' agricultural lending philosophy is a blending of strong, positive cash flow supported by an adequate collateral position, along with a demonstrated capacity to withstand short-term negative impact if necessary. Applicable governmental subsidies and affiliated programs are utilized if warranted to accomplish these parameters. Approximately 14% of the Banks' loans have been made for agricultural purposes. The Banks have not experienced a material adverse effect on their business as a result of defaults on agricultural loans and do not anticipate at the present time experiencing any such effect in the future.

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Consumer Loans. Consumer loans are typically available to finance home improvements and consumer purchases, such as automobiles, household furnishings, boats and education. These loans are made on both a secured and an unsecured basis. The following types of consumer loans are available:

- automobiles and trucks
- boats and recreational vehicles
- personal loans and lines of credit
- home equity lines of credit
- home improvement and rehabilitation loans
- consumer real estate loans

Other types of credit programs, such as loans to nonprofit organizations, to public entities, for community development and to other governmental offered programs also are available.

First National, Boone Bank, State Bank and United Bank offer trust services typically found in a commercial bank with trust powers, including the administration of estates, conservatorships, personal and corporate trusts and agency accounts. The Banks also provide farm management, investment and custodial services for individuals, businesses and non-profit organizations.

The Banks earn income from the origination of residential mortgages that are sold in the secondary real estate market without retaining the mortgage servicing rights.

The Banks offer traditional banking services, such as safe deposit boxes, wire transfers, direct deposit of payroll and social security checks, automated teller machine access and automatic drafts (ACH) for various accounts.

Credit Management

The Company strives to achieve sound credit risk management. In order to achieve this goal, the Company has established uniform credit policies and underwriting criteria for the Banks' loan portfolios. The Banks diversify in the types of loans offered and are subject to regular credit examinations, annual internal and external loan audits and annual review of large loans, as well as quarterly reviews of loans experiencing deterioration in credit quality. The Company attempts to identify potential problem loans early, charge off loans promptly and maintain an adequate allowance for loan losses. The Company has established credit guidelines for the Banks' lending portfolios which include guidelines relating to the more commonly requested loan types, as follows:

Commercial Real Estate Loans - Commercial real estate loans, including construction and development loans, are normally based on loan to appraisal value ratios of 80% and secured by a first priority lien position. Loans are typically subject to interest rate adjustments no less frequently than 5 years from origination. Fully amortized monthly repayment terms normally do not exceed twenty years. Projections and cash flows that show ability to service debt within the amortization period are required. Property and casualty insurance is required to protect the Banks' collateral interests. Commercial and construction real estate loans represent approximately 41% of the loan portfolio. Major risk factors for commercial real estate loans, as well as the other loan types described below, include a geographic concentration in central Iowa; the dependence of the local economy upon several large governmental entities, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that is dependent on weather conditions and government programs.

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Commercial and Agricultural Operating Lines - These loans are made to businesses and farm operations with terms up to twelve months. The credit needs are generally seasonal with the source of repayment coming from the entity's normal business cycle. Cash flow reviews are completed to establish the ability to service the debt within the terms of the loan. A first priority lien on the general assets of the business normally secures these types of loans. Loan to value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s).

Commercial and Agricultural Term Loans – These loans are made to businesses and farm operations to finance equipment, breeding stock and other capital expenditures. Terms are generally the lesser of five years or the useful life of the asset. Term loans are normally secured by the asset being financed and are often additionally secured with the general assets of the business. Loan to value is generally 75% of the cost or value of the assets. Loans are normally guaranteed by the principal(s). Commercial and agricultural operating and term loans represent approximately 24% of the loan portfolio.

Residential First Mortgage Loans – Proceeds of these loans are used to buy or refinance the purchase of residential real estate with the loan secured by a first lien on the real estate. Most of the residential mortgage loans originated by the Banks (including servicing rights) are sold in the secondary mortgage market due to the higher interest rate risk inherent in the 15 and 30 year fixed rate terms consumers prefer. Loans that are originated and not sold in the secondary market generally have higher interest rates and have rate adjustment periods of no longer than seven years. The maximum amortization of first mortgage residential real estate loans is 30 years. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. Property insurance is required on all loans to protect the Banks' collateral position. Loans secured by one to four family residential properties represent approximately 22% of the loan portfolio.

Home Equity Term Loans – These loans are normally for the purpose of home improvement or other consumer purposes and are secured by a junior mortgage on residential real estate. Loan-to-value ratios normally do not exceed 90% of market value.

Home Equity Lines of Credit - The Banks offer a home equity line of credit with a maximum term of 60 months. These loans are secured by a junior mortgage on the residential real estate and normally do not exceed a loan-to-market value ratio of 90% with the interest adjusted quarterly.

Consumer Loans – Consumer loans are normally made to consumers under the following guidelines. Automobiles - loans on new and used automobiles generally will not exceed 80% and 75% of the value, respectively. Recreational vehicles and boats - 66% of the value. Mobile home - maximum term on these loans is 180 months with the loan-to-value ratio generally not exceeding 66%. Each of these loans is secured by a first priority lien on the assets and requires insurance to protect the Banks' collateral position. Unsecured - The term for unsecured loans generally does not exceed 12 months. Consumer and other loans represent approximately 5% of the loan portfolio.

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Employees

At December 31, 2007, the Banks had a total of 180 full-time equivalent employees and the Company had an additional 12 full-time employees. The Company and Banks provide their employees with a comprehensive program of benefits, including comprehensive medical and dental plans, long-term and short-term disability coverage, and a 401(k) profit sharing plan. Management considers its relations with employees to be satisfactory. Unions represent none of the employees.

Market Area

The Company operates five commercial banks with locations in Story, Boone, Polk and Marshall Counties in central Iowa.

First National is located in Ames, Iowa with a population of 50,731. The major employers are Iowa State University, Ames Laboratories, Iowa Department of Transportation, Mary Greeley Medical Center, National Veterinary Services Laboratory, Ames Community Schools, City of Ames, Barilla, Sauer-Danfoss and McFarland Clinic. First National's primary business includes providing retail banking services and business and consumer lending. First National has a minimum exposure to agricultural lending.

Boone Bank is located in Boone, Iowa with a population of 12,800. Boone is the county seat of Boone County. The major employers are Fareway Stores, Inc., Patterson Dental Supply Co., Union Pacific Railroad, and Communication Data Services. Boone Bank provides lending services to the agriculture, commercial and real estate markets.

State Bank is located in Nevada, Iowa with a population of 6,658. Nevada is the county seat of Story County. The major employers are Print Graphics, General Financial Supply, Central Iowa Printing, Burke Corporation and Almaco. State Bank provides various types of loans with a major agricultural presence. It provides a wide variety of banking services including trust, deposit, ATM, and merchant card processing.

Randall-Story Bank is located in Story City, Iowa with a population of 3,228. The major employers are Bethany Manor, American Packaging, Precision Machine and Record Printing. Located in a major agricultural area, it has a strong presence in this type of lending. As a full service commercial bank it provides a full line of products and services.

United Bank is located in Marshalltown, Iowa with a population of 26,123. The major employers are Swift & Co., Fisher Controls International, Lennox Industries and Marshalltown Medical & Surgical Center. The Bank offers a full line of loan, deposit, and trust services. Loan services include primarily commercial and consumer types of credit including operating lines, equipment loans, automobile financing and real estate loans.

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Competition

The geographic market area served by the Banks is highly competitive with respect to both loans and deposits. The Banks compete principally with other commercial banks, savings and loan associations, credit unions, mortgage companies, finance divisions of auto and farm equipment companies, agricultural suppliers and other financial service providers. Some of these competitors are local, while others are statewide or nationwide. The major commercial bank competitors include F & M Bank, U.S. Bank National Association and Wells Fargo Bank, each of which have a branch office or offices within the Banks' primary trade areas. Among the advantages such larger banks have are their ability to finance extensive advertising campaigns and to allocate their investment assets to geographic regions of higher yield and demand. These larger banking organizations have much higher legal lending limits than the Banks and thus are better able to finance large regional, national and global commercial customers.

In order to compete with the other financial institutions in their primary trade areas, the Banks use, to the fullest extent possible, the flexibility which is accorded by independent status. This includes an emphasis on specialized services, local promotional activity and personal contacts by the Banks' officers, directors and employees. In particular, the Banks compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services. The Banks compete for loans primarily by offering competitive interest rates, experienced lending personnel and quality products and services.

As of December 31, 2007, there were 29 FDIC insured institutions having approximately 70 offices or branch offices within Boone, Story, and Marshall County, Iowa where the Banks' offices are primarily located. First National, State Bank and Randall-Story Bank together have the largest percentage of deposits in Story County and Boone Bank has the highest percentage of deposits in Boone County.

The Banks also compete with the financial markets for funds. Yields on corporate and government debt securities and commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for funds with equity, money market, and insurance products offered by brokerage and insurance companies. This competitive trend will likely continue in the future.

The Company anticipates bank competition will continue to change materially over the next several years as more financial institutions, including the major regional and national banks, continue to consolidate. Credit unions, which are not subject to income taxes, have a significant competitive advantage and provide additional competition in the Company's local markets.

Supervision and Regulation

The following discussion generally refers to certain statutes and regulations affecting the banking industry. These references provide brief summaries and therefore do not purport to be complete and are qualified in their entirety by reference to those statutes and regulations. In addition, due to the numerous statutes and regulations that apply to and regulate the banking industry, many are not referenced below.

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USA Patriot Act. The USA Patriot Act was enacted in 2001 which, together with regulations issued pursuant to this act, substantially broadened previously existing anti-money laundering law and regulation, increased compliance, due diligence and reporting obligations for financial institutions, created new crimes and penalties and required federal banking agencies, in reviewing merger and other acquisition transactions, to consider the effectiveness of the parties in combating money laundering activities. The Act requires all financial institutions to establish certain anti-money laundering compliance and due diligence programs that are reasonably designed to detect and report instances of money laundering. The Company believes its compliance policies, procedures and controls satisfy the material requirements of the Patriot Act and regulations.

Sarbanes-Oxley Act. The Sarbanes-Oxley Act was enacted in 2002 to, among other things, increase corporate responsibility and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the federal securities laws. This act generally applies to all companies that are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The Act implements significant changes in the responsibilities of officers and directors of public companies and makes certain changes to the corporate reporting obligation of those companies and their external auditors. Among the requirements and prohibitions addressed by the act are certifications required by CEOs and CFOs of periodic reports filed with the SEC; accelerated reporting of stock transactions by directors, officers and large shareholders; prohibitions against personal loans from companies to directors and executive officers (except loans made in the ordinary course of business); requirements for public companies' audit committees; requirements for auditor independence; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and executive officers in the 12-month period following initial publication of any financial statements that later require restatement; various increased criminal penalties for violations of securities laws; and the creation of a public company accounting oversight board. Rules adopted by the SEC to implement various provisions of the act include CEO and CFO certifications related to fair presentation of financial statements and financial information in public filings, as well as management's evaluation of disclosure controls and procedures; disclosure of whether any audit committee members qualify as a "financial expert"; disclosures related to audit committee composition and auditor pre-approval policies; disclosure related to adoption of a written code of ethics; reconciling non-GAAP financial information with GAAP in public communications; disclosure of off-balance sheet transactions; and disclosure related to director independence and the director nomination process. The Company has adopted modifications to its corporate governance procedures to comply with the provisions of the act and regulations.

The Company and the Banks are subject to extensive federal and state regulation and supervision. Regulation and supervision of financial institutions is primarily intended to protect depositors and the FDIC rather than shareholders of the Company. The laws and regulations affecting banks and bank holding companies have changed significantly over recent years, particularly with the passage of the Financial Services Modernization Act. There is reason to expect that similar changes will continue in the future. Any change in applicable laws, regulations or regulatory policies may have a material effect on the business, operations and prospects of the Company. The Company is unable to predict the nature or the extent of the effects on its business and earnings that any fiscal or monetary policies or new federal or state legislation may have in the future.

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The Company

The Company is a bank holding company by virtue of its ownership of the Banks, and is registered as such with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), which subjects the Company and the Banks to supervision and examination by the Federal Reserve. Under the BHCA, the Company files with the Federal Reserve annual reports of its operations and such additional information as the Federal Reserve may require.

Source of Strength to the Banks. The Federal Reserve takes the position that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve's position that in serving as a source of strength to its subsidiary banks, bank holding companies should use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. It should also maintain the financial flexibility and capital raising capacity to obtain additional resources for providing assistance to its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both.

Federal Reserve Approval. Bank holding companies must obtain the approval of the Federal Reserve before they: (i) acquire direct or indirect ownership or control of any voting stock of any bank if, after such acquisition, they would own or control, directly or indirectly, more than 5% of the voting stock of such bank; (ii) merge or consolidate with another bank holding company; or (iii) acquire substantially all of the assets of any additional banks.

Non-Banking Activities. With certain exceptions, the BHCA also prohibits bank holding companies from acquiring direct or indirect ownership or control of voting stock in any company other than a bank or a bank holding company unless the Federal Reserve finds the company's business to be incidental to the business of banking. When making this determination, the Federal Reserve in part considers whether allowing a bank holding company to engage in those activities would offer advantages to the public that would outweigh possible adverse effects. A bank holding company may engage in permissible non-banking activities on a de novo basis, if the holding company meets certain criteria and notifies the Federal Reserve within ten (10) business days after the activity has commenced.

Under the Financial Services Modernization Act, eligible bank holding companies may elect (with the approval of the Federal Reserve) to become a "financial holding company." Financial holding companies are permitted to engage in certain financial activities through affiliates that had previously been prohibited activities for bank holding companies. Such financial activities include securities and insurance underwriting and merchant banking. At this time, the Company has not elected to become a financial holding company, but may choose to do so at some time in the future.

Control Transactions. The Change in Bank Control Act of 1978, as amended, requires a person or group of persons acquiring "control" of a bank holding company to provide the Federal Reserve with at least 60 days prior written notice of the proposed acquisition. Following receipt of this notice, the Federal Reserve has 60 days to issue a notice disapproving the proposed acquisition, but the Federal Reserve may extend this time period for up to another 30 days. An acquisition may be completed before the disapproval period expires if the Federal Reserve issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, would constitute the acquisition of control. In addition, any "company" would be required to obtain the approval of the Federal Reserve under the BHCA before acquiring 25% (or 5% if the "company" is a bank holding company) or more of the outstanding shares of the Company, or otherwise obtain control over the Company.

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Affiliate Transactions. The Company and the Banks are deemed affiliates within the meaning of the Federal Reserve Act, and transactions between affiliates are subject to certain restrictions. Generally, the Federal Reserve Act: (i) limits the extent to which the financial institution or its subsidiaries may engage in "covered transactions" with an affiliate; and (ii) requires all transactions with an affiliate, whether or not "covered transactions," to be on terms substantially the same, or at least as favorable to the institution or subsidiary, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar transactions.

State Law on Acquisitions. Iowa law permits bank holding companies to make acquisitions throughout the state. However, Iowa currently has a deposit concentration limit of 15% on the amount of deposits in the state that any one banking organization can control and continue to acquire banks or bank deposits (by acquisitions), which applies to all depository institutions doing business in Iowa.

Banking Subsidiaries

Applicable federal and state statutes and regulations governing a bank's operations relate, among other matters, to capital adequacy requirements, required reserves against deposits, investments, loans, legal lending limits, certain interest rates payable, mergers and consolidations, borrowings, issuance of securities, payment of dividends, establishment of branches and dealings with affiliated persons.

First National and United Bank are national banks subject to primary federal regulation and supervision by the Office of the Comptroller of the Currency (the "OCC"). The FDIC, as an insurer of the deposits, also has some limited regulatory authority over First National and United Bank. State Bank, Boone Bank and Randall-Story Bank are state banks subject to regulation and supervision by the Iowa Division of Banking. The three state Banks are also subject to regulation and examination by the FDIC, which insures their respective deposits to the maximum extent permitted by law. The federal laws that apply to the Banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for loans. The laws and regulations governing the Banks generally have been promulgated to protect depositors and the deposit insurance fund of the FDIC and not to protect stockholders of such institutions or their holding companies.

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The OCC and FDIC each has authority to prohibit banks under their supervision from engaging in what it considers to be an unsafe and unsound practice in conducting their business. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires federal banking regulators to adopt regulations or guidelines in a number of areas to ensure bank safety and soundness, including internal controls, credit underwriting, asset growth, management compensation, ratios of classified assets to capital and earnings. FDICIA also contains provisions which are intended to change independent auditing requirements, restrict the activities of state-chartered insured banks, amend various consumer banking laws, limit the ability of "undercapitalized banks" to borrow from the Federal Reserve's discount window, require regulators to perform periodic on-site bank examinations and set standards for real estate lending.

Borrowing Limitations. Each of the Banks is subject to limitations on the aggregate amount of loans that it can make to any one borrower, including related entities. Subject to numerous exceptions based on the type of loans and collateral, applicable statutes and regulations generally limit loans to one borrower of 15% of total equity and reserves. Each of the Banks is in compliance with applicable loans to one borrower requirements.

FDIC Insurance. Generally, customer deposit accounts in banks are insured by the FDIC for up to a maximum amount of $100,000 for single accounts, $250,000 for self-directed retirement accounts, $100,000 for joint accounts, and $100,000 for qualifying revocable trust accounts. The FDIC has adopted a risk-based insurance assessment system under which depository institutions contribute funds to the FDIC insurance fund based on their risk classification. The FDIC may terminate the deposit insurance of any insured depository institution if it determines after an administrative hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law.

Capital Adequacy Requirements. The Federal Reserve, the FDIC and the OCC (collectively, the "Agencies") have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and account for off-balance sheet items. Failure to achieve and maintain adequate capital levels may give rise to supervisory action through the issuance of a capital directive to ensure the maintenance of required capital levels. Each of the Banks is in compliance with applicable capital level requirements.

The current guidelines require all federally regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders' equity, qualifying perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles and the allowance for loan and lease losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term preferred stock, 45% of unrealized gain of equity securities and general reserve for loan and lease losses up to 1.25% of risk weighted assets. None of the Banks has received any notice indicating that it will be subject to higher capital requirements.

Under these guidelines, banks' assets are given risk weights of 0%, 20%, 50% or 100%. Most loans are assigned to the 100% risk category, except for first mortgage loans fully secured by residential property and, under certain circumstances, residential construction loans (both carry a 50% rating). Most investment securities are assigned to the 20% category, except for municipal or state revenue bonds (which have a 50% rating) and direct obligations of or obligations guaranteed by the United States Treasury or United States Government Agencies (which have a 0% rating).

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The Agencies have also implemented a leverage ratio, which is equal to Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk based guidelines. The principal objective of the leverage ratio is to limit the maximum degree to which a bank may leverage its equity capital base. The minimum required leverage ratio for top rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points. Any institution operating at or near the 3% level is expected to be a strong banking organization without any supervisory, financial or operational weaknesses or deficiencies. Any institutions experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

Prompt Corrective Action. Regulations adopted by the Agencies impose even more stringent capital requirements. The FDIC and other Agencies must take certain "prompt corrective action" when a bank fails to meet capital requirements. The regulations establish and define five capital levels: (i) "well-capitalized," (ii) "adequately capitalized," (iii) "undercapitalized," (iv) "significantly undercapitalized" and (v) "critically undercapitalized." Increasingly severe restrictions are imposed on the payment of dividends and management fees, asset growth and other aspects of the operations of institutions that fall below the category of being "adequately capitalized". Undercapitalized institutions are required to develop and implement capital plans acceptable to the appropriate federal regulatory agency. Such plans must require that any company that controls the undercapitalized institution must provide certain guarantees that the institution will comply with the plan until it is adequately capitalized. As of February 28, 2008, neither the Company nor any of the Banks were subject to any regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure. Furthermore, as of that same date, each of the Banks was categorized as “well capitalized” under regulatory prompt corrective action provisions.

Restrictions on Dividends. Dividends paid to the Company by the Banks is the major source of Company cash flow. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National Bank, as a national bank, generally may pay dividends, without obtaining the express approval of the Office of the Comptroller of the Currency, in amount up to its retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Randall-Story Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

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Reserves Against Deposits. The Federal Reserve requires all depository institutions to maintain reserves against their transaction accounts (primarily checking accounts) and non-personal time deposits. Generally, reserves of 3% must be maintained against total transaction accounts of $45,800,000 or less (subject to an exemption not in excess of the first $8,500,000 of transaction accounts). A reserve of $1,374,000 plus 10% of amounts in excess of $45,800,000 must be maintained in the event total transaction accounts exceed $45,800,000. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy applicable liquidity requirements. Because required reserves must be maintained in the form of vault cash or a noninterest bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce the earning assets of the Banks.

Regulatory Enforcement Authority

The enforcement powers available to federal and state banking regulators are substantial and include, among other things, the ability to assess civil monetary penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, enforcement actions must be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions, or inactions, may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Applicable law also requires public disclosure of final enforcement actions by the federal banking agencies.

National Monetary Policies

In addition to being affected by general economic conditions, the earnings and growth of the Banks are affected by the regulatory authorities' policies, including the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply, credit conditions and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government securities, changes in reserve requirements against bank deposits and the Federal Reserve Discount Rate, which is the rate charged member banks to borrow from the Federal Reserve Bank. These instruments are used in varying combinations to influence overall growth and distribution of credit, bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid on deposits.

The monetary policies of the Federal Reserve have had a material impact on the operating results of commercial banks in the past and are expected to have a similar impact in the future. Also important in terms of effect on banks are controls on interest rates paid by banks on deposits and types of deposits that may be offered by banks. The Depository Institutions Deregulation Committee, created by Congress in 1980, phased out ceilings on the rate of interest that may be paid on deposits by commercial banks and savings and loan associations, with the result that the differentials between the maximum rates banks and savings and loans can pay on deposit accounts have been eliminated. The effect of deregulation of deposit interest rates has been to increase banks' cost of funds and to make banks more sensitive to fluctuation in market rates.

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Availability of Information on Company Website

The Company files periodic reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The Company makes available on or through its website free of charge all periodic reports filed by the Company with the SEC, including any amendments to such reports, as soon as reasonably practicable after such reports have been electronically filed with the SEC. The address of the Company's website on the Internet is: www.amesnational.com.

The Company will provide a paper copy of these reports free of charge upon written or telephonic request directed to John P. Nelson, Vice President and Secretary, 405 Fifth Street, Ames, Iowa 50010 or (515) 232-6251 or by email request at info@amesnational.com. The information found on the Company's website is not part of this or any other report the Company files with the SEC.

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Executive Officers of Company and Banks

The following table sets forth summary information about the executive officers of the Company and certain executive officers of the Banks. Unless otherwise indicated, each executive officer has served in his current position for the past five years.

Name	Age	Position with the Company or Bank and Principal Occupation and Employment During the Past Five Years
Scott T. Bauer	45	Named President of First National Bank in 2007. Previously served as Executive Vice President and Senior Vice President of First National Bank.
Kevin G. Deardorff	53	Vice President & Technology Director of the Company.
Leo E. Herrick	66	President of United Bank commencing June, 2002. Previously, employed as Chairman of the Board and President of F&M Bank-Iowa, Marshalltown, Iowa.
Daniel L. Krieger	71	Chairman of the Company since 2003 and President of Company from 1997 to 2007. Previously served as President of First National. Also serves as a Director of the Company, Chairman of the Board and Trust Officer of First National and Chairman of the Board of Boone Bank and United Bank.
Stephen C. McGill	53	President of State Bank since 2003. Previously served as Senior Vice President of State Bank. Director of State Bank & Trust Co.
John P. Nelson	41	Vice President, Secretary and Treasurer of Company. Also serves as Director of Randall-Story Bank.
Thomas H. Pohlman	57	Named President of the Company in 2007. Previously served as Chief Operating Officer of the Company in 2006 and President of First National from 1999 to 2007. Director of the Company and First National Bank & State Bank & Trust Co,
Jeffrey K. Putzier	46	President of Boone Bank since 1999. Director of Boone Bank & Trust Co.
Harold E. Thompson	62	President of Randall Story Bank since 2003. Previously served as Executive Vice President of Randall-Story State Bank. Director of Randall-Story State Bank.
Terrill L. Wycoff	64	Executive Vice President of First National since 2000. Director of First National Bank.

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ITEM 1A. RISK FACTORS

Set forth below is a description of risk factors related to the Company's business, provided to enable investors to assess, and be appropriately apprised of, certain risks and uncertainties the Company faces in conducting its business. An investor should carefully consider the risks described below and elsewhere in this Report, which could materially and adversely affect the Company's business, results of operations or financial condition. The risks and uncertainties discussed below are also applicable to forward-looking statements contained in this Report and in other reports filed by the Company with the Securities and Exchange Commission. Given these risks and uncertainties, investors are cautioned not to place undue reliance on forward-looking statements.

General Business, Economic and Political Conditions.

The Company's earnings are affected by general business, economic and political conditions. For example, a depressed economic environment increases the likelihood of lower employment levels and recession, which could adversely affect Company earnings. General business and economic conditions that could affect the Company include short-term and long-term interest rates, inflation, fluctuations in both debt and equity capital markets and the strength of the national and local economies in which the Company operates. Political conditions can also affect the Company's earnings through the introduction of new regulatory schemes and changes in tax laws.

Rising Interest Rates

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 its deposits and other borrowings). Therefore, in a rising interest rate environment, interest expense will 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.

Concentration of Operations

The Company's operations are concentrated in central Iowa. As a result of this geographic concentration, the Company's results may correlate to the economic conditions in this area. Deterioration in economic conditions, particularly in the industries on which this area depends (including agriculture which, in turn, is dependent upon weather conditions and government support programs), may adversely affect the quality of the Company's loan portfolio and the demand for the Company's products and services, and accordingly, its results of operations.

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Risks Associated with Loans

A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Company has underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying the Company's loan portfolio. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect results of operations.

Competition with Larger Financial Institutions

The banking and financial services business in the Company's market area continues to be a competitive field and is becoming more competitive as a result of:

- changes in regulations;
- changes in technology and product delivery systems; and
- the accelerating pace of consolidation among financial services providers.

It may be difficult to compete effectively in the Company's market, and results of operations could be adversely affected by the nature or pace of change in competition. The Company competes for loans, deposits and customers with various bank and non-bank financial services providers, many of which are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services.

Trading Volume

The trading volume in the Company's common stock on the Nasdaq Capital Market is relatively limited compared to those of larger companies listed on the Nasdaq Capital Market, the Nasdaq Global Markets, the New York Stock Exchange or other consolidated reporting systems or stock exchanges. A change in the supply or demand for the Company's common stock may have a more significant impact on the price of the Company's stock than for more actively traded companies.

Technological Advances

The financial services industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. The Company's future success will depend, in part, on its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in the Company's operations. Many of our competitors have substantially greater resources than the Company to invest in technological improvements.

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Government Regulations

Current and future legislation and the policies established by federal and state regulatory authorities will affect the Company's operations. The Company and its Banks are subject to extensive supervision of, and examination by, federal and state regulatory authorities which may limit the Company's growth and the return to our shareholders by restricting certain activities, such as:

- the payment of dividends to the Company's shareholders;
- the payment of dividends to the Company from the Banks;
- possible mergers with or acquisitions of or by other institutions;
- investment policies;
- loans and interest rates on loans;
- interest rates paid on deposits;
- expansion of branch offices; and/or
- the possibility to provide or expand securities or trust services.

The Company cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any changes may have on future business and earnings prospects. The cost of compliance with regulatory requirements may adversely affect the Company's net income.

Equity Prices

A substandard performance in the Company's equity portfolio could lead to a reduction in the historical level of realized security gains, thereby negatively impacting the Company's earnings. The Company invests capital that may be utilized for future expansion in a portfolio of primarily financial stocks with an estimated fair market value of approximately $10 million as of December 31, 2007. The Company focuses on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company has not received any written comments from the staff of the SEC regarding its periodic or current reports filed in 2007 under the Exchange Act.

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ITEM 2. PROPERTIES

The Company's office is housed in the main office of First National located at 405 Fifth Street, Ames, Iowa and occupies approximately 3,357 square feet. A lease agreement between the Company and First National provides the Company will make available for use by First National an equal amount of interior space at the Company's building located at 2330 Lincoln Way in lieu of rental payments. The main office is owned by First National consists of approximately 45,000 square feet and includes a drive-through banking facility. In addition to its main office, First National conducts its business through two full-service offices, the University office and the North Grand office, and one super-market location, the Cub Food office. A new full-service office opened in April of 2007 in Ankeny, Iowa and occupies approximately 14,000 square feet. The University office is located in a 16,000 square foot multi-tenant property owned by the Company. A 24-year lease agreement with the Company has been modified in 2002 to provide that an equal amount of interior space will be made available to the Company at First National's main office at 405 Fifth Street in lieu of rental payments. First National will continue to rent the drive-up facilities of approximately 1,850 square feet at this location for $1,200 per month. The Cub Foods office is leased by First National under a 20 year lease with a five year initial term and three, five year renewal options. The current annual rental payment is $21,000. All of the properties owned by the Company and First National are free of any mortgages.

State Bank conducts its business from its main office located at 1025 Sixth Street, Nevada, Iowa and from two additional full-service offices located in McCallsburg and Colo, Iowa. All of these properties are owned by State Bank free of any mortgage.

Boone Bank conducts its business from its main office located at 716 Eighth Street, Boone, Iowa and from one additional full-service office also located in Boone, Iowa. All properties are owned by Boone Bank free of any mortgage.

Randall-Story Bank conducts its business from its main office located at 606 Broad Street, Story City, Iowa which is owned by Randall-Story Bank free of any mortgage.

United Bank conducts its business from its main office located at 2101 South Center Street, Marshalltown, Iowa. The 5,200 square foot premise was constructed in 2002. In 2005, United Bank purchased an office location at 29 S. Center Street in Marshalltown that is 1,972 square feet. In 2007, United Bank purchased a commercial building located at 10 Westwood Drive, in Marshalltown that is 2,304 square feet for future expansion. All properties are owned by United Bank free of any mortgage.

The property the Company owns is located at 2330 Lincoln Way, Ames, Iowa consisting of a multi tenant building of approximately 16,000 square feet. First National leases 5,422 square feet of this building to serve as its University Office. 4,131 square feet of the remaining space is currently leased to five tenants who occupy the space for business purposes; the remaining 3,536 square feet of rentable space is currently unoccupied. The Company owns a real estate property adjacent to 2330 Lincoln Way at 2318 Lincoln Way which consists of a single story commercial building with 2,400 square feet of leased space that is currently leased by one tenant for business purposes.

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ITEM 3. LEGAL PROCEEDINGS

The Banks are from time to time parties to various legal actions arising in the normal course of business. The Company believes that there is no threatened or pending proceeding against the Company or the Banks, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company or the Banks.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

There were no matters submitted to a vote of the shareholders of the Company during the fourth quarter of 2007.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

On February 29, 2008, the Company had approximately 561 shareholders of record and an estimated 946 additional beneficial owners whose shares were held in nominee titles through brokerage or other accounts. The Company's common stock is traded on the NASDAQ Capital Market under the symbol "ATLO". Trading in the Company's common stock is, however, relatively limited.

Based on information provided to and gathered by the Company on an informal basis, the Company believes that the high and low sales price for the common stock on a per share basis during the last two years is as follows:

	2007			2006	
	Market Price			Market Price	
Quarter	High	Low	Quarter	High	Low
1st	$ 22.44	$ 20.56	1st	$ 28.57	$ 22.85
2nd	$ 23.19	$ 21.00	2nd	$ 26.00	$ 19.75
3rd	$ 21.70	$ 19.06	3rd	$ 22.75	$ 21.41
4th	$ 21.75	$ 17.64	4th	$ 22.69	$ 19.82

The Company declared aggregate annual cash dividends in 2007 and 2006 of $10,183,000 and $9,801,000, respectively, or $1.08 per share in 2007 and $1.04 per share in 2006. In February 2008, the Company declared an aggregate cash dividend of $2,640,000 or $.28 per share. Quarterly dividends declared during the last two years were as follows:

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	2007	2006
Quarter	Cash dividends declared per share	Cash dividends declared per share
1st	$ 0.27	$ 0.26
2nd	0.27	0.26
3rd	0.27	0.26
4th	0.27	0.26

The decision to declare any such cash dividends in the future and the amount thereof rests within the discretion of the Board of Directors of the Company and will be subject to, among other things, the future earnings, capital requirements and financial condition of the Company and certain regulatory restrictions imposed on the payment of dividends by the Banks. Such restrictions are discussed in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources and in Note 11 of the Company's financial statements included herein.

The Board of Directors of the Company approved a stock repurchase program on November 14, 2007. The Company has a strong capital position and this program provides an opportunity to repurchase Company stock on the open market when it is deemed to be favorably priced for repurchase. The program authorizes the repurchase of up to 100,000 shares during the calendar year 2008, or approximately 1% of 9,429,580 shares of common stock presently outstanding. The repurchases will be made in open market transactions at the discretion of management using Company cash. The timing and actual number of shares purchased will depend on a variety of factors such as price, the Company's liquidity position and other market conditions. The program may be limited or discontinued at any time without notice. The Company did not repurchase any shares in 2007.

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The following performance graph provides information regarding cumulative, five-year total return on an indexed basis of the Company's Common Stock as compared with the NASDAQ Composite Index, the SNL Midwest OTC Bulletin Board Bank Index (“Midwest OTC Bank Index”) and the SNL NASDAQ Bank Index prepared by SNL Financial L.C. of Charlottesville, Virginia. The Midwest OTC Bank Index reflects the performance of 140 bank holding companies operating principally in the Midwest as selected by SNL Financial. The SNL NASDAQ Bank Index is comprised of 363 bank and bank holding companies listed on the NASDAQ market throughout the United States. The indexes assume the investment of $100 on December 31, 2002 in the Common Stock, the NASDAQ Composite Index, Midwest OTC Bank Index and the NASDAQ Bank Index with all dividends reinvested. The Company’s stock price performance shown in the following graph is not indicative of future stock price performance.

	Period Ending					
Index	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
Ames National Corporation	100.00	129.84	186.07	183.66	157.00	153.47
NASDAQ Composite	100.00	150.01	162.89	165.13	180.85	198.60
SNL NASDAQ Bank	100.00	129.08	147.94	143.43	161.02	126.42
Midwest OTC Bank Index	100.00	126.23	150.40	156.59	164.90	160.97

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ITEM 6. SELECTED FINANCIAL DATA

The following financial data of the Company for the five years ended December 31, 2003 through 2007 is derived from the Company's historical audited financial statements and related footnotes. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and the consolidated financial statements and related notes contained elsewhere in this Annual Report.

	Year Ended December 31				
(dollars in thousands, except per share amounts)	2007	2006	2005	2004	2003
STATEMENT OF INCOME DATA					
Interest income	$ 47,562	$ 44,296	$ 41,306	$ 37,354	$ 35,314
Interest expense	23,537	21,306	15,933	10,564	10,339
Net interest income	24,025	22,990	25,373	26,790	24,975
Provision (credit) for loan losses	(94)	(183)	331	479	645
Net interest income after provision (credit) for loan losses	24,119	23,173	25,042	26,311	24,330
Noninterest income	7,208	6,674	5,613	5,269	6,435
Noninterest expense	16,776	15,504	15,210	14,935	14,819
Income before provision for income tax	14,551	14,343	15,445	16,645	15,946
Provision for income tax	3,542	3,399	3,836	4,255	4,321
Net Income	$ 11,009	$ 10,944	$ 11,609	$ 12,390	$ 11,625

	2007	2006	2005	2004	2003
DIVIDENDS AND EARNINGS PER SHARE DATA					
Cash dividends declared	$ 10,183	$ 9,801	$ 9,417	$ 7,590	$ 7,142
Cash dividends declared per share	$ 1.08	$ 1.04	$ 1.00	$ 0.81	$ 0.76
Basic and diluted earnings per share	$ 1.17	$ 1.16	$ 1.23	$ 1.32	$ 1.24
Weighted average shares outstanding	9,427,503	9,422,402	9,415,599	9,405,705	9,393,672
BALANCE SHEET DATA					
Total assets	$ 861,591	$ 838,853	$ 819,384	$ 839,753	$ 752,786
Net loans	463,651	429,123	440,318	411,639	355,533
Deposits	690,119	680,356	668,342	658,176	619,549
Stockholders' equity	110,021	112,923	109,227	110,924	107,325
Equity to assets ratio	12.77%	13.46%	13.33%	13.21%	14.26%
FIVE YEAR FINANCIAL PERFORMANCE					
Net income	$ 11,009	$ 10,944	$ 11,609	$ 12,390	$ 11,625
Average assets	843,788	818,450	831,198	793,076	726,945
Average stockholders' equity	111,371	109,508	109,802	108,004	104,141
Return on assets (net income divided by average assets)	1.30%	1.34%	1.40%	1.56%	1.60%
Return on equity (net income divided by average equity)	9.89%	9.99%	10.57%	11.47%	11.16%
	3.39%	3.29%	3.56%	3.97%	4.02%

Net interest margin (net interest income divided by average earning assets)					
Efficiency ratio (noninterest expense divided by noninterest income plus net interest income)	53.71%	52.27%	49.09%	46.59%	47.18%
Dividend payout ratio (dividends per share divided by net income per share)	92.31%	89.66%	81.30%	61.27%	61.46%
Dividend yield (dividends per share divided by closing year-end market price)	5.54%	4.95%	3.89%	3.01%	3.91%
Equity to assets ratio (average equity divided by average assets)	13.20%	13.38%	13.21%	13.62%	14.33%

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ITEM 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Ames National Corporation (Company) is a bank holding company established in 1975 that owns and operates five bank subsidiaries (Banks) in central Iowa. The following discussion is provided for the consolidated operations of the Company and its Banks, First National, State Bank, Boone Bank, Randall-Story Bank and 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 and managing its own bond and equity portfolio. 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 twelve individuals to assist with financial reporting, human resources, marketing, audit, compliance, technology systems and the coordination of management activities, in addition to 180 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 prompt response times and 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 improve profitability while enabling the Company to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cashflow 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 and dividends on equity investments held by the Company and the Banks. 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; and (iv) occupancy expenses for maintaining the Banks' facilities. 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 deposit accounts 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 reported net income of $11,009,000 for the year ended December 31, 2007 compared to $10,944,000 and $11,609,000 reported for the years ended December 31, 2006 and 2005, respectively. This represents a increase of 0.6% when comparing 2007 to 2006 with net interest income improving 4% but nearly offset by higher non-interest expense associated with opening the Ankeny office of First National. The decline in net income in 2006 from 2005 of 6% was primarily the result of lower net interest income which, in turn, resulted from higher market interest rates that caused deposit interest expense to increase more quickly than interest income on earning assets. Earnings per share for 2007 were $1.17 compared to $1.16 in 2006 and $1.23 in 2005. All of the Company's five Banks had profitable operations during 2007.

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The Company's return on average equity for 2007 was 9.89% compared to 9.99% and 10.57% in 2006 and 2005, respectively, and the return on average assets for 2007 was 1.30% compared to 1.34% in 2006 and 1.40% in 2005. A higher level of average equity and average assets in 2007 compared to 2006 caused both the return on average equity and return on average assets to decline in 2007 compared to the previous year. Lower net interest income was the primary contributor to the lower the return on average equity and return on average assets in 2006 compared to 2005.

The following discussion will provide a summary review of important items relating to:

- Challenges
- Key Performance Indicators
- Industry Results
- Income Statement Review
- Balance Sheet Review
- Asset Quality Review and Credit Risk Management
- Liquidity and Capital Resources
- Interest Rate Risk
- Inflation
- Forward-Looking Statements

Challenges

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

- Banks have historically earned higher levels of net interest income by investing in longer term loans and securities at higher yields and paying lower deposit expense rates on shorter maturity deposits. However, the difference between the yields on short term and long term investments was very low for much of 2006 and 2007, making it more difficult to manage net interest margins. If the yield curve was to flatten or invert in 2008, the Company's net interest margin may compress and net interest income may be negatively impacted. Historically, management has been able to position the Company's assets and liabilities to earn a satisfactory net interest margin during periods when the yield curve is flat or inverted by appropriately managing credit spreads on loans and maintaining adequate liquidity to provide flexibility in an effort to hold down funding costs. Management would seek to follow a similar approach in dealing with this challenge in 2008.

- While interest rates declined in the latter part of 2007 and may continue to decline during 2008, interest rates may eventually increase and 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 will 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.

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- 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.

- A substandard performance in the Company's equity portfolio could lead to a reduction in the historical level of realized security gains, thereby negatively impacting the Company's earnings. The Company invests capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks with an estimated fair market value of approximately $10 million as of December 31, 2007. The Company focuses on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market. However, this strategy did not prove successful in 2007 as problems in the residential mortgage industry caused a significant decline in the market value of the Company's financial stocks. The Company had $9 million in money market account balances (at the holding company level on an unconsolidated basis) as of December 31, 2007 as a result of fourth quarter 2007 stock sales to divest of several stocks in the portfolio. Those proceeds will be reinvested in 2008 as suitable investments are identified. Unrealized gains in the Company's equity portfolio totaled $3.3 million as of December 31, 2007 after recognizing realized gains of $1.4 in the portfolio during the year. This compares to unrealized gains of $9.5 million (at the holding company level on an unconsolidated basis) as of December 31, 2006 after recognizing realized gains of $1.1 million during 2006.

- The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated in 2007 and contributed to the Company's increased level of non-performing loans. Presently, the Company has $2.6 million in impaired loans with two Des Moines development companies with specific reserves totaling $89,000; however, $402,000 was charged-off in the fourth quarter of 2007 relating to one of these borrowers. 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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Key Performance Indicators

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 8,533 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.

Selected Indicators for the Company and the Industry

	Year Ended December 31,					
	2007		2006		2005	
	Company	Industry	Company	Industry	Company	Industry
Return on assets	1.30%	0.86%	1.34%	1.28%	1.40%	1.28%
Return on equity	9.89%	8.17%	9.99%	12.34%	10.57%	12.46%
Net interest margin	3.39%	3.29%	3.29%	3.31%	3.56%	3.49%
Efficiency ratio	53.71%	59.37%	52.27%	56.79%	49.09%	57.24%
Capital ratio	13.20%	7.98%	13.38%	8.23%	13.21%	8.25%

Key performance 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 return on assets ratio is in line with that of the industry; however, this ratio has declined in 2007 as compared to 2006 and 2005 as the result of a higher level of 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 equity ratio is below that of the industry primarily as a result the higher level of capital the Company maintains for future growth and acquisitions.

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- Net Interest Margin

This ratio is calculated by dividing net interest income by average earning assets. Earning assets consist primarily 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 deposit accounts and other borrowings. The Company's net interest margin is in line with peer bank averages and has improved since 2006 as a result of higher volume and yields on loans and investments.

- 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 compares favorably to the industry average but is higher than in 2006 primarily as a result of the initial non-interest expenses incurred by the opening of First National's Ankeny office.

- Capital Ratio

The 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 fourth quarter of 2007:

Quarterly Net Income Declines to a 16-Year Low

Record-high loan-loss provisions, record losses in trading activities and goodwill impairment expenses combined to dramatically reduce earnings at a number of FDIC-insured institutions in the fourth quarter of 2007. Fourth-quarter net income of $5.8 billion was the lowest amount reported by the industry since the fourth quarter of 1991, when earnings totaled $3.2 billion. It was $29.4 billion (83.5%) less than insured institutions earned in the fourth quarter of 2006. The average return on assets (ROA) in the quarter was 0.18%, down from 1.20% a year earlier. This is the lowest quarterly ROA since the fourth quarter of 1990, when it was a negative 0.19%. Insured institutions set aside a record $31.3 billion in provisions for loan losses in the fourth quarter, more than three times the $9.8 billion they set aside in the fourth quarter of 2006. Trading losses totaled $10.6 billion, marking the first time that the industry has posted a quarterly net trading loss. In the fourth quarter of 2006, the industry had trading revenue of $4.0 billion. Expenses for goodwill and other intangibles totaled $7.4 billion, compared to $1.6 billion a year earlier. Against these negative factors, net interest income remained one of the few positive elements in industry performance. Net interest income for the fourth quarter totaled $92.0 billion, an 11.8-percent ($9.7-billion) year-over-year increase.

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Net Charge-Off Rate Rises to Five-Year High

Net charge-offs registered a sharp increase in the fourth quarter, rising to $16.2 billion, compared to $8.5 billion in the fourth quarter of 2006. The annualized net charge-off rate in the fourth quarter was 0.83%, the highest since the fourth quarter of 2002. Net charge-offs were up year-over-year in all major loan categories except loans to the farm sector (agricultural production loans and real estate loans secured by farmland). Net charge-offs of loans to commercial and industrial (C&I) borrowers were $1.6 billion (104.5%) higher than in the fourth quarter of 2006. Net charge-offs of residential mortgage loans were up by $1.3 billion (144.2%), and charge-offs of home equity lines of credit were $1.0 billion (378.4%) higher. Credit card charge-offs were up by $1.0 billion (33.0%), and charge-offs of other loans to individuals increased by $1.1 billion (58.4%).

Growth in Noncurrent Loans Accelerates

Despite the heightened level of charge-offs, the rising trend in noncurrent loans that began in mid-2006 continued to gain momentum in the fourth quarter. Total noncurrent loans — loans 90 days or more past due or in nonaccrual status — rose by $26.9 billion (32.5%) in the last three months of 2007. This is the largest percentage increase in a single quarter in the 24 years for which noncurrent loan data are available. Eight institutions accounted for half of the total increase in noncurrent loans in the fourth quarter, but noncurrent loans were up at half of all insured institutions. The percentage of loans that were noncurrent at year-end was 1.39%, the highest level since the third quarter of 2002. The fourth-quarter increase in noncurrent loans was led by noncurrent residential mortgage loans, which grew by $11.1 billion (31.7%). The percentage of residential mortgage loans that were noncurrent rose from 1.57% to 2.06% during the quarter and is now at the highest level in the 17 years that noncurrent mortgage data have been reported. Noncurrent real estate construction and development loans increased by $8.4 billion (73.2%), noncurrent credit card loans rose by $1.9 billion (26.0%), noncurrent home equity loans were up by $1.6 billion (43.1%), and noncurrent other loans to individuals increased by $1.2 billion (26.6%). Only the farm loan categories registered declines in noncurrent amounts.

Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the last three years.

Critical Accounting Policy

The discussion contained in this Item 7 and other disclosures included within this report are based 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.

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The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" accompanying the Company's audited financial statements. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified the allowance for loan losses to be the Company's most critical accounting policy.

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 collectibility 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.

In December of 2006, the Office of the Comptroller of the Currency and other federal banking regulatory agencies issued an inter-agency policy statement to provide guidance to boards of directors and management concerning the process for reviewing and determining the allowance for loan losses and to ensure consistency of that process with generally accepted accounting principles. In response, the Company amended its Loan Policy in November of 2007 to implement the guidance contained in the policy statement. Under the amended Loan Policy, the judgments utilized by management in establishing specific reserves for problem credits have now become more influenced by the lack of payment performance and net collateral shortfalls in the event of collateral liquidation. Previously, the Loan Policy had focused more on general weaknesses that resulted in loans being adversely classified by federal banking regulatory agencies and establishing specific reserves in line with historic regulatory accepted levels, which typically lead to higher levels of specific reserves for such credits. As a result of implementing the guidance contained in the amended Loan Policy, specific reserves as of December 31, 2007 declined when compared to specific reserves as of December 31, 2006; however, the effect of the implementation on the overall allowance for loan losses was not significant. For further discussion concerning the allowance for loan losses and the process of establishing specific reserves, see the section of this Report entitled Asset Quality Review and Credit Risk Management – Analysis of the Allowance for Loan Losses.

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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.

ASSETS

	2007			2006			2005		
(dollars in thousands)	Average balance	Revenue	Yield	Average balance	Revenue	Yield	Average balance	Revenue	Yield
Interest-earning assets									
Loans 1									
Commercial	$ 78,241	$ 6,201	7.93%	$ 70,581	$ 5,490	7.78%	$ 66,581	$ 4,286	6.44%
Agricultural	31,964	2,696	8.43%	33,054	2,758	8.34%	29,772	2,143	7.20%
Real estate	321,225	21,209	6.60%	306,991	19,655	6.40%	310,438	18,912	6.09%
Consumer and other	22,658	1,523	6.72%	27,540	1,691	6.14%	29,206	1,638	5.61%
Total loans (including fees)	$ 454,088	$ 31,629	6.97%	$ 438,166	$ 29,594	6.75%	$ 435,997	$ 26,979	6.19%
Investment securities									
Taxable	$ 205,203	$ 9,858	4.80%	$ 212,897	$ 9,195	4.32%	$ 216,785	$ 8,823	4.07%
Tax-exempt 2	137,109	8,930	6.51%	123,427	7,913	6.41%	126,323	8,006	6.34%
Total investment securities	$ 342,312	$ 18,788	5.49%	$ 336,324	$ 17,108	5.09%	$ 343,108	$ 16,829	4.90%
Interest bearing deposits with banks	$ 864	$ 37	4.28%	$ 4,114	$ 139	3.38%	$ 7,037	$ 169	2.40%
Federal funds sold	4,630	233	5.03%	4,229	224	5.30%	4,833	131	2.71%
Total interest-earning assets	$ 801,894	$ 50,687	6.32%	$ 782,833	$ 47,065	6.01%	$ 790,975	$ 44,108	5.58%
Noninterest-earning assets									
Cash and due from banks	$ 18,086			$ 17,056			$ 22,885		
Premises and equipment, net	13,618			11,005			9,229		
Other, less allowance for loan losses	10,190			7,556			8,109		
Total noninterest-earning assets	$ 41,894			$ 35,617			$ 40,223		

TOTAL ASSETS	$ 843,788	$ 818,450	$ 831,198

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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Average Balances and Interest Rates(continued)

LIABILITIES AND STOCKHOLDERS' EQUITY

(dollars in thousands)	2007 Average balance	2007 Revenue/ expense	2007 Yield/ rate	2006 Average balance	2006 Revenue/ expense	2006 Yield/ rate	2005 Average balance	2005 Revenue/ expense	2005 Yield/ rate
Interest-bearing liabilities									
Deposits									
Savings, NOW accounts, and money markets	$ 309,787	$ 7,734	2.50%	$ 314,567	$ 8,250	2.62%	$ 323,334	$ 5,757	1.78%
Time deposits < $100,000	179,740	7,996	4.45%	182,241	7,071	3.88%	173,966	5,530	3.18%
Time deposits > $100,000	107,600	5,325	4.95%	99,123	4,422	4.46%	90,687	3,095	3.41%
Total deposits	$ 597,127	$ 21,055	3.53%	$ 595,931	$ 19,743	3.31%	$ 587,987	$ 14,382	2.45%
Other borrowed funds	57,047	2,482	4.35%	36,388	1,563	4.30%	56,443	1,551	2.75%
Total Interest-bearing liabilities	$ 654,174	$ 23,537	3.60%	$ 632,319	$ 21,306	3.37%	$ 644,430	$ 15,933	2.47%
Noninterest-bearing liabilities									
Demand deposits	$ 70,459			$ 70,095			$ 69,577		
Other liabilities	7,784			6,528			7,389		
Stockholders' equity	$ 111,371			$ 109,508			$ 109,802		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 843,788			$ 818,450			$ 831,198		
Net interest income		$ 27,150	3.39%		$ 25,759	3.29%		$ 28,177	3.56%
Spread Analysis									
Interest income/average assets		$ 50,687	6.01%		$ 47,065	5.75%		$ 44,108	5.31%
Interest expense/average assets		23,537	2.79%		21,306	2.60%		15,931	1.92%
Net interest income/average		27,150	3.22%		25,759	3.15%		28,177	3.39%

assets

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Rate and Volume Analysis

The rate and volume analysis is used to determine how much of the change in interest income or expense is the result of a change in volume or a change in interest rate. For example, commercial loan interest income increased $711,000 in 2007 compared to 2006. An increased volume of commercial loans added $604,000 in income in 2007 and higher interest rates increased interest income in 2007 by $107,000.

The following table sets forth, on a tax-equivalent basis, a summary of the changes in net interest income resulting from changes in volume and rates.

(dollars in thousands)	2007 Compared to 2006			2006 Compared to 2005		
	Volume	Rate	Total [1]	Volume	Rate	Total
Interest income						
Loans						
Commercial	$ 604	$ 107	$ 711	$ 270	$ 934	$ 1,204
Agricultural	(92)	30	(62)	253	362	615
Real estate	928	626	1,554	(212)	955	743
Consumer and other	(318)	150	(168)	(97)	150	53
Total loans (including fees)	$ 1,122	$ 913	$ 2,035	$ 214	$ 2,401	$ 2,615
Investment securities						
Taxable	$ (339)	$ 1,002	$ 663	$ (161)	$ 533	$ 372
Tax-exempt	891	126	1,017	(182)	89	(93)
Total investment securities	$ 552	$ 1,128	$ 1,680	$ (343)	$ 622	279
Interest bearing deposits with banks	(154)	53	(101)	$ (84)	$ 53	$ (31)
Federal funds sold	21	(13)	8	(18)	112	94
Total Interest-earning assets	$ 1,541	$ 2,081	$ 3,622	$ (231)	$ 3,188	$ 2,957
Interest-bearing liabilities						
Deposits						
Savings, NOW accounts, and money markets	$ (156)	$ (360)	$ (516)	$ (160)	$ 2,653	$ 2,493
Time deposits < $100,000	(98)	1,023	925	274	1,267	1,541
Time deposits > $100,000	395	508	903	308	1,020	1,328
Total deposits	$ 141	$ 1,171	$ 1,312	$ 422	$ 4,940	$ 5,362
Other borrowed funds	901	18	919	(672)	683	11
Total Interest-bearing liabilities	$ 1,042	$ 1,189	$ 2,231	$ (250)	$ 5,623	$ 5,373
Net interest income/earning assets	$ 499	$ 892	$ 1,391	$ 19	$ (2,435)	$ (2,416)

1 The change in interest due to both volume and yield/rate has been allocated to change due to volume and change due to yield/rate in proportion to the absolute value of the change in each.

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Net Interest Income

The Company's largest component contributing to net income is net interest income, which is the difference between interest earned on earning assets (which are primarily loans and investments) and interest paid on interest bearing liabilities (which are primarily deposits accounts and other borrowings). The volume of and yields earned on earning assets and the volume of and the rates paid on interest bearing liabilities determine net interest income. Refer to the tables preceding this paragraph for additional detail. Interest earned and interest paid is also affected by general economic conditions, particularly changes in market interest rates, and by government policies and the action of regulatory authorities. Net interest income divided by average earning assets is referred to as net interest margin. For the years December 31, 2007, 2006 and 2005, the Company's net interest margin was 3.39%, 3.29% and 3.56%, respectively.

Net interest income during 2007, 2006 and 2005 totaled $24,025,000, $22,990,000 and $25,373,000, respectively, representing a 5% increase in 2007 compared to 2006 and a 9% decrease in 2006 from 2005. Net interest income improved in 2007 compared to 2006 as the yields and volumes improved on loans and investments. The decline in net interest income in 2006 compared to 2005 was the result of higher market interest rates causing interest expense to increase more quickly than interest income.

The high level of competition in the local markets and will continue to put downward pressure on the net interest margin of the Company. Currently, the Company's largest market, Ames, Iowa, has ten banks, two thrifts, four credit unions and several other financial investment companies. Multiple banks are also located in the Company's other communities creating similarly competitive environments.

Provision for Loan Losses

The provision for loan losses reflects management's judgment of the expense to be recognized in order to maintain an adequate allowance for loan losses. The Company's credit for loan losses for the year ending December 31, 2007 was $94,000 compared to a credit for loan losses of $183,000 during the same period last year. A reduction in the specific reserves for problem credits allowed a decrease in the required level of the allowance for loan losses calculated by the Banks for 2007 and 2006. The decrease in estimated allowance in 2006 created the credit for loan losses compared to the $331,000 of provision expense for loan losses during 2005. Refer to the Asset Quality and Credit Risk Management discussion for additional details with regard to loan loss provision expense.

Management believes the allowance for loan losses to be adequate to absorb probable losses in the current portfolio. This statement is based upon management's continuing evaluation of inherent risks in the current loan portfolio, current levels of classified assets and general economic factors. The Company will continue to monitor the allowance and make future adjustments to the allowance as conditions dictate.

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Noninterest Income and Expense

Total noninterest income is comprised primarily of fee-based revenues from trust and agency services, bank-related service charges on deposit activities, net securities gains generated primarily by the Company's equity holdings, merchant and ATM fees related to electronic processing of merchant and cash transactions and secondary market income.

Noninterest income during 2007, 2006 and 2005 totaled $7,208,000, $6,674,000 and $5,613,000, respectively, representing an 8% increase in 2007 from 2006 and a 19% increase in 2006 from 2005. The higher non-interest income in 2007 compared to 2006 related to higher realized gains on the sale of securities and improved trust department income. The increase in 2006 is primarily the result of a first quarter $471,000 gain on the foreclosure of a commercial real estate property where the fair market value determined by an independent appraisal exceeded the loan carrying amount, an increase in realized gains on the sale of securities in the Company's equity portfolio, and higher trust department income.

Noninterest expense for the Company consists of all operating expenses other than interest expense on deposits and other borrowed funds. Historically, the Company has not had any material expenses relating to discontinued operations, extraordinary losses or adjustments from a change in accounting principles. Salaries and employee benefits are the largest component of the Company's operating expenses and comprise 60% of noninterest expenses in 2007.

Noninterest expense during 2007, 2006 and 2005 totaled $16,776,000, $15,504,000 and $15,210,000, respectively, representing an 8% increase in 2007 compared to a 2% increase in 2006. The primary reason for the increase in 2007 was the opening of First National's Ankeny office in April of 2007.   Lower incentive compensation for senior officers of the Company and Banks contributed to the limited increase in noninterest expense in 2006 compared to 2005. The percentage of noninterest expense to average assets was 1.99% in 2007, compared to 1.89% and 1.83% during 2006 and 2005, respectively.

Provision for Income Taxes

The provision for income taxes for 2007, 2006 and 2005 was $3,542,000, $3,399,000 and $3,836,000, respectively. This amount represents an effective tax rate of 24% during 2007, compared to 24% and 25% for 2006 and 2005, respectively. The Company's marginal federal tax rate is currently 35%. The difference between the Company's effective and marginal tax rate is primarily related to investments made in tax exempt securities.

Balance Sheet Review

The Company's assets are comprised primarily of loans and investment securities. Average earning asset maturity or repricing dates are less than five years for the combined portfolios as the assets are funded for the most part by short term deposits with either immediate availability or less than one year average maturities. This exposes the Company to risk with regard to changes in interest rates that are more fully explained in Item 7A of this report "Quantitative and Qualitative Disclosures about Market Risk".

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Total assets increased to $861,591,000 in 2007 compared to $838,853,000 in 2006, a 3% increase. The loan portfolio grew $35 million, offset by a decline of $15 million in the Company's investment portfolio when comparing year end 2007 and 2006.

Loan Portfolio

Net loans for the year ended December 31, 2007 totaled $463,651,000, up from the $429,123,000 as of December 31, 2006, an increase of 8%. The increase in loan volume can be primarily attributed to higher origination in 2007 of commercial and commercial real estate loans. Loans are the primary contributor to the Company's revenues and cash flows. The average yield on loans was 148 and 166 basis points higher in 2007 and 2006, respectively, in comparison to the average tax-equivalent investment portfolio yields.

Types of Loans

The following table sets forth the composition of the Company's loan portfolio for the past five years ending at December 31, 2007.

(dollars in thousands)	2007	2006	2005	2004	2003
Real Estate					
Construction	$ 46,730	$ 30,600	$ 23,973	$ 21,042	$ 13,126
1-4 family residential	104,380	103,620	102,043	97,612	84,645
Commercial	147,023	139,149	153,920	160,176	150,723
Agricultural	33,684	31,092	30,606	27,443	24,297
Commercial	78,616	73,760	71,430	57,189	38,555
Agricultural	36,133	33,434	32,216	30,713	27,815
Consumer and other	23,002	24,276	33,340	24,584	23,242
Total loans	469,568	435,931	447,528	418,759	362,403
Deferred loan fees, net	137	276	445	644	819
Total loans net of deferred fees	$ 469,431	$ 435,655	$ 447,083	$ 418,115	$ 361,584

The Company's loan portfolio consists of real estate loans, commercial loans, agricultural loans and consumer loans. As of December 31, 2007, gross loans totaled approximately $470 million, which equals approximately 68% of total deposits and 55% of total assets. The Company's peer group (consisting of 405 bank holding companies with total assets of $500 to $1,000 million) loan to deposit ratio as of December 31, 2007 was a much higher 92%. The primary factor relating to the lower loan to deposit ratio for the Company compared to peer group averages is a more conservative underwriting philosophy. As of December 31, 2007, the majority of the loans were originated directly by the Banks to borrowers within the Banks' principal market areas. There are no foreign loans outstanding during the years presented.

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Real estate loans include various types of loans for which the Banks hold real property as collateral and consist of loans primarily on commercial properties and single family residences. Real estate loans typically have fixed rates for up to five years, with the Company's loan policy permitting a maximum fixed rate maturity of up to 15 years. The majority of construction loan volume is to contractors to construct commercial buildings and these loans generally have maturities of up to 12 months. The Banks originate residential real estate loans for sale to the secondary market for a fee.

Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, floor-plans, inventory and accounts receivable; capital expenditure loans to finance equipment and other fixed assets; and letters of credit. These loans generally have short maturities, have either adjustable or fixed rates and are unsecured or secured by inventory, accounts receivable, equipment and/or real estate.

Agricultural loans play an important part in the Banks' loan portfolios. Iowa is a major agricultural state and is a national leader in both grain and livestock production. The Banks play a significant role in their communities in financing operating, livestock and real estate activities for area producers.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Banks' consumer lending is for vehicles, consolidation of personal debts, household appliances and improvements.

The interest rates charged on loans vary with the degree of risk and the amount and maturity of the loan. Competitive pressures, market interest rates, the availability of funds and government regulation further influence the rate charged on a loan. The Banks follow a loan policy, which has been approved by both the board of directors of the Company and the Banks, and is overseen by both Company and Bank management. These policies establish lending limits, review and grading criteria and other guidelines such as loan administration and allowance for loan losses. Loans are approved by the Banks' board of directors and/or designated officers in accordance with respective guidelines and underwriting policies of the Company. Credit limits generally vary according to the type of loan and the individual loan officer's experience. Loans to any one borrower are limited by applicable state and federal banking laws.

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Maturities and Sensitivities of Loans to Changes in Interest Rates as of December 31, 2007

The contractual maturities of the Company's loan portfolio are as shown below. Actual maturities may differ from contractual maturities because individual borrowers may have the right to prepay loans with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years	Total
Real Estate				
Construction	$ 32,275	$ 12,842	$ 1,613	$ 46,730
1-4 family residential	9,407	40,652	54,321	104,380
Commercial	56,581	58,300	32,142	147,023
Agricultural	3,168	4,477	26,039	33,684
Commercial	27,221	39,745	11,650	78,616
Agricultural	25,270	10,122	741	36,133
Consumer and other	2,292	16,868	3,842	23,002
Total loans	$ 156,214	$ 183,006	$ 130,348	$ 469,568

	After one year but within five years	After five years
Loan maturities after one year with:		
Fixed rates	$ 153,616	$ 36,455
Variable rates	29,390	93,893
	$ 183,006	$ 130,348

Loans Held For Sale

Mortgage origination funding awaiting delivery to the secondary market totaled $345,000 and $526,000 as of December 31, 2007 and 2006, respectively. Residential mortgage loans are originated by the Banks and sold to several secondary mortgage market outlets based upon customer product preferences and pricing considerations. The mortgages are sold in the secondary market to eliminate interest rate risk and to generate secondary market fee income. It is not anticipated at the present time that loans held for sale will become a significant portion of total assets.

Investment Portfolio

Total investments as of December 31, 2007 were $339,942,000, a decrease of $15 million or 4% from the prior year end. As of December 31, 2007 and 2006, the investment portfolio comprised 39% and 42% of total assets, respectively.

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The following table presents the market values, which represent the carrying values due to the available-for-sale classification, of the Company’s investment portfolio as of December 31, 2007, 2006 and 2005, respectively. This portfolio provides the Company with a significant amount of liquidity.

(dollars in thousands)	2007	2006	2005
U.S. treasury securities	$ 524	$ 509	$ 516
U.S. government agencies	95,597	123,192	134,288
U.S. government mortgage-backed securities	26,877	16,553	19,988
States and political subdivisions	133,283	119,908	88,385
Corporate bonds	64,953	60,624	59,567
Equity securities	18,708	33,786	30,766
Total	$ 339,942	$ 354,572	$ 333,510

Investments in states and political subdivisions represent purchases of municipal bonds located primarily in the state of Iowa and contiguous states.

Investment in other securities includes corporate debt obligations of companies located and doing business throughout the United States. The debt obligations were all within the credit ratings acceptable under the Company’s investment policy with the exception of the corporate debt obligations of one corporation that has a Moody’s sub investment quality rating of Ba3 as of December 31, 2007. These corporate bonds had a fair market and carrying value as of December 31, 2007 of $713,000 and $750,000, respectively, and mature in November of 2008. The Company does not consider the corporate bonds to be other than temporarily impaired as of December 31, 2007. As of December 31, 2007, the Company did not have securities from a single issuer, except for the United States Government or its agencies, which exceeded 10% of consolidated stockholders’ equity. The equity securities portfolio consists primarily of financial and utility stocks as of December 31, 2007, 2006, and 2005.

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Investment Maturities as of December 31, 2007

The investments in the following table are reported by contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years but within ten years	After ten years	Total
U.S. treasury securities	-	$ 524	-	-	$ 524
U.S. government agencies	$ 19,470	36,926	$ 35,692	$ 3,509	95,597
U.S. government mortgage-backed securities	3,748	6,787	$ 9,003	$ 7,339	26,877
States and political subdivisions	19,576	47,994	52,030	13,683	133,283
Corporate bonds	17,482	23,018	24,453	-	64,953
Total	$ 60,276	$ 115,249	$ 121,178	$ 24,531	$ 321,234
Weighted average yield					
U.S. treasury	-	5.20%	-	-	5.20%
U.S. government agencies	3.73%	4.80%	5.54%	5.13%	4.87%
U.S government mortgage-backed securities	3.61%	4.14%	5.32%	5.48%	4.79%
States and political subdivisions*	5.88%	6.30%	6.39%	6.47%	6.29%
Corporate bonds	4.78%	5.79%	5.73%	-	5.50%
Total	4.73%	5.58%	5.93%	5.98%	5.58%

*Yields on tax-exempt obligations of states and political subdivisions have been computed on a tax-equivalent basis.

Deposits

Total deposits equaled $690,119,000 and $680,356,000 as of December 31, 2007 and 2006, respectively. The increase of $9,763,000 can be attributed to deposit growth at First National and United Bank. The deposit category seeing the largest balance increases was demand and the large time certificates of deposit accounts.

The Company's primary source of funds is customer deposits. The Company attempts to attract noninterest-bearing deposits, which are a low-cost funding source. In addition, the Banks offer a variety of interest-bearing accounts designed to attract both short-term and longer-term deposits from customers. Interest-bearing accounts earn interest at rates established by Bank management based on competitive market factors and the Company's need for funds. While nearly 73% of the Banks' certificates of deposit mature in the next year, it is anticipated that a majority of these certificates will be renewed. Rate sensitive certificates of deposits in excess of $100,000 are subject to somewhat higher volatility with regard to renewal volume as the Banks adjust rates based upon funding needs. In the event a substantial volume of certificates are not renewed, the Company has sufficient liquid assets and borrowing lines to fund significant runoff. A sustained reduction in deposit volume would have a significant negative impact on the Company's operation and liquidity. The Company has $2,558,000 of brokered deposits as of December 31, 2007 and

$7,406,000 as of December 31, 2006.

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Average Deposits by Type

The following table sets forth the average balances for each major category of deposit and the weighted average interest rate paid for deposits during the years ended December 31, 2007, 2006 and 2005.

	2007		2006		2005	
(dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand deposits	$ 70,459	-	$ 70,095	-	$ 69,577	-
Interest bearing demand deposits	152,898	2.29%	153,619	2.44%	154,156	1.63%
Money market deposits	130,548	3.06%	134,078	3.16%	141,492	2.12%
Savings deposits	26,341	0.86%	26,870	0.99%	27,686	0.90%
Time certificates < $100,000	179,740	4.45%	182,241	3.88%	173,966	3.18%
Time certificates > $100,000	107,600	4.95%	99,123	4.46%	90,687	3.41%
	$ 667,586		$ 666,026		$ 657,564	

Deposit Maturity

The following table shows the amounts and remaining maturities of time certificates of deposit that had balances of $100,000 and over as of December 31, 2007, 2006 and 2005.

(dollars in thousands)	2007	2006	2005
3 months or less	$ 31,926	$ 33,393	$ 25,933
Over 3 through 12 months	50,646	45,898	47,279
Over 12 through 36 months	23,723	20,047	26,431
Over 36 months	2,894	2,893	1,399
Total	$ 109,189	$ 102,231	$ 101,042

Borrowed Funds

Borrowed funds that may be utilized by the Company are comprised of Federal Home Loan Bank (FHLB) advances, federal funds purchased, Treasury, Tax, and Loan option notes, and repurchase agreements. Borrowed funds are an alternative funding source to deposits and can be used to fund the Company's assets and unforeseen liquidity needs. FHLB advances are loans from the FHLB that can mature daily or have longer maturities for fixed or floating rates of interest. Federal funds purchased are borrowings from other banks that mature daily. Securities sold under agreement to repurchase (repurchase agreements) are similar to deposits as they are funds lent by various Bank customers; however, the bank pledges investment securities to secure such borrowings. The Company has repurchase agreements that reprice daily and longer term maturities. Treasury, Tax, and Loan option notes consist of short term borrowing of tax deposits from the federal government and are not a significant source of borrowing for the Company.

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The following table summarizes the outstanding amount of, and the average rate on, borrowed funds as of December 31, 2007, 2006 and 2005.

	2007		2006		2005	
(dollars in thousands)	Balance	Average Rate	Balance	Average Rate	Balance	Average Rate
Federal funds purchased and repurchase agreements	$ 30,033	3.39%	$ 34,728	4.42%	$ 34,660	3.38%
Other short-term borrowings	737	4.94%	1,470	4.92%	2,861	4.52%
FHLB term advances	4,000	4.67%	2,000	5.03%	-	-%
Term repurchase agreements	20,000	4.24%	-	-%	-	-%
Total	$ 54,770	3.81%	$ 38,198	4.47%	$ 37,521	3.46%

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Average Annual Borrowed Funds

The following table sets forth the average amount of, the average rate paid and maximum outstanding balance on, borrowed funds for the years ended December 31, 2007, 2006 and 2005.

	2007		2006		2005	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Federal funds purchased& repurchase agreements	$ 46,447	4.28%	$ 34,692	4.24%	$ 55,337	2.72%
Other short-term borrowings	967	5.86%	1,029	5.73%	1,096	4.29%
FHLB term advances	2,414	4.97%	667	5.03%	-	-%
Term repurchase agreements	7,219	4.42%	-	-%	-	-%
Total	$ 57,047	4.35%	$ 36,388	4.30%	$ 56,443	2.75%
Maximum Amount Outstanding during the year						
Federal funds purchased and repurchase agreements	$ 58,457		$ 44,928		$ 70,489	
Other short-term borrowings	$ 1,684		$ 2,415		$ 5,000	
FHLB term advances	$ 4,000		$ 2,000		$ -	
Term repurchase agreements	$ 24,000		$ -		$ -	

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 that assist customers with their credit needs to conduct business. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. As of December 31, 2007, the most likely impact of these financial instruments on revenues, expenses, or cash flows of the Company would come from unidentified credit risk causing higher provision expense for loan losses in future periods. These financial instruments are not expected to have a significant impact on the liquidity or capital resources of the Company. For additional information, see footnote 10 of the "Notes to Consolidated Statements" and the "Liquidity and Capital Resources" section of this discussion.

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Contractual Obligations

The following table sets forth the balance of contractual obligations by maturity period as of December 31, 2007 (in thousands).

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Deposits	$ 690,119	$ 612,661	$ 67,789	$ 9,611	$ 58
Federal funds purchased and securities sold under agreements to repurchase	30,033	30,033	-	-	-
Other short-term borrowings	737	737	-	-	-
Long-term borrowings	24,000	-	16,000	8,000	-
Operating lease obligation	84	21	42	21	-
Purchase obligations	1,683	778	905	-	-
Total	$ 746,656	$ 644,230	$ 84,736	$ 17,632	$ 58

Purchase obligations include data processing and Internet banking services contracts that include termination provisions that would accelerate all future payments in the event the Company changed service providers prior to the contracts' expirations.

Asset Quality Review and Credit Risk Management

The Company's credit risk is centered in the loan portfolio, which on December 31, 2007 totaled $463,651,000 as compared to $429,123,000 as of December 31, 2006, an increase of 8%. Net loans comprise 54% of total assets as of the end of 2007. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of a transaction and to quantify and manage credit risk on a portfolio basis. As the following chart indicates, the Company's non-performing assets have increased from their historically low levels and total $7,395,000 as of December 31, 2007. The Company's level of problem assets as a percentage of assets of 0.88% as December 31, 2007 are slightly lower than the average for FDIC insured institutions as of December 31, 2007 of 0.90%. Though non-performing assets have increased, management believes that the allowance for loan losses remains adequate based on its analysis of the non-performing assets and the portfolio as a whole.

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Non-performing Assets

The following table sets forth information concerning the Company's non-performing assets for the past five years ending December 31, 2007.

(dollars in thousands)	2007	2006	2005	2004	2003
Non-performing assets:					
Nonaccrual loans	$ 3,249	$ 291	$ 606	$ 1,896	$ 1,756
Loans 90 days or more past due and still accruing	1,300	758	83	80	431
Total non-performing loans	4,549	1,049	689	1,976	2,187
Other real estate owned	2,846	2,808	1,742	772	159
Total non-performing assets	$ 7,395	$ 3,857	$ 2,431	$ 2,748	$ 2,346

The accrual of interest on non-accrual and other impaired loans is discontinued at 90 days or when, in the opinion of management, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Interest income on restructured loans is recognized pursuant to the terms of the new loan agreement. Interest income on other impaired loans is monitored and based upon the terms of the underlying loan agreement. However, the recorded net investment in impaired loans, including accrued interest, is limited to the present value of the expected cash flows of the impaired loan or the observable fair market value of the loan’s collateral.

At December 31, 2007 and 2006, the Company had non-performing loans of approximately $4,549,000 and $1,049,000, respectively. The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated in 2007 and contributed to the Company’s increased level of non-performing loans. Presently, the Company has $2.6 million in impaired loans with two Des Moines development companies with specific reserves totaling $89,000; however, $402,000 was charged-off in the fourth quarter of 2007 relating to one of these borrowers. 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.

Impaired loan totaled $5,485,000 as of December 31, 2007 and were $936,000 higher than the non-performing loans as of the same date. During 2007, the Company revised it process for determining whether a loan is impaired. Previously, the Company considered impaired loans to generally include the non-performing loans consisting of non accrual loans and loans past due 90 days or more and still accruing. Under the revised approach, the Company now considers other loans that may or may not meet the former criteria but are considered to meet the definition of impaired. For example, one credit relationship is not currently meeting the definition of non-performing as the result of principal payments not being more than 90 day past due. Management has concluded that the borrower is unable to make timely payments; however, present collateral margins have precluded the established of specific reserves or placing the loan on non-accrual status. While this change resulted in more loans being reported as impaired this period, the Company does not believe that the change had a significant impact on the overall allowance for loan losses.

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The allowance for loan losses related to these impaired loans was approximately $247,000 and $142,000 at December 31, 2007 and 2006, respectively. The average balances of impaired loans for the years ended December 31, 2007 and 2006, were $2,486,000 and $1,729,000, respectively. For the years ended December 31, 2007, 2006, and 2005, interest income, which would have been recorded under the original terms of such loans, was approximately $346,000, $42,000, and $41,000, respectively, with $180,000, $1,000, and $0, respectively, recorded. Loans greater than 90 days past due and still accruing interest were approximately $1,300,000 and $758,000 at December 31, 2007 and 2006, respectively.

Summary of the Allowance for Loan Losses

The provision for loan losses represents an expense charged against earnings to maintain an adequate allowance for loan losses. The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial condition of the borrower; a realistic determination of value and adequacy of underlying collateral; the condition of the local economy and the condition of the specific industry of the borrower; an analysis of the levels and trends of loan categories; and a review of delinquent and classified loans.

The adequacy of the allowance for loan losses is evaluated quarterly by management and the respective Bank boards. This evaluation focuses on specific loan reviews, changes in the type and volume of the loan portfolio given the current economic conditions and historical loss experience. Any one of the following conditions may result in the review of a specific loan: concern about whether the customer's cash flow or collateral are sufficient to repay the loan; delinquent status; criticism of the loan in a regulatory examination; the accrual of interest has been suspended; or other reasons, including when the loan has other special or unusual characteristics which warrant special monitoring.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgment about information available to them at the time of their examination.

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Analysis of the Allowance for Loan Losses

The Company's policy is to charge-off loans when, in management's opinion, the loan is deemed uncollectible, although concerted efforts are made to maximize future recoveries. The following table sets forth information regarding changes in the Company's allowance for loan losses for the most recent five years.

(dollars in thousands)	2007	2006	2005	2004	2003
Balance at beginning of period	$ 6,533	$ 6,765	$ 6,476	$ 6,051	$ 5,758
Charge-offs:					
Real Estate					
Construction	402	-	-	-	24
1-4 Family Residential	1	6	-	19	5
Commercial	25	-	28	93	-
Agricultural	-	-	-	-	-
Commercial	-	-	-	3	392
Agricultural	-	-	-	-	-
Consumer and other	299	99	119	115	43
Total Charge-offs	727	105	147	230	464
Recoveries:					
Real Estate					
Construction	-	-	-	-	-
1-4 Family Residential	1	1	-	-	-
Commercial	-	-	-	-	-
Agricultural	-	-	-	-	-
Commercial	21	6	33	13	100
Agricultural	-	-	-	-	-
Consumer and other	47	49	72	163	12
Total Recoveries	69	56	105	176	112
Net charge-offs	658	49	42	54	352
Additions (deductions) charged (credited) to operations	(94)	(183)	331	479	645
Balance at end of period	$ 5,781	$ 6,533	$ 6,765	$ 6,476	$ 6,051
Average Loans Outstanding	$ 454,088	$ 438,166	$ 435,997	$ 385,347	$ 349,812
Ratio of net charge-offs during the period to average loans outstanding	0.14%	0.01%	0.01%	0.01%	0.10%
Ratio of allowance for loan losses to total loans net of deferred fees	1.23%	1.50%	1.51%	1.55%	1.67%

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The allowance for loan losses decreased to $5,781,000 at the end of 2007 in comparison to the allowance of $6,533,000 at year end 2006 as a result of net charge-offs of $658,000 in 2007 and a reduction in specific reserves for problem credits. A reduction in the specific reserve for a problem credit and declining loan demand allowed for a decrease in the required level of the allowance for loan losses calculated by the Banks for year end 2006 compared to 2005. The increase in the reserve levels in 2005 compared to 2004 can be attributed to the growth in the Company's commercial loan portfolio at First National and United Bank. The increase in the reserve levels in 2004 compared to 2003 relate primarily to general reserves established by First National.

General reserves for loan categories normally range from 0.89% to 1.77% of the outstanding loan balances. As loan volume increases, the general reserve levels increase with that growth. As the previous table indicates, negative loan provisions have been utilized in 2007 and 2006 as specific reserves for problem credits have declined, in part, due to charge-off of problem credits. The allowance relating to commercial real estate, 1-4 family residential and commercial loans are the largest reserve components. Construction and commercial real estate loans have higher general reserve levels than 1-4 family and agricultural real estate loans as management perceives more risk in this type of lending. Elements contributing to the higher risk level include a higher percentage of watch and problem loans, higher past due percentages, declining collateral values and less favorable economic conditions for those portfolios. As of December 31, 2007, commercial real estate loans have general reserves ranging from 1.09% to 1.42%. The level of non performing loans as of December 31, 2007 has increased since 2006 but remains at a manageable level.

Loans that the Banks have identified as having higher risk levels are reviewed individually in an effort to establish adequate loss reserves. These reserves are considered specific reserves and are directly impacted by the credit quality of the underlying loans. Normally, as the actual or expected level of non-performing loans increase, the specific reserves also increase. For December 31, 2007, however, specific reserves decreased to $247,000 from the $1,477,000 reserved at year end 2006, in part, due to the charge-off of credits with specific reserves, an improved condition of certain credits and a change in the Company's method of determining specific reserves. The revised methodology resulted from implementing guidance provided by federal regulatory agencies as more fully described in this management discussion under Critical Accounting Policy.

For December 31, 2006, specific reserves increased $534,000 or 2% compared to year end 2005 levels as the volume of problem credits increased in 2006. As of December 31, 2005, specific reserves increased $76,000 over 2004 as the level of watch credits increased. As of December 31, 2004, specific reserves decreased $431,000 or 24% over year end 2003 as the result of improved loan quality. As of December 31, 2003, specific reserves increased $146,000 or 9% over year end 2002. The specific reserves are dependent upon assumptions regarding the liquidation value of collateral and the cost of recovering collateral including legal fees. Changing the amount of specific reserves on individual loans has historically had the largest impact on the reallocation of the reserve among different parts of the portfolio.

Other factors that are considered when determining the adequacy of the reserve include historical losses; watch, substandard and impaired loan volume; collecting past due loans; loan growth; loan to value ratios; loan administration; collateral values and economic factors. The Company's concentration risks include geographic concentration in central Iowa; the local economy's dependence upon several large governmental entity employers, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that, in turn, is dependent on weather conditions and government programs. However, no assurances can be made that losses will remain at the relatively favorable levels experienced over the past five years.

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Allocation of the Allowance for Loan Losses

The following table sets forth information concerning the Company’s allocation of the allowance for loan losses.

(dollars in thousands)	2007		2006		2005		2004		2003	
	Amount	%*	Amount	%*	Amount	%*	Amount	%*	Amount	%*
Balance at end of period applicable to:										
Real Estate										
Construction	$ 733	9.92%	$ 372	7.02%	$ 258	5.36%	$ 429	5.02%	$ 196	3.62%
1-4 family residential	1,061	22.23%	1,231	23.77%	1,127	22.80%	1,021	23.31%	948	23.36%
Commercial	1,964	31.39%	2,396	31.92%	2,534	34.39%	2,676	38.25%	2,663	41.59%
Agricultural	407	7.17%	428	7.13%	421	6.84%	486	6.55%	458	6.70%
Commercial	943	16.74%	983	16.92%	1,158	15.96%	809	13.66%	775	10.64%
Agricultural	466	7.69%	499	7.67%	511	7.20%	360	7.33%	488	7.68%
Consumer and other	207	4.85%	276	5.57%	390	7.45%	302	5.87%	255	6.41%
Unallocated	-		348		366		393		268	
	$ 5,781	100%	$ 6,533	100%	$ 6,765	100%	$ 6,476	100%	$ 6,051	100%

* Percent of loans in each category to total loans.

Liquidity and Capital Resources

Liquidity management is the process by which the Company, through its Banks’ Asset and Liability Committees (ALCO), ensures that adequate liquid funds are available to meet its financial commitments on a timely basis, at a reasonable cost and within acceptable risk tolerances. These commitments include funding credit obligations to borrowers, funding of mortgage originations pending delivery to the secondary market, withdrawals by depositors, maintaining adequate collateral for pledging for public funds, trust deposits and borrowings, paying dividends to shareholders, payment of operating expenses, funding capital expenditures and maintaining deposit reserve requirements.

Liquidity is derived primarily from core deposit growth and retention; principal and interest payments on loans; principal and interest payments, sale, maturity and prepayment of investment securities; net cash provided from operations; and access to other funding sources. Other funding sources include federal funds purchased lines, Federal Home Loan Bank (FHLB) advances and other capital market sources.

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As of December 31, 2007, the level of liquidity and capital resources of the Company remain at a satisfactory level and compare favorably to that of other FDIC insured institutions. Management believes that the Company's liquidity sources will be sufficient to support its existing operations for the foreseeable future.

The liquidity and capital resources discussion will cover the follows topics:

- Review of the Company's Current Liquidity Sources
- Review of the Consolidated Statements of Cash Flows
- Review of Company Only Cash Flows
- Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs
- Capital Resources

Review of the Company's Current Liquidity Sources

Liquid assets of cash on hand, balances due from other banks, federal funds sold and interest-bearing deposits in financial institutions for December 31, 2007, 2006 and 2005 totaled $32,179,000, $31,154,000 and $24,376,000, respectively. The higher balance of liquid assets as of December 31, 2007 relates to a higher level of due from banks balances associated with checks in the process of collection.

Other sources of liquidity available to the Banks include available borrowings with the Federal Home Loan Bank of Des Moines, Iowa of $42,551,000 and federal funds borrowing capacity at correspondent banks of $99,500,000. As of December 31, 2007, the Company had outstanding FHLB advances of $4,000,000, Treasury Tax and Loan option notes of $737,000, and securities sold under agreement to repurchase daily and term of $30,033,000, and $20,000,000, respectively.

Total investments as of December 31, 2007 were $339,942,000 compared to $354,572,000 as of year end 2006. As of December 31, 2007 and 2006, the investment portfolio as a percentage of total assets was 39% and 42%, respectively. This provides the Company with a significant amount of liquidity since all investments are classified as available for sale as of December 31, 2007 and 2006 and have pretax net unrealized gains of $2,999,000 and $9,075,000, respectively.

The investment portfolio serves an important role in the overall context of balance sheet management in terms of balancing capital utilization and liquidity. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity and credit considerations. The portfolio's scheduled maturities represent a significant source of liquidity.

Review of the Consolidated Statements of Cash Flows

Operating cash flows for December 31, 2007, 2006 and 2005 totaled $10,764,000, $11,055,000 and $9,472,000, respectively. The decrease in operating cash flows in 2007 compared to 2006 included a smaller increase of accrued expenses. The primary reason for the increase in operating cash flows in 2006 compared to 2005 was the source of cash provided by loans held for sale and higher accrued expenses and other liabilities.

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Net cash provided by (used in) investing activities for December 31, 2007, 2006 and 2005 was ($17,576,000), ($15,751,000) and $14,558,000, respectively. The net cash used in investing activities in 2007 was primarily utilized to fund increased loan demand while maturing and sold investments exceeded investment purchases for the year. The source of cash provided by loans in 2006 compared to the investment in loans in 2005 was the largest variance in comparing the two years investing activities.

Net cash provided by (used in) financing activities for December 31, 2007, 2006 and 2005 totaled $16,346,000, $3,113,000 and ($24,697,000), respectively. In 2007, other borrowings were the primary source of funds, while in 2006; deposit growth was the primary source of cash flows. A decline in securities sold under agreements to repurchase was the primary use of financing funds in 2005. As of December 31, 2007, the Company did not have any external debt financing, off balance sheet financing arrangements or derivative instruments linked to its stock.

Review of Company Only Cash Flows

The Company's liquidity on an unconsolidated basis is heavily dependent upon dividends paid to the Company by the Banks. The Company requires adequate liquidity to pay its expenses and pay stockholder dividends. In 2007, dividends from the Banks amounted to $8,849,000 compared to $8,734,000 in 2006. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National and United Bank, as national banks, generally may pay dividends, without obtaining the express approval of the Office of the Comptroller of the Currency ("OCC"), in an amount up to their retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits, as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Randall-Story Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. United Bank is not expected to generate sufficient earnings to pay any dividends in 2008. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

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The Company has unconsolidated interest bearing deposits and marketable investment securities totaling $30,345,000 that are presently available to provide additional liquidity to the Banks.

Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs

No material capital expenditures or material changes in the capital resource mix are anticipated at this time. Commitments to extend credit totaled $96,753,000 as of December 31, 2007 compared to a total of $79,629,000 at the end of 2006. The timing of these credit commitments varies with the underlying borrowers; however, the Company has satisfactory liquidity to fund these obligations as of December 31, 2007. The primary cash flow uncertainty would be a sudden decline in deposits causing the Banks to liquidate securities. Historically, the Banks have maintained an adequate level of short term marketable investments to fund the temporary declines in deposit balances. There are no known trends in liquidity and cash flow needs as of December 31, 2007 that are a concern to management.

Capital Resources

The Company's total stockholders' equity decreased to $110,021,000 at December 31, 2007, from $112,923,000 at December 31, 2006. At December 31, 2007 and 2006, stockholders' equity as a percentage of total assets was 12.8% and 13.5%, respectively. Total equity decreased primarily due to depreciation in the Company's investment portfolio. The capital levels of the Company currently exceed applicable regulatory guidelines as of December 31, 2007.

The Board of Directors of the Company approved a stock repurchase program on November 14, 2007. The Company has a strong capital position and this program provides an opportunity to repurchase Company stock on the open market when it is deemed to be favorably priced for repurchase. The program authorizes the repurchase of up to 100,000 shares during the calendar year 2008, or approximately 1% of 9,429,580 shares of common stock presently outstanding. The repurchases will be made in open market transactions at the discretion of management using Company cash. The timing and actual number of shares purchased will depend on a variety of factors such as price, the Company's liquidity position and other market conditions. The program may be limited or discontinued at any time without notice. The Company did not repurchase any shares in 2007.

Interest Rate Risk

Interest rate risk refers to the impact that a change in interest rates may have on the Company's earnings and capital. Management's objectives are to control interest rate risk and to ensure predictable and consistent growth of earnings and capital. Interest rate risk management focuses on fluctuations in net interest income identified through computer simulations to evaluate volatility, varying interest rate, spread and volume assumptions. The risk is quantified and compared against tolerance levels.

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The Company uses a third-party computer software simulation modeling program to measure its exposure to potential interest rate changes. For various assumed hypothetical changes in market interest rates, numerous other assumptions are made such as prepayment speeds on loans, the slope of the Treasury yield curve, the rates and volumes of the Company's deposits and the rates and volumes of the Company's loans. This analysis measures the estimated change in net interest income in the event of hypothetical changes in interest rates.

Another measure of interest rate sensitivity is the gap ratio. This ratio indicates the amount of interest-earning assets repricing within a given period in comparison to the amount of interest-bearing liabilities repricing within the same period of time. A gap ratio of 1.0 indicates a matched position, in which case the effect on net interest income due to interest rate movements will be minimal. A gap ratio of less than 1.0 indicates that more liabilities than assets reprice within the time period and a ratio greater than 1.0 indicates that more assets reprice than liabilities.

The simulation model process provides a dynamic assessment of interest rate sensitivity, whereas a static interest rate gap table is compiled as of a point in time. The model simulations differ from a traditional gap analysis, as a traditional gap analysis does not reflect the multiple effects of interest rate movement on the entire range of assets and liabilities and ignores the future impact of new business strategies.

Inflation

The primary impact of inflation on the Company's operations is to increase asset yields, deposit costs and operating overhead. Unlike most industries, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than they would on non-financial companies. Although interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services, increases in inflation generally have resulted in increased interest rates. The effects of inflation can magnify the growth of assets and, if significant, require that equity capital increase at a faster rate than would be otherwise necessary.

Forward-Looking Statements and Business Risks

The discussion in the foregoing Management Discussion and Analysis and elsewhere in this Report contains forward-looking statements about the Company, its business and its prospects. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include use of the words "believe", "expect", "anticipate", "intend", "plan", "estimate" or words of similar meaning, or future or conditional verbs su "will", "would", "should", "could" or "may". Forward-looking statements, by their nature, are subject to risks a uncertainties. A number of factors, many of which are beyond the Company's control, could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. Such risks and uncertainties with respect to the Company include, but are not limited to, those related to the economic conditions, particularly in the concentrated geographic area in which the Company and the Banks operate, competitive products and pricing, adequacy of the allowance for loan losses established by the Banks, fiscal and monetary policies of the U.S. government, changes in governmental regulations affecting financial institutions, (including regulatory fees and capital requirements), changes in prevailing interest rates, credit risk management and asset/liability management, the financial and securities markets and the availability of and costs associated with sources of liquidity.
Additional risks and uncertainties that could affect forward-looking statements are discussed in Item 1A of this Report under the heading "Risk Factors". Undue reliance should not be placed on these forward-looking statements.

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These factors may not constitute all factors that could cause actual results to differ materially from those discussed in any forward-looking statement. The Company operates in a continually changing business environment and new facts emerge from time to time. It cannot predict such factors nor can it assess the impact, if any, of such factors on its financial position or its results of operations. Accordingly, forward-looking statements should not be relied upon as a predictor of actual results. The Company disclaims any responsibility to update any forward-looking statement provided in this document.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk is comprised primarily of interest rate risk arising from its core banking activities of making loans and taking deposits. Interest rate risk is the risk that changes in market interest rates may adversely affect the Company's net interest income. Management continually develops and applies strategies to mitigate this risk. Management does not believe that the Company's primary market risk exposure and how that exposure was managed in 2007 changed when compared to 2006.

Based on a simulation modeling analysis performed as of December 31, 2007, the following table presents the estimated change in net interest income in the event of hypothetical changes in interest rates for the various rate shock levels:

Net Interest Income at Risk

Estimated Change in Net Interest Income for Year Ending December 31, 2007

(dollars in thousands)	$ Change	% Change
+200 Basis Points	(1,716)	(6.2)%
+100 Basis Points	(752)	(2.7)%
-100 Basis Points	731	2.6%
-200 Basis Points	1,203	4.3%

As shown above, at December 31, 2007, the estimated effect of an immediate 200 basis point increase in interest rates would decrease the Company's net interest income by 6.2% or approximately $1,716,000 in 2007. The estimated effect of an immediate 200 basis point decrease in rates would increase the Company's net interest income by 4.3% or approximately $1,203,000 in 2007. The Company's Asset Liability Management Policy establishes parameters for a 200 basis point change in interest rates. Under this policy, the Company and the Banks' objective is to properly structure the balance sheet to prevent a 200 basis point change in interest rates from causing a decline in net interest income by more than 15% in one year compared to the base year that hypothetically assumes no change in interest rates.

Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions. Actual values may differ from those projections set forth above. Further, the computations do not contemplate any actions the Company may undertake in response to changes in interest rates. Current interest rates on certain liabilities are at a level that does not allow for significant repricing should market interest rates decline considerably.

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Contractual Maturity or Repricing

The following table sets forth the estimated maturity or re-pricing, and the resulting interest sensitivity gap, of the Company's interest-earning assets and interest-bearing liabilities and the cumulative interest sensitivity gap at December 31, 2007. The expected maturities are presented on a contractual basis. Actual maturities may differ from contractual maturities because of prepayment assumptions, early withdrawal of deposits and competition.

(dollars in thousands)	Less than three months	Three months to one year	One to five years	Over five years	Cumulative Total
Interest - earning assets					
Interest-bearing deposits with banks	$ 635	$ -	$ -	$ -	$ 635
Federal funds sold	5,500	-	-	-	5,500
Investments *	12,257	48,018	115,247	164,420	339,942
Loans	132,382	23,832	183,099	130,255	469,568
Loans held for sale	345	-	-	-	345
Total interest - earning assets	$ 151,119	$ 71,850	$ 298,346	$ 294,675	$ 815,990
Interest - bearing liabilities					
Interest bearing demand deposits	$ 160,672	$ -	$ -	$ -	$ 160,672
Money market and savings deposits	162,292	-	-	-	162,292
Time certificates < $100,000	36,654	89,833	50,839	-	177,326
Time certificates > $100,000	31,926	50,645	26,561	58	109,190
Other borrowed funds	30,770	-	24,000	-	54,770
Total interest - bearing liabilities	$ 422,314	$ 140,478	$ 101,400	$ 58	$ 664,250
Interest sensitivity gap	$ (271,195)	$ (68,628)	$ 196,946	$ 294,617	$ 151,740
Cumulative interest sensitivity gap	$ (271,195)	$ (339,823)	$ (142,877)	$ 151,740	$ 151,740
Cumulative interest sensitivity gap as a percent of total assets	-31.48%	-39.44%	-16.58%	17.61%	

*Investments with maturities over 5 years include the market value of equity securities of $18,708.

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As of December 31, 2007, the Company's cumulative gap ratios for assets and liabilities repricing within three months and within one year were a negative 31% and 39%, respectively, meaning more liabilities than assets are scheduled to reprice within these periods. This situation suggests that a decrease in market interest rates may benefit net interest income and that an increase in interest rates may negatively impact the Company. The liability sensitive gap position is largely the result of classifying the interest bearing NOW accounts, money market accounts and savings accounts as immediately repriceable. Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities and periods to repricing, they may react differently to changes in market interest rates. Also, interest rates on assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other assets and liabilities may follow changes in market interest rates. Additionally, certain assets have features that restrict changes in the interest rates of such assets, both on a short-term basis and over the lives of such assets.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Ames National Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Ames National Corporation's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Ames National Corporation's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we determined that, as of December 31, 2007, the Company's internal control over financial reporting is effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2007 has been audited by Clifton Gunderson LLP, an independent registered public accounting firm, as stated in their report which appears herein.

/s/ Thomas H. Pohlman
Thomas H. Pohlman, President
(Principal Executive Officer)

/s/ John P. Nelson
John P. Nelson, Vice President
(Principal Financial Officer)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Ames National Corporation
Ames, Iowa

We have audited the accompanying consolidated balance sheets of Ames National Corporation and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion of these consolidated financial statements based on our audits. The consolidated statements of income, stockholders' equity and cash flows of Ames National Corporation and subsidiaries for the year ended December 31, 2005 were audited by other auditors whose report dated January 20, 2006 was unqualified.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ames National Corporation and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Ames National Corporation and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2008 expressed an unqualified opinion.

/s/ Clifton Gunderson LLP

West Des Moines, Iowa
February 25, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Ames National Corporation
Ames, Iowa

We have audited Ames National Corporation and subsidiaries internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Ames National Corporation's management is responsible for maintaining effective internal control over the financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

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In our opinion, Ames National Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based upon criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Ames National Corporation and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended and our report dated February 25, 2008 expressed an unqualified opinion.

/s/ Clifton Gunderson LLP

West Des Moines, Iowa
February 25, 2008

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McGladrey & Pullen
Certified Public Accountants

Report of Independent Registered Public Accounting Firm

To the Board of Directors
Ames National Corporation
Ames, Iowa

We have audited the consolidated statements of operations, stockholders' equity and cash flows of Ames National Corporation and subsidiaries for the year ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Ames National Corporation and subsidiaries for the year ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey & Pullen LLP

Des Moines, Iowa
January 20, 2006

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2007 and 2006

ASSETS	2007	2006
Cash and due from banks	$ 26,044,577	$ 16,510,082
Federal funds sold	5,500,000	13,100,000
Interest bearing deposits in financial institutions	634,613	1,544,306
Securities available-for-sale	339,942,064	354,571,864
Loans receivable, net	463,651,000	429,122,541
Loans held for sale	344,970	525,999
Bank premises and equipment, net	13,446,865	12,617,741
Accrued income receivable	8,022,900	7,871,365
Deferred income taxes	929,326	-
Other assets	3,074,833	2,989,090
Total assets	$ 861,591,148	$ 838,852,988
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$ 80,638,995	$ 77,638,264
NOW accounts	160,672,326	158,584,115
Savings and money market	162,291,544	159,401,753
Time, $100,000 and over	109,189,660	102,230,631
Other time	177,326,270	182,501,710
Total deposits	690,118,795	680,356,473
Federal funds purchased and securities sold under agreements to repurchase	30,033,321	34,727,897
Other short-term borrowings	737,420	1,470,116
Long-term borrowings	24,000,000	2,000,000
Dividend payable	2,545,987	2,450,503
Deferred income taxes	-	1,187,948
Accrued expenses and other liabilities	4,135,102	3,736,739
Total liabilities	751,570,625	725,929,676
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; 9,429,580 and 9,425,013 shares issued and outstanding as of December 31, 2007 and 2006, respectively	18,859,160	18,850,026
Additional paid-in capital	22,588,691	22,498,904
Retained earnings	66,683,016	65,856,627
Accumulated other comprehensive income-net unrealized gain on securities available-for-sale	1,889,656	5,717,755
Total stockholders' equity	110,020,523	112,923,312

Total liabilities and stockholders' equity	$ 861,591,148	$ 838,852,988

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Interest and dividend income:			
Loans, including fees	$ 31,629,493	$ 29,593,896	$ 26,979,358
Securities:			
Taxable	9,304,036	8,830,356	8,558,156
Tax-exempt	4,828,248	4,226,941	4,190,268
Federal funds sold	232,723	224,882	130,182
Dividends	1,567,578	1,419,617	1,447,663
Total interest and dividend income	47,562,078	44,295,692	41,305,627
Interest expense:			
Deposits	21,055,100	19,742,379	14,380,214
Other borrowed funds	2,482,030	1,563,149	1,552,894
Total interest expense	23,537,130	21,305,528	15,933,108
Net interest income	24,024,948	22,990,164	25,372,519
Provision (credit) for loan losses	(94,100)	(182,686)	331,282
Net interest income after provision (credit) for loan losses	24,119,048	23,172,850	25,041,237
Noninterest income:			
Trust department income	2,014,277	1,462,734	1,375,308
Service fees	1,855,964	1,840,699	1,796,503
Securities gains, net	1,466,697	1,135,136	795,780
Gain on sales of loans held for sale	743,009	564,819	606,277
Merchant and ATM fees	553,644	645,517	570,914
Gain on sale or foreclosure of real estate	-	482,203	-
Other	574,759	542,924	468,410
Total noninterest income	7,208,350	6,674,032	5,613,192
Noninterest expense:			
Salaries and employee benefits	10,041,947	9,408,293	9,208,902
Data processing	2,239,595	2,185,478	2,126,040
Occupancy expenses	1,292,424	1,159,750	1,148,738
Other operating expenses	3,202,281	2,750,341	2,726,222
Total noninterest expense	16,776,247	15,503,862	15,209,902
Income before income taxes	14,551,151	14,343,020	15,444,527
Provision for income taxes	3,542,049	3,399,403	3,835,992
Net income	$ 11,009,102	$ 10,943,617	$ 11,608,535

Basic earnings per share	$	1.17	$	1.16	$	1.23

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2007, 2006 and 2005

	Comprehensive Income	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance, December 31, 2004		$ 18,919,380	$ 22,225,516	$ 63,200,352	$ (889,020)	$ 7,467,712	$ 110,923,940
Comprehensive income:							
Net income	$ 11,608,535	-	-	11,608,535	-	-	11,608,535
Other comprehensive income, unrealized losses on securities, net of reclassification adjustment, net of tax benefit	(4,175,858)	-	-	-	-	(4,175,858)	(4,175,858)
Total comprehensive income	$ 7,432,677						
Cash dividends declared, $1.00 per share		-	-	(9,417,253)	-	-	(9,417,253)
Retirement of treasury stock		(96,984)	(113,932)	(678,104)	889,020	-	-
Sale of 8,073 shares of common stock		16,146	271,791	-	-	-	287,937
Balance, December 31, 2005		18,838,542	22,383,375	64,713,530	-	3,291,854	109,227,301
Comprehensive income:							
Net income	$ 10,943,617	-	-	10,943,617	-	-	10,943,617
Other comprehensive income, unrealized gain on securities, net	2,425,901	-	-	-	-	2,425,901	2,425,901

of reclassification adjustment, net of tax							
Total comprehensive income	$ 13,369,518						
Cash dividends declared, $1.04 per share		-	-	(9,800,520)	-	-	(9,800,520)
Sale of 5,742 shares of common stock		11,484	115,529	-	-	-	127,013
Balance, December 31, 2006		18,850,026	22,498,904	65,856,627	-	5,717,755	112,923,312
Comprehensive income:							
Net income	$ 11,009,102	-	-	11,009,102	-	-	11,009,102
Other comprehensive income, unrealized losses on securities, net of reclassification adjustment, net of tax benefit	(3,828,099)	-	-	-	-	(3,828,099)	(3,828,099)
Total comprehensive income	$ 7,181,003						
Cash dividends declared, $1.08 per share		-	-	(10,182,713)	-	-	(10,182,713)
Sale of 4,567 shares of common stock		9,134	89,787	-	-	-	98,921
Balance, December 31, 2007		$ 18,859,160	$ 22,588,691	$ 66,683,016	$ -	$ 1,889,656	$ 110,020,523

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 11,009,102	$ 10,943,617	$ 11,608,535
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision (credit) for loan losses	(94,100)	(182,686)	331,282
Amortization and accretion	(244,069)	131,704	478,244
Depreciation	1,086,400	973,257	915,213
Provision for deferred taxes	130,978	107,200	(226,170)
Securities gains, net	(1,466,697)	(1,135,136)	(795,778)
Change in assets and liabilities:			
Decrease (increase) in loans held for sale	181,029	455,281	(675,561)
Increase in accrued income receivable	(151,535)	(1,237,570)	(371,371)
Increase in other assets	(85,743)	(798,438)	(1,022,681)
Increase (decrease) in accrued expenses and other liabilities	398,363	1,798,232	(770,194)
Net cash provided by operating activities	10,763,728	11,055,461	9,471,519
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of securities available-for-sale	(88,955,529)	(69,015,999)	(59,049,297)
Proceeds from sale of securities available-for-sale	23,445,749	6,013,192	24,937,433
Proceeds from maturities and calls of securities available-for-sale	75,773,995	46,795,165	57,750,361
Net decrease in interest bearing deposits in financial institutions	909,693	4,439,236	3,591,632
Net decrease (increase) in federal funds sold	7,600,000	(12,800,000)	19,565,000
Net decrease (increase) in loans	(34,434,359)	11,377,830	(29,081,652)
Purchase of bank premises and equipment, net	(1,915,524)	(2,560,158)	(3,155,417)
Net cash provided by (used in) investing activities	(17,575,975)	(15,750,734)	14,558,060
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in deposits	9,762,322	12,014,138	10,166,496
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	(4,694,576)	67,914	(29,412,492)
Proceeds from other borrowings, net	21,267,304	608,986	2,861,130
Dividends paid	(10,087,229)	(9,704,835)	(8,599,597)
Proceeds from issuance of stock	98,921	127,013	287,937
Net cash provided by (used in) financing activities	16,346,742	3,113,216	(24,696,526)
Net increase (decrease) in cash and cash equivalents	9,534,495	(1,582,057)	(666,947)
CASH AND DUE FROM BANKS			
Beginning	16,510,082	18,092,139	18,759,086
Ending	$ 26,044,577	$ 16,510,082	$ 18,092,139

(Continued)

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash payments for:			
Interest	$ 23,456,721	$ 21,064,363	$ 15,154,109
Income taxes	3,691,664	3,461,781	3,979,665

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Description of business: Ames National Corporation and subsidiaries (the Company) operates in the commercial banking industry through its subsidiaries in Ames, Boone, Story City, Nevada and Marshalltown, Iowa. Loan and deposit customers are located primarily in Story, Boone, Hamilton and Marshall Counties and adjacent counties in Iowa.

Segment information: The Company uses the "management approach" for reporting information about segments in annual and interim financial statements. The management approach is based on the way the chief operating decision-maker organizes segments within a company for making operating decisions and assessing performance. Based on the "management approach" model, the Company has determined that its business is comprised of one operating segment: banking. The banking segment generates revenues through personal, business, agricultural and commercial lending, management of the investment securities portfolio, providing deposit account services and providing trust services.

Consolidation: The consolidated financial statements include the accounts of Ames National Corporation (the Parent Company) and its wholly-owned subsidiaries, First National Bank, Ames, Iowa; State Bank & Trust Co., Nevada, Iowa; Boone Bank & Trust Co., Boone, Iowa; Randall-Story State Bank, Story City, Iowa; and United Bank & Trust NA, Marshalltown, Iowa (collectively, the Banks). All significant intercompany transactions and balances have been eliminated in consolidation.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and fair value of financial instruments.

Cash and cash equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks. The Company reports net cash flows for customer loan transactions, deposit transactions and short-term borrowings with maturities of 90 days or less.

Securities available-for-sale: The Company classifies all securities as available for sale. Available for sale securities are those the Company may decide to sell if needed for liquidity, asset-liability management or other reasons. Available for sale securities are reported at fair value, with net unrealized gains and losses reported as other comprehensive income or loss and as a separate component of stockholders' equity, net of tax.

Gains and losses on the sale of securities are determined using the specific identification method based on amortized cost and are reflected in results of operation at the time of sale. Interest and dividend income, adjusted by amortization of purchase premium or discount over the estimated life of the security using the level yield method, is included in income as earned.

Declines in the fair value of available for sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment

in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

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Loans held for sale: Loans held for sale are the loans the Banks have the intent to sell in the foreseeable future. They are carried at the lower of aggregate cost or market value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Gains and losses on sales of loans are recognized at settlement dates and are determined by the difference between the sale proceeds and the carrying value of the loans.

Loans: Loans are stated at the principal amount outstanding, net of deferred loan fees and the allowance for loan losses. Interest on loans is credited to income as earned based on the principal amount outstanding. The Banks' policy is to discontinue the accrual of interest income on any loan 90 days or more past due unless the loans are well collateralized and in the process of collection. Income on nonaccrual loans is subsequently recognized only to the extent that cash payments are received. Nonaccrual loans are returned to an accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to timely payment of principal or interest.

Allowance for loan losses: The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in the loan portfolio. The allowance is based upon a continuing review of past loan loss experience, current economic conditions, the underlying collateral value securing the loans and other adverse situations that may affect the borrower's ability to repay. Loans which are deemed to be uncollectible are charged off and deducted from the allowance. Recoveries on loans charged-off and the provision for loan losses are added to the allowance. This evaluation is inherently subjective and requires estimates that are susceptible to significant revisions as more information becomes available.

The allowance consists primarily of specific and general/unallocated components. The specific component relates to loans that are classified either as doubtful, substandard or special mention and meet the definition of impaired. For impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers the remaining loans and is based on historical loss experience adjusted for qualitative factors, including internal factors such as remaining classified loan volume, delinquency trends of the loan portfolios and loan growth. External environmental factors considered include the current state of the overall collateral values and other economic factors as identified. The unallocated component of the allowance will also provide a margin for the imprecision inherent in the methodologies utilized in the estimation of the allowance.

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 payments of principal or 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. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include residential first mortgage loans secured by one-to-four family residences, residential construction loans, and automobile loans. Commercial and agricultural loans and mortgage loans secured by other properties are evaluated individually for impairment when analysis of borrower operating results and financial condition indicates that underlying cash flows of the borrower's business are not adequate to meet its debt service requirements. Often this is associated with a delay or shortfall in payments of 90 days or more. Nonaccrual loans are often also considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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Premises and equipment: Premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using straight-line and accelerated methods over the estimated useful lives of the respective assets. Depreciable lives range from 3 to 7 years for equipment and 15 to 39 years for premises.

Trust department assets: Property held for customers in fiduciary or agency capacities is not included in the accompanying consolidated balance sheets, as such items are not assets of the Banks.

Income taxes: Deferred income taxes are provided on temporary differences between financial statement and income tax reporting. Temporary differences are differences between the amounts of assets and liabilities reported for financial statement purposes and their tax bases. Deferred tax assets are recognized for temporary differences that will be deductible in future years' tax returns and for operating loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns. Benefits from tax positions taken or expected to be taken in a tax return are not recognized if the likelihood that the tax position would be sustained upon examination by a taxing authority is considered to be 50 percent or less.

The Company files a consolidated federal income tax return, with each entity computing its taxes on a separate company basis. For state tax purposes, the Banks file franchise tax returns, while the Parent Company files a corporate income tax return.

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). The Company believes that the adoption and application of FIN 48 was not significant to the 2007 consolidated financial statements. The Company has adopted the policy of classifying interest and penalties as income tax expense.

Comprehensive income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the stockholders' equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income. Gains and losses on available-for-sale securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges are reclassified to net income at the time of the charge.

Financial instruments with off-balance-sheet risk: The Company, in the normal course of business, makes commitments to make loans which are not reflected in the consolidated financial statements. A summary of these commitments is disclosed in Note 10.

Transfers of financial assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

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Cash and due from banks, federal funds sold and interest-bearing deposits in financial institutions: The recorded amount of these assets approximates fair value.

Securities available-for-sale: Fair values of securities available-for-sale are based on bid prices published in financial newspapers, bid quotations received from securities dealers, or quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

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

Loans: 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.

Deposit liabilities: Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and 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.

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

Long-term borrowings: Fair values of 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.

Commitments to extend credit and standby letters of credit: The fair values of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and credit worthiness of the counterparties. The carry value and fair value of the commitments to extend credit and standby letters of credit are not considered significant.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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Earnings per share: Basic earnings per share computations for the years ended December 31, 2007, 2006 and 2005, were determined by dividing net income by the weighted-average number of common shares outstanding during the years then ended. The Company had no potentially dilutive securities outstanding during the periods presented.

The following information was used in the computation of basic earnings per share for the years ended December 31, 2007, 2006, and 2005.

	2007	2006	2005
Basic earning per share computation:			
Net income	$ 11,009,102	$ 10,943,617	$ 11,608,535
Weighted average common shares outstanding	9,427,503	9,422,402	9,415,599
Basic EPS	$ 1.17	$ 1.16	$ 1.23

Stock Split: On June 15, 2005, shareholders of the Company approved an amendment to the Restated Articles of Incorporation increasing the Company's authorized common stock from 6 million to 18 million shares and reducing the par value of such common stock from $5.00 to $2.00 per share. The purpose of the amendment was to provide a sufficient number of shares of authorized common stock to accommodate a 3-for-1 stock split previously approved by the Board of Directors of the Company on May 11, 2005. The stock split was effective July 15, 2005 for holders of record as of July 1, 2005. Share and per share data for all periods presented have been restated to reflect the stock split.

New Accounting Pronouncements: The following new accounting pronouncements may affect future financial reporting by the Company:

In September 2006, the FASB issued Statement No. 157 (SFAS No. 157), Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 generally for financial assets and liabilities, and is effective for fiscal years beginning after November 15, 2008 generally for non-financial assets and liabilities. The Company does not expect that the adoption of SFAS No. 157 will have a material effect on its financial position or results of operations.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is evaluating if it will adopt the fair value option of SFAS No. 159 and what impact the adoption will have on the consolidated financial statements if adopted.

Note 2. Restrictions on Cash and Due from Banks

The Federal Reserve Bank requires member banks to maintain certain cash and due from bank reserves. The subsidiary banks' reserve requirements totaled approximately $2,665,000 and $2,847,000 at December 31, 2007 and 2006, respectively.

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Note 3. Debt and Equity Securities

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

2007:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury	$ 497,277	$ 26,883	$ -	$ 524,160
U.S. government agencies	94,500,440	1,207,999	(111,206)	95,597,233
U.S. government mortgage-backed securities	27,064,931	27,833	(215,392)	26,877,372
State and political subdivisions	132,698,746	963,002	(379,397)	133,282,351
Corporate bonds	65,455,863	527,546	(1,030,111)	64,953,298
Equity securities	16,725,353	3,326,847	(1,344,550)	18,707,650
	$ 336,942,610	$ 6,080,110	$ (3,080,656)	$ 339,942,064

2006:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury	$ 496,493	$ 12,199	$ -	$ 508,692
U.S. government agencies	124,156,765	451,183	(1,415,960)	123,191,988
U.S. government mortgage-backed securities	17,027,697	16,233	(491,241)	16,552,689
State and political subdivisions	119,698,521	969,283	(759,686)	119,908,118
Corporate bonds	60,204,400	853,289	(433,822)	60,623,867
Equity securities	23,912,185	9,914,125	(39,800)	33,786,510
	$ 345,496,061	$ 12,216,312	$ (3,140,509)	$ 354,571,864

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The amortized cost and estimated fair value of debt securities available-for-sale as of December 31, 2007, are shown below by contractual maturity. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 60,466,254	$ 60,275,160
Due after one year through five years	114,175,977	115,247,320
Due after five years through ten years	121,075,039	121,180,900
Due after ten years	24,499,987	24,531,034
	320,217,257	321,234,414
Equity securities	16,725,353	18,707,650
	$ 336,942,610	$ 339,942,064

At December 31, 2007 and 2006, securities with a carrying value of approximately $148,124,970 and $163,497,000, respectively, were pledged as collateral on public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law. Securities sold under agreements to repurchase are held by the Company's safekeeping agent.

For the years ended December 31, 2007, 2006, and 2005, proceeds from sales of available-for-sale securities amounted to $23,445,749, $6,013,192, and $24,937,433, respectively. Gross realized gains and gross realized losses on sales of available-for-sale securities were $4,369,185 and $2,902,488, respectively, in 2007, $1,333,136 with no losses, respectively, in 2006, and $1,287,962 and $236,182, respectively, in 2005. The tax provision applicable to the net realized gains and losses amounted to approximately $587,000, $454,000, and $318,000, respectively. Other-than-temporary impairments recognized as a component of income were $0 in 2007, $198,000 in 2006, and $256,000 in 2005.

The components of other comprehensive income (loss) - net unrealized gains (losses) on securities available-for-sale for the years ended December 31, 2007, 2006, and 2005, were as follows:

	2007	2006	2005
Unrealized holding gains (losses) arising during the period	$ (4,609,651)	$ 4,985,773	$ (5,832,566)
Reclassification adjustment for net gains realized in net income	(1,466,697)	(1,135,136)	(795,780)
Net unrealized gains (losses) before tax effect	(6,076,348)	3,850,637	(6,628,346)
Tax effect	2,248,249	(1,424,736)	2,452,488
Other comprehensive income -Net unrealized gains (losses)on securities	$ (3,828,099)	$ 2,425,901	$ (4,175,858)

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Unrealized losses and fair value, aggregated by investment category and length of time that indi