KENTUCKY BANCSHARES INC /KY/
Form 10-Q
May 16, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2011
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________________ to ___________________

Commission File Number: 000-52598

KENTUCKY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Kentucky	61-0993464
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
P.O. Box 157, Paris, Kentucky	40362-0157
(Address of principal executive offices)	(Zip Code)

Registrant?s telephone number, including area code: (859) 987-1795

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes _____ No _____

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

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

Number of shares of Common Stock outstanding as of April 30, 2011:
2,742,929.

KENTUCKY BANCSHARES, INC.

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Item 1 – Financial Statements

KENTUCKY BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands)	3/31/2011	12/31/2010
Assets		
Cash and due from banks	$ 14,468	$ 12,517
Federal funds sold	151	5,108
Cash and cash equivalents	14,619	17,625
Securities available for sale	176,318	176,867
Loans	414,143	411,830
Allowance for loan losses	(5,641)	(4,925)
Net loans	408,502	406,905

Federal Home Loan Bank stock	6,731	6,731
Real estate owned, net	9,550	8,424
Bank premises and equipment, net	17,266	17,308
Interest receivable	3,868	4,526
Mortgage servicing rights	972	958
Goodwill	13,117	13,117
Other intangible assets	945	1,009
Other assets	4,613	5,473
Total assets	$ 656,501	$ 658,943
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	$ 132,006	$ 105,519
Time deposits, $100,000 and over	88,508	111,239
Other interest bearing	318,265	320,643
Total deposits	538,779	537,401
Repurchase agreements and other borrowings	6,222	7,179
Federal Funds Purchased	2,256	-
Federal Home Loan Bank advances	36,605	43,206
Subordinated debentures	7,217	7,217
Interest payable	1,191	1,257
Other liabilities	1,226	1,640
Total liabilities	593,496	597,900
Stockholders' equity		
Preferred stock, 300,000 shares authorized and unissued	-	-
Common stock, no par value; 10,000,000 shares authorized; 2,742,929 and 2,738,039 shares issued and outstanding on March 31,2011 and December 31, 2010	12,519	12,498
Retained earnings	50,444	49,797
Accumulated other comprehensive income /(loss)	42	(1,252)
Total stockholders' equity	63,005	61,043
Total liabilities & stockholders' equity	$ 656,501	$ 658,943

See Accompanying Notes

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)
(in thousands, except per share amounts)

	Three Months Ending	
	3/31/2011	3/31/2010
INTEREST INCOME:		
Loans, including fees	$ 5,818	$ 5,910
Securities		
Taxable	796	760
Tax exempt	763	814
Other	81	87
Total interest income	7,458	7,571
INTEREST EXPENSE:		
Deposits	1,192	2,092
Repurchase agreements and other borrowings	21	40
Federal Home Loan Bank advances	367	514
Subordinated debentures	58	56
Total interest expense	1,638	2,702
Net interest income	5,820	4,869
Loan loss provision	750	450
Net interest income after provision	5,070	4,419
NON-INTEREST INCOME:		

Service charges	1,003	1,096
Loan service fee income	44	25
Trust department income	166	115
Securities available for sale gains (losses), net	3	3
Gain on sale of mortgage loans	148	126
Brokerage Income	39	22
Debit Card Interchange Income	392	332
Other	32	28
Total other income	1,827	1,747
NON-INTEREST EXPENSE:		
Salaries and employee benefits	2,716	2,449
Occupancy expenses	755	688
Repossession expenses (net)	79	260
FDIC Insurance	229	242
Legal and professional fees	170	124
Data processing	217	203
Debit Card Expenses	170	143
Amortization	64	65
Advertising and marketing	152	129
Taxes other than payroll, property and income	210	195
Telephone	162	85
Postage	77	76
Loan fees	30	45
Other	399	468
Total other expenses	5,430	5,172
Income before taxes	1,467	994
Income taxes	205	49
Net income	$ 1,262	$ 945
Other Comprehensive Income, net of tax and reclassifications:		
Change in Unrealized Gains on Securities	1,294	206
Comprehensive Income	$ 2,556	$ 1,151
Earnings per share		
Basic	$ 0.46	$ 0.35
Diluted	0.46	0.35

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (unaudited)
(in thousands, except share information)

	--Common Stock(1)--			Accumulated Other Comprehensive	S
	Shares	Amount	Retained Earnings	Income / (Loss)	

Balances, January 1, 2011	2,738,039	$ 12,498	$ 49,797	$(1,252)
Common stock issued, including tax benefit, net	5,890	-	-	-
Stock based compensation expense	-	26	-	-
Common stock purchased and retired	(1,000)	(5)	(12)	-
Net change in unrealized gain (loss) on securities available for sale, net of tax and reclassifications	-	-	-	1,294
Net income	-	-	1,262	-
Dividends declared - $0.22 per share	-	-	(603)	-
Balances, March 31, 2011	2,742,929	$ 12,519	$ 50,444	$ 42

(1)Common Stock has no par value; amount includes Additional Paid-in Capital

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)	Three Months Ended	
	3/31/2011	3/31/2010
Cash Flows From Operating Activities		
Net Income	$ 1,262	$ 945
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	398	394
Securities amortization (accretion), net	(17)	203
Stock based compensation expense	26	28
Provision for loan losses	750	450
Securities gains, net	(3)	(3)
Originations of loans held for sale	(5,980)	(5,179)
Proceeds from sale of loans	6,128	4,597
Gains on sale of fixed assets	-	1
Losses (gains)on other real estate	2	(5)
Gain on sale of mortgage loans	(148)	(126)
Changes in:		
Interest receivable	658	258
Real estate owned, net	-	279
Other assets	797	182
Interest payable	(66)	854
Other liabilities	(1,081)	(2,307)
Net cash from operating activities	2,726	571

Cash Flows From Investing Activities		
Purchases of securities	(7,473)	(43,228)
Proceeds from principal payments, maturities and calls of securities	10,003	20,662
Net change in loans	(4,245)	(950)
Purchases of bank premises and equipment	(263)	(647)
Proceeds from the sale of bank premises	-	3
Proceeds from the sale of other real estate	772	330
Net cash from investing activities	(1,206)	(23,830)
Cash Flows From Financing Activities:		
Net change in deposits	1,378	69,162
Net change in repurchase agreements and other borrowings	1,499	(1,260)
Payments on Federal Home Loan Bank advances	(6,583)	(1,581)
Payments on note payable	(200)	(200)
Purchase of common stock	(17)	-
Dividends paid	(603)	(576)
Net cash from financing activities	(4,526)	65,545
Net change in cash and cash equivalents	(3,006)	42,286
Cash and cash equivalents at beginning of period	17,625	34,421
Cash and cash equivalents at end of period	$ 14,619	$ 76,707
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest expense	$ 1,704	$ 1,848
Income taxes	-	-
Supplemental disclosures of non-cash investing activities		
Real estate acquired through foreclosure	$ 1,898	$ 1,801

See Accompanying Notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial information presented as of any date other than December 31 has been prepared from the Company?s books and records without audit. The accompanying consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Certain financial information that is normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America, but is not required for interim reporting purposes, has been condensed or omitted. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of such financial statements, have been included. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Basis of Presentation: The consolidated financial statements include the accounts of Kentucky Bancshares, Inc. (the ?Company?, ?we?, ?our? or ?us?), its wholly-owned subsidiary, Kentucky Bank (the Bank), and the Bank?s wholly-owned subsidiary, KB Special Assets Unit, LLC. Intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations: The Bank operates under a state bank charter and provides full banking services, including trust services, to customers located in Bourbon, Clark, Elliott, Harrison, Jessamine, Rowan, Scott, Woodford and adjoining counties in Kentucky. As a state bank, the Bank is subject to regulation by the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation (FDIC). The Company, a bank holding company, is regulated by the Federal Reserve.

Estimates in the Financial Statements: 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. The allowance for loan losses, mortgage servicing rights, real estate owned, goodwill and fair value of financial instruments are particularly subject to change.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

Adoption of New Accounting Standards

ASU 2011-01 - Receivables (Topic 310) ? Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update 2010-20. The FASB issued this ASU to address concerns that the introduction of the new disclosure requirements of ASC 310-10-50-31 through 50-34 (i.e. ASU 2010-20) for troubled debt restructurings in one reporting period followed by a change in the definition of what constitutes a troubled debt restructuring (see ASU 2011-02 below) shortly thereafter would be burdensome. This ASU provided that such disclosures would be deferred until the effective date of ASU 2011-02 which is discussed in further detail immediately below.

ASU No. 2011-02 - Receivables (Topic 310) ? A Creditor?s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This ASU was issued to improve financial reporting by creating greater consistency in the way GAAP is applied for various types of debt restructurings. The ASU clarifies which loan modifications constitute troubled debt restructurings (TDRs). It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. Although, the ASU does not amend the accounting for troubled debt restructurings, it is expected that application of the clarifications contained in the ASU will result in more modifications being considered troubled debt restructurings.

In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. The provisions of this ASU clarify the guidance on a creditor?s evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the ASU clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor?s ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. In addition, the ASU provides ?a not all inclusive? list of six indicators for creditors to consider when determining if a debtor is experiencing financial difficulties which can be found in 310-40-15-20.

For public companies, the new guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. As a result of applying the amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively. For example, a December 31, year-end company public company will be required to adopt the provisions of the ASU on July 1, 2011. If the company entered into a loan modification between the dates of January 1 and June 30, the company would be required to apply the provisions contained in the ASU to that loan modification to determine if the modification is a TDR. Any impairment resulting from a receivable now considered a TDR, would be recognized in the period ending September 30, 2011. For nonpublic entities, the ASU is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. Early application is permitted.

2. SECURITIES AVAILABLE FOR SALE

INVESTMENT SECURITIES

Period-end securities are as follows:
(in thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
March 31, 2011				
U.S. government agencies	$ 38,317	$ 32	$ (384)	$ 37,965
States and political subdivisions	81,323	1,752	(455)	82,620
Mortgage-backed - residential	56,345	16	(922)	55,439
Equity securities	270	24	-	294
Total	$ 176,255	$ 1,824	$ (1,761)	$ 176,318
December 31, 2010				
U.S. government agencies	$ 43,238	$ 49	$ (309)	$ 42,978
States and political subdivisions	81,887	1,039	(1,773)	81,153

Mortgage-backed - residential	53,369	20	(948)	52,441
Equity securities	270	25	-	295
Total	$ 178,764	$ 1,133	$ (3,030)	$ 176,867

The amortized cost and fair value of securities at March 31, 2011 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity are shown separately.

(in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 227	$ 328
Due after one year through five years	26,431	26,303
Due after five years through ten years	32,352	32,703
Due after ten years	60,630	61,251
	119,640	120,585
Mortgage-backed - residential	56,345	55,439
Equity	270	294
Total	$ 176,255	$ 176,318

The Company reported recognized gross gains on securities available for sale of $3 thousand for the three months ending March 31, 2011 and March 31, 2010. During these periods, the Company had no sales of securities. The reported gains were due to securities that were called during the period.

Securities with unrealized losses at March 31, 2011 and at December 31, 2010 not recognized in income are as follows:

March 31, 2011

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agencies	$ 24,854	$ (384)	$ -	$ -	$24,854	$ (384)
States and municipals	17,039	(447)	588	(8)	17,627	(455)
Mortgage-backed - residential	50,462	(922)	-	-	50,462	(922)
Total temporarily impaired	$ 92,355	$(1,753)	$ 588	$ (8)	$92,943	$(1,76

December 31, 2010

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agencies	$ 29,904	$ (309)	$ -	$ -	$ 29,904	$ (309)
States and municipals	45,084	(1,649)	1,939	(124)	47,022	(1,773)
Mortgage-backed - residential	48,421	(948)	-	-	48,421	(9
Total temporarily impaired	$123,409	$(2,906)	$ 1,939	$ (124)	$125,347	$ (3,0

We evaluate securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In analyzing an issuer?s financial condition, we may consider many factors including, (1) whether the securities are issued by the federal government or its agencies, (2) whether downgrades by bond rating agencies have occurred, (3) the results of reviews of the issuer?s financial condition and near-term prospects, (4) the length of time and the extent to which the fair value has been less than cost, and (5) whether we intend to sell the investment security or more likely than not will be required to sell the investment security before its anticipated recovery.

Unrealized losses on securities included in the tables above have not been recognized into income because (1) all rated securities are investment grade and are of high credit quality, (2) management does not intend to sell and it is more likely than not that management would not be required to sell the securities prior to their anticipated recovery, (3) management believes the decline in fair value is largely due to changes in interest rates and (4) management believes the declines in fair value are temporary. The Company believes the fair value is expected to recover as the securities approach maturity.

3. LOANS

Loans at period-end are as follows:
(in thousands)

	3/31/11	12/31/10
Commercial	$ 26,426	$ 22,840
Real estate construction	14,130	13,518
Real estate mortgage:		
1-4 family residential	158,134	158,877
Multi-family residential	12,538	13,519
Non-farm & non-residential	104,322	105,580
Agricultural	79,606	78,375
Consumer	18,756	18,830
Other	231	291
Total	$ 414,143	$ 411,830

Activity in the allowance for loan losses for the three month periods indicated was as follows:

Three Months Ended March 31, 2011
(in thousands)

	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
Commercial	$ 235	$ 18	$ -	$ 6	$ 223
Real estate Construction	721	-	-	(50)	671
Real estate mortgage:					
1-4 family residential	1,827	90	4	548	2,289
Multi-family residential	148	-	144	(27)	265
Non-farm & non-residential	889	15	14	16	904
Agricultural	265	-	11	(37)	239
Consumer	582	53	6	50	585
Other	58	222	185	16	37
Unallocated	200	-	-	228	428
	$ 4,925	$ 398	$ 364	$ 750	$ 5,641

	Three Months Ended March 31, 2010 (in thousands)
Balance at Beginning of Period	$ 7,600
Amounts Charged-off:	
Commercial	19
Real estate Construction	547
Real estate mortgage:	
1-4 family residential	260
Multi-family residential	-
Non-farm & non-residential	1,453
Agricultural	74
Consumer	236
Total Charged-off Loans	2,589
Recoveries on Amounts Previously Charged-off:	
Commercial	43
Real estate Construction	-
Real estate mortgage:	
1-4 family residential	5
Multi-family residential	-
Non-farm & non-residential	98
Agricultural	8
Consumer	148
Total Recoveries	302
Net Charge-offs	2,287
Provision for Loan Losses	450
Balance at End of Period	5,763

The following tables present the balance in the allowance for loan losses and the recorded investment (excluding accrued interest receivable amounting to $2.5 million as of March 31, 2011 and $3.3 million at December 31, 2010) in loans by portfolio segment and based on impairment method as of March 31, 2011 and December 31 2010:

As of March 31, 2011
(in thousands)

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Allowance for Loan Losses:			
Commercial	$ -	$ 223	$ 223
Real estate construction	372	299	671
Real estate mortgage:			
1-4 family residential	522	1,767	2,289
Multi-family residential	94	171	265
Non-farm & non-residential	290	614	904
Agricultural	6	233	239
Consumer	-	585	585
Other	-	37	37
Unallocated	-	428	428
	$ 1,284	$ 4,357	$ 5,641
Loans:			
Commercial	$ -	$ 26,426	$ 26,426
Real estate construction	6,132	7,998	14,130
Real estate mortgage:			
1-4 family residential	4,652	153,482	158,134

Multi-family residential	1,577	10,961	12,538
Non-farm & non-residential	5,870	98,452	104,322
Agricultural	6,276	73,330	79,606
Consumer	-	18,756	18,756
Other	-	231	231
	$ 24,507	$ 389,636	$ 414,143

As of December 31, 2010
(in thousands)

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Allowance for Loan Losses:			
Commercial	$ -	$ 235	$ 235
Real estate construction	382	339	721
Real estate mortgage:			
1-4 family residential	272	1,555	1,827
Multi-family residential	12	136	148
Non-farm & non-residential	127	762	889
Agricultural	6	259	265
Consumer	-	582	582
Other	-	58	58
Unallocated	-	200	200
	$ 799	$ 4,126	$ 4,925
Loans:			
Commercial	$ -	$ 22,840	$ 22,840
Real estate construction	6,288	7,230	13,518
Real estate mortgage:			
1-4 family residential	3,886	154,991	158,877
Multi-family residential	2,484	11,035	13,519
Non-farm & non-residential	6,347	99,233	105,580
Agricultural	792	77,583	78,375
Consumer	-	18,830	18,830
Other	-	291	291
	$ 19,797	$ 392,033	$ 411,830

The following table presents individually impaired average loan balances by class as of March 31, 2011:

(in thousands)	3/31/11 Average
Commercial	$ -
Real Estate construction	6,348
Real estate mortgage:	
1-4 family residential	3,611
Multi-family residential	2,031
Non-farm & non-residential	5,807
Agricultural	3,534
Installment	-
Other	-
Total	$ 21,331

Cash-basis interest income recognized during impairment for the three months ending March 31, 2011 is shown below:

(in thousands)

3/31/11

Commercial	$ -
Real estate construction	-
Real estate mortgage:	
1-4 family residential	5
Multi-family residential	-
Non-farm & non-residential	-
Agricultural	29
Consumer	-
Other	-
Total	$ 34

The annual average of individually impaired loans as of December 31, 2010 was $11.7 million and $149 thousand was recognized during 2010 as interest income on a cash-basis.

The following tables present loans individually evaluated for impairment by class of loans as of March 31, 2011 and December 31, 2010:

As of March 31, 2011
(in thousands)

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real estate construction	2,973	2,973	-
Real estate mortgage:			
1-4 family residential	1,179	1,179	-
Multi-family residential	889	889	-
Non-farm & non-residential	5,015	5,015	-
Agricultural	6,180	6,180	-
Consumer	-	-	-
Other	-	-	-
Total	16,236	16,236	-
With an allowance recorded:			
Commercial	-	-	-
Real estate construction	3,159	3,159	372
Real estate mortgage:			
1-4 family residential	3,473	3,473	522
Multi-family residential	688	688	94
Non-farm & non-residential	855	855	290
Agricultural	96	96	6
Consumer	-	-	-
Other	-	-	-
Total	8,271	8,271	1,284
Total impaired loans	$ 24,507	$ 24,507	$ 1,284

As of December 31, 2010
(in thousands)

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			

Commercial	$ -	$ -	$ -
Real estate construction	2,178	2,178	-
Real estate mortgage:			
1-4 family residential	1,404	1,404	-
Multi-family residential	1,381	1,381	-
Non-farm & non-residential	4,464	4,464	-
Agricultural	696	696	-
Consumer	-	-	-
Other	-	-	-
Total	10,123	10,123	-
With an allowance recorded:			
Commercial	-	-	-
Real estate construction	4,109	4,109	382
Real estate mortgage:			
1-4 family residential	2,482	2,482	272
Multi-family residential	1,103	1,103	12
Non-farm & non-residential	1,884	1,884	127
Agricultural	96	96	6
Consumer	-	-	-
Other	-	-	-
Total	9,674	9,674	799
Total Impaired Loans	$ 19,797	$ 19,797	$ 799

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of March 31, 2011 and December 31, 2010:

As of March 31, 2011

(in thousands)	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Commercial	$ -	$ -
Real estate construction	3,296	-
Real estate mortgage:		
1-4 family residential	3,345	353
Multi-family residential	1,577	-
Non-farm & non-residential	654	-
Agricultural	1,668	348
Consumer	17	-
Other	-	-
Total	$ 10,557	$ 701

As of December 31, 2010

(in thousands)	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Commercial	$ 18	$ -
Real estate construction	3,451	-
Real estate mortgage:		
1-4 family residential	3,381	684
Multi-family residential	2,484	-
Non-farm & non-residential	2,115	3
Agricultural	1,016	-
Consumer	14	19
Other	-	-

Total	$ 12,479	$ 706

Nonaccrual loans secured by real estate make up 99.7% of the total nonaccruals.

Nonaccrual loans are included in impaired loans. A loan is impaired when full payment under the contractual terms is not expected.

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

During the first three months of 2011, $1.9 million of impaired loans were transferred to other real estate owned and $398 thousand recorded in charge offs which contributed to a reduction in nonaccrual loan balances.

The following tables present the aging of the recorded investment in past due and non-accrual loans as of March 31, 2011 and December 31, 2010 by class of loans:

As of March 31, 2011
(in thousands)

	30?59 Days Past Due	60?89 Days Past Due	Loans Past Due Over 90 Days Still Accruing	Non-accrual	Total Past Due & Non-accrual
Commercial	$ 32	$ 46	$ -	$ -	$ 78
Real estate construction	81	-	-	3,296	3,377
Real estate mortgage:					
1-4 family residential	2,682	65	353	3,345	6,445
Multi-family residential		-	-	1,577	1,577
Non-farm & non-residential	193	237	-	654	1,084
Agricultural	813	436	348	1,668	3,265
Consumer	102	16	-	17	135
Other	-	-	-	-	-
Total	$ 3,903	$ 800	$ 701	$ 10,557	$ 15,961

As of December 31, 2010
(in thousands)

	30?59 Days Past Due	60?89 Days Past Due	Loans Past Due Over 90 Days Still Accruing	Non-accrual	Total Past Due & Non-accrual
Commercial	$ 246	$ -	$ -	$ 18	$ 264
Real estate construction	192	-	-	3,452	3,644
Real estate mortgage:					
1-4 family residential	4,215	224	684	3,381	8,504
Multi-family residential	49	-	-	2,484	2,533
Non-farm & non-residential	121	113	3	2,114	2,351
Agricultural	1,101	141	-	1,016	2,258

Consumer	192	29	19	14	254
Other	-	-	-	-	-
Total	$ 6,116	$ 507	$ 706	$ 12,479	$ 19,808

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $200,000 primarily non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of March 31, 2011 and December 31, 2010, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

As of March 31, 2011
(in thousands)

	Pass	Special Mention	Substandard	Doubtful
Commercial	$ 32,806	$ 1,302	$ 279	$ 16
Real estate construction	4,620	3,178	6,207	125
Real estate mortgage:				
1-4 family residential	136,975	10,486	10,615	57
Multi-family residential	10,805	44	1,689	-
Non-farm & non-residential	88,466	1,539	6,053	287
Agricultural	65,378	6,939	7,289	-
Total	$339,050	$23,488	$32,132	$ 485

As of December 31, 2010
(in thousands)

	Pass	Special Mention	Substandard	Doubtful
Commercial	$ 21,225	$ 1,310	$ 305	$ -
Real estate construction	3,412	3,620	6,486	-
Real estate mortgage:				
1-4 family residential	138,066	11,029	9,721	60
Multi-family residential	10,872	44	2,603	-
Non-farm & non-residential	98,032	1,071	6,478	-
Agricultural	72,091	4,664	1,620	-
Total	$343,698	$21,738	$27,213	$ 60

For consumer loans, the Company evaluates the credit quality based on the aging of the recorded investment in loans, which was previously presented. Non-performing consumer loans are loans which are greater than 90 days past due or on non-accrual status, and total $17 thousand at March 31, 2011 and $33 thousand at December 31, 2010.

The Company has no troubled debt restructurings as of March 31, 2011 and December 31, 2010.

4. REAL ESTATE OWNED

Activity in the valuation allowance was as follows:

	For the three months ending: 2011	2010
	(in thousands)	
Beginning of year	$ 799	$ 12
Additions charged to expense	-	279
Recovery from sale	(3)	-
End of period	$ 796	$ 291

Expenses related to foreclosed assets include:

	2011	2010
Net loss (gain) on sales	$ 2	$ (5)
Provision for unrealized losses	-	279
Operating expenses (receipts), net of rental income	78	(19)
End of period	$ 80	$ 255

5. EARNINGS PER SHARE

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options.

The factors used in the earnings per share computation follow:

	Three Months Ended March 31 2011	2010
	(in thousands)	
Basic Earnings Per Share		
Net Income	$ 1,262	$ 945

Weighted average common shares outstanding	2,731	2,732
Basic earnings per share	$ 0.46	$ 0.35
Diluted Earnings Per Share		
Net Income	$ 1,262	$ 945
Weighted average common shares outstanding	2,731	2,732
Add dilutive effects of assumed exercise of stock options	4	-
Weighted average common and dilutive potential common shares outstanding	2,735	2,732
Diluted earnings per share	$ 0.46	$ 0.35

Stock options for 31,540 shares of common stock for three months ended March 31, 2011 and 33,490 shares of common stock for the three months ended March 31, 2010 was excluded from diluted earnings per share because their impact was antidilutive. Stock grants of 17,655 shares of common stock for the three months ended March 31, 2011 and 21,705 shares of common stock for the three months ended March 31, 2010 was excluded from diluted earnings per share because their impact was antidilutive.

6. STOCK COMPENSATION

We have four share based compensation plans as described below.

Two Stock Option Plans

Under our now expired 1999 Employee Stock Option Plan (the ?1999 Plan?), we granted certain officers and key employees stock option awards which vest and become fully exercisable at the end of five years and provide for issuance of up to 100,000 options. Under the now expired 1993 Non-Employee Directors Stock Ownership Incentive Plan (together with the 1999 Plan, the ?Stock Option Plans?), we also granted certain directors stock option awards which vest and become fully exercisable immediately and provide for issuance of up to 20,000 options. For each Stock Option Plan, the exercise price of each option, which has a ten year life, was equal to the market price of our stock on the date of grant.

The combined summary of activity for 2011 in the expired Stock Option Plans follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	32,640	$29.48		
Granted	-	-		
Forfeited or expired	(1,100)	23.61		
Exercised	-	-		
Outstanding, end of period	31,540	$29.69	36.7 months	$ -
Vested and expected to vest	31,540	$29.69	36.7 months	$ -
Exercisable, end of period	31,540	$29.69	36.7 months	$ -

As of March 31, 2011, there was $0 of total unrecognized compensation cost related to nonvested stock options granted under either Plan. Since both Stock Option Plans have expired, as of March 31, 2011 no additional options can be granted under either of these plans.

2005 Restricted Stock Grant Plan

On May 10, 2005, our stockholders approved a restricted stock grant plan. Total shares issuable under the plan are 50,000. There were 5,955 shares issued during 2011 and 4,020 shares issued during 2010. There were 65 shares forfeited during the first three months of 2011 and 60 shares forfeited during the first three months of 2010. As of March 31, 2011, the restricted stock grant plan allows for additional restricted stock share awards of up to 24,611 shares.

A summary of changes in the Company?s nonvested shares for the year follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value	Fair Value Per Share
Nonvested at January 1, 2011	10,486	$ 231,659	$22.09
Granted	5,955	100,496	16.88
Vested	(3,311)	(81,435)	24.60
Forfeited	(65)	(1,089)	16.75
Nonvested at March 31, 2011	13,065	$ 249,631	19.11

As of March 31, 2011, there was $209,106 of total unrecognized compensation cost related to nonvested shares granted under the restricted stock grant plan. The cost is expected to be recognized over a weighted-average period of 5 years.

2009 Stock Award Plan

On May 13, 2009, our stockholders approved a stock award plan that provides for the granting of both incentive and nonqualified stock options and other share based awards. Total shares issuable under the plan are 150,000. As of March 31, 2011 no awards have been granted under the plan and 150,000 shares are still available.

7. FAIR VALUE MEASUREMENTS

ASC Topic 820, ?Fair Value Measurements and Disclosures?, defines fair value, establishes a framework for measuring fair value, and sets forth disclosures about fair value measurements. ASC Topic 825, ?Financial Instruments?, allows entities to choose to measure certain financial assets and liabilities at fair value. The Company has not elected the fair value option for any financial assets or liabilities.

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This Topic describes three levels of inputs that may be used to measure fair value:

Level 1 ? Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 ? Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 ? Significant unobservable inputs that reflect a company?s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value:

Investment Securities: The fair values for available for sale investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Mortgage Servicing Rights: Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income, resulting in a Level 3 classification.

Assets and Liabilities Measured on a Recurring Basis

Available for sale investment securities are the Company?s only balance sheet item that meet the disclosure requirements for instruments measured at fair value on a recurring basis. Disclosures are as follows in the tables below.

(In thousands)	Fair Value Measurements at March 31, 2011 Using:		
	Quoted Prices In Active Markets for	Significant Other	Significant

Description	Fair Value	Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
U. S. government agencies	$ 37,965	$ -	$ 37,965	$ -
States and municipals	82,620	-	82,620	-
Mortgage-backed - residential	55,439	-	55,439	-
Equity securities	294	294	-	-
Total	$176,318	$ 294	$176,024	$ -

(In thousands) Fair Value Measurements at December 31, 2010 Using:

Description	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U. S. government agencies	$ 42,978	$ -	$ 42,978	$ -
States and municipals	81,153	-	81,153	-
Mortgage-backed - residential	52,441	-	52,441	-
Equity securities	295	295	-	-
Total	$176,867	$ 295	$176,572	$ -

Assets measured at fair value on a non-recurring basis are summarized below:

(In thousands) Fair Value Measurements at March 31, 2011 Using:

Description	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Real estate commercial	$ -	$ -	$ -	$ -
Real estate construction	2,787	-	-	2,787
Real Estate Mortgage:				
1-4 family residential	2,951	-	-	2,951
Multi-family residential	594	-	-	594
Non-farm & non-residential	565	-	-	565

Agricultural	90	-	-	90
Total impaired loans	6,987	-	-	6,987
Other real estate owned:				
Residential	3,158	-	-	3,158
Commercial real estate	1,665	-	-	1,665
Total other real estate owned	4,823	-	-	4,823
Loan servicing rights	177	-	-	177

(In thousands) Fair Value Measurements at December 31, 2010 Using:

Description	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Real estate commercial	$ -	$ -	$ -	$ -
Real estate construction	3,727	-	-	3,727
Real Estate Mortgage:				
1-4 family residential	2,209	-	-	2,209
Multi-family residential	1,092	-	-	1,092
Non-farm & non-residential	1,757	-	-	1,757
Agricultural	90	-	-	90
Total impaired loans	8,875	-	-	8,875
Other real estate owned:				
Residential	3,365	-	-	3,365
Commercial real estate	1,668	-	-	1,668
Total other real estate owned:	5,033	-	-	5,033
Loan servicing rights	138	-	-	138

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $7.9 million, with a valuation allowance of $1.4 million at March 31, 2011, resulting in an additional provision of $614 thousand for loan losses for the three months ending March 31, 2011. The provision for the three months ending March 31, 2011 is $750 thousand.

Other real estate owned which is measured at fair value less costs to sell, had a net carrying amount of $4.0 million, which is made up of the outstanding balance of $4.8 million, net of a valuation allowance of $796 thousand at March 31, 2011. The write-down for the three months ending March 31, 2011 is $0.

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were approximately $143.0 million at March 31, 2011 and $142.1 million at December 31, 2010. The fair value of servicing rights was approximately $1.2 million at March 31, 2011 and $1.1 million at December 31, 2010. During the first quarter of 2011, the carrying value of the servicing rights was written up $20 thousand due to a positive valuation adjustment.

Fair Value of Financial Instruments

The fair values of the Company?s financial instruments at March 31, 2011 and December 31, 2010 are as follows:

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets				
Cash and cash equivalents	$ 14,619	$ 14,619	$ 17,625	$ 17,625
Securities	176,318	176,318	176,867	176,867
Loans, net	408,591	409,283	406,905	407,925
FHLB stock	6,731	N/A	6,731	N/A
Interest receivable	3,868	3,868	4,526	4,526
Financial liabilities				
Deposits	$ 538,779	$ 541,546	$ 537,401	$ 539,939
Securities sold under agreements to repurchase and other borrowings	6,222	6,221	7,179	7,178
FHLB advances	36,605	38,163	43,206	45,071
Subordinated debentures	7,217	6,971	7,217	6,151
Interest payable	1,191	1,191	1,257	1,257

The methods and assumptions, not previously presented, used to estimate fair value are described as follows: Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk (including consideration of widening credit spreads). Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material.

Item 2 - MANAGEMENT?S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This discussion contains forward-looking statements under the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. These statements are not historical facts, but rather statements based on our current expectations regarding our business strategies and their intended results and our future performance. Forward-looking statements are preceded by terms such as ?expects,? ?believes,? ?anticipates,? ?intends? and similar expressions.

Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements included herein will prove to be accurate. Factors that could cause actual results to differ from the results discussed in the forward-looking statements include, but are not limited to: economic conditions (both generally and more specifically in the markets, including the tobacco market and the thoroughbred horse industry, in which we and our bank operate); competition for our subsidiary?s customers from other providers of financial and mortgage services; government legislation, regulation and monetary policy (which changes from time to time and over which we have no control); changes in interest rates (both generally and more specifically mortgage interest rates); material unforeseen changes in the liquidity, results of operations, or financial condition of our subsidiary?s customers; adequacy of the allowance for losses on loans and the level of future provisions for losses on loans; and other risks detailed in our filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond our control.

You are cautioned not to place undue reliance on any forward-looking statements made by us or on our behalf. We undertake no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Summary

The Company recorded net income of $1.3 million, or $0.46 basic earnings and diluted earnings per share for the first three months ending March 31, 2011 compared to $945 thousand or $0.35 basic earnings and diluted earnings per share for the three month period ending March 31, 2010. The first three months earnings reflects an increase of 33.7% compared to the same time period in 2010, due primarily to an increase in net interest income of $951 thousand and a decrease in repossession expense of $181 thousand. These positive changes to net income during 2011 were partially offset by an increase of $300 thousand for the provision for loan losses and an increase in employee salaries and benefits of $267 thousand.

Return on average assets was 0.76% for the three months ended March 31, 2011 and 0.54% for the three month period ended March 31, 2010. Return on average equity was 8.2% for the three month period ended March 31, 2011 and 6.1% for the same period in 2010.

Gross Loans increased $2.4 million from $411.8 million on December 31, 2010 to $414.2 million on March 31, 2011. The overall increase is attributed mostly an increase in commercial loans of $3.6 million, an increase in agricultural loans of $1.2 million and an increase of $612 thousand in real estate construction loans. These increases were partially offset by a decrease in non-farm & non-residential loans of $1.2 million, a decrease in multi-family residential loans of $981 thousand and a decrease of $743 thousand in 1-4 family residential property loans.

Total deposits increased from $537.4 million on December 31, 2010 to $538.8 million on March 31, 2011, an increase of $1.4 million. This increase is primarily the result of an increase in non-interest bearing deposit accounts of $26.5 million. This increase is not all attributed to additional deposits being placed with the bank as part of the increase is attributed to deposit accounts changing from time deposits to non-interest bearing demand deposit accounts. Time deposits $100 thousand and over decreased $22.7 million and other interest bearing deposit accounts decreased $2.4 million.

Net Interest Income

Net interest income is the difference between interest income earned on interest-earning assets and the interest expense paid on interest-bearing liabilities.

Net interest income was $5.8 million for the three months ended March 31, 2011 compared to $4.9 million for the three months ended March 31, 2010, an increase of 19.5%. The interest spread of 3.85% for the first three months of 2011 is up from 3.02% reported for the same period in 2010, an increase of 83 basis points. Rates have remained fairly low in the past year. The significant increase in the net interest spread is largely attributed to a decrease in the cost of certificate of deposit accounts. For the first three months ending March 31, 2011, the cost of total deposits was 0.88% compared to 1.50% for the same time period in 2010. Increasing non-interest bearing deposit accounts has also helped to lower the cost of deposits.

For the first three months, the yield on assets increased from 4.74% in 2010 to 4.96% in 2011. The year to date average balance of federal funds sold decreased $35.6 million for the first three months in 2011 compared to 2010 due to an influx of short term deposits in 2010. This helped to increase the yield on earning assets in 2011 because of the low rates earned on federal funds sold. Also, the yield on loans increased ten basis points in the first three months of 2011 compared to 2010. The cost of liabilities decreased from 1.72% in 2010 to 1.11% in 2011. Year to date average loans decreased $13.8 million, or 3.25% from March 31, 2010 to March 31, 2011. Loan interest income has decreased $92 thousand for the first three months of 2011 compared to the first three months of 2010. Year to date average deposits decreased from March 31, 2010 to March 31, 2011, down $18.4 million or 3.25%. The decrease is primarily the result of a decrease in time deposits that matured during the fourth quarter of 2010. Deposit interest expense has decreased $900 thousand for the first three months of 2011 compared to the same period in 2010. Year to date average borrowings decreased $17.3 million, or 24.81% from March 31, 2010 to March 31, 2011. The decrease is primarily the result of paying off FHLB advances when they come due and not replacing them. Interest expense on borrowed funds has decreased $164 thousand for the first three months of 2011 compared to the same period in 2010.

The volume rate analysis for 2011 that follows indicates that $460 thousand of the decrease in interest income is attributable to the decrease in volume, while the change in rates contributed to an increase of $347 thousand in interest income. Even more affected by volume and rate changes was the liability side of the balance sheet. The average rate of the Company?s total outstanding deposits and borrowing liabilities decreased from 1.72% in 2010 to 1.11% in 2011. Based on the volume rate analysis that follows, the lower level of interest rates contributed to a decrease of $610 thousand in interest expense, while the change in volume was responsible for a $454 thousand decrease in interest expense. As a result, the 2011 net interest income increase is mostly attributed to decreases in rates on deposits and an increase in rates on loans.

The accompanying analysis of changes in net interest income in the following table shows the relationships of the volume and rate portions of these changes in 2010. Changes in interest income and expenses due to both rate and volume are allocated on a pro rata basis.

Changes in Interest Income and Expense

(in thousands)	2011 vs. 2010		
	Increase (Decrease) Due to Change in		
	Volume	Rate	Net Change
INTEREST INCOME			
Loans	$ (599)	$ 507	$ (92)
Investment Securities	165	(180)	(15)
Federal Funds Sold and Securities Purchased under Agreements to Resell	(25)	19	(6)
Deposits with Banks	(1)	1	-
Total Interest Income	(460)	347	(113)
INTEREST EXPENSE			
Deposits			
Demand	15	18	33
Savings	11	(21)	(10)
Negotiable Certificates of Deposit and Other Time Deposits	(301)	(622)	(923)
Securities sold under agreements to repurchase and other borrowings	(8)	(9)	(17)
Federal Home Loan Bank advances	(171)	24	(147)
Total Interest Expense	(454)	(610)	(1,064)
Net Interest Income	$ (6)	$ 957	$ 951

Non-Interest Income

Non-interest income increased $80 thousand for the three months ended March 31, 2011 compared to the same period in 2010 to $1.8 million, due primarily to an increase in debit card interchange income of $60 thousand and an increase in trust fees and commissions of $51 thousand. Service charges decreased $93 thousand for the comparable time. This decrease was mostly due to a decrease of $104 thousand in overdraft fee income.

The gain on the sale of mortgage loans increased from $126 thousand in the first three months of 2010 to $148 thousand during the first three months of 2011, an increase of $22 thousand. The volume of loans sold during the first three months of 2011 increased $1.5 million compared to the same time period in 2010. The volume of mortgage loan originations and sales is generally inverse to rate changes. A change in the mortgage loan rate environment can have a significant impact on the related gain on sale of mortgage loans. Loan service fee income was $44 thousand for the three months ending March 31, 2011 compared to $25 thousand for the three months ending March 31, 2010, an increase of $19 thousand. During the first quarter of 2011, a positive valuation adjustment was booked for $20 thousand for the Mortgage Servicing Right.

Non-Interest Expense

Total non-interest expenses increased $258 thousand for the three month period ended March 31, 2011 compared to the same period in 2010.

For the comparable three month periods, salaries and benefits increased $267 thousand, an increase of 10.9%. The increase is attributed largely to additional employees being hired throughout 2010 and in the first quarter of 2011. The number of full time equivalent employees at March 31, 2011 was 189 compared to 178 one year ago. In addition, $60 thousand was expensed in the first quarter of 2011 to accrue for unused vacation time that employees can carry over into future periods and unused major illness time that certain employees may be eligible to receive upon retirement. The Company began accruing for this liability in the second quarter of 2010.
Occupancy expenses increased $67 thousand to $755 thousand for the first three months of 2011 compared to the same time period in 2010. The increase in occupancy expense during 2011 is primarily the result of an increase in depreciation expense of $16 thousand and an increase in computer maintenance of $33 thousand.

Legal and professional fees increased $46 thousand for the first three months ended March 31, 2011 compared to the same time period in 2010. The increase is primarily from additional collection efforts for problem loans. Repossession expenses decreased $181 thousand for the first three months ended March 31, 2011 compared to the same time period in 2010. Repossession expenses are reported net of income earned on the repossessed properties. Repossession expenses were higher during the first quarter of 2010 when compared to the same time period in 2011 due to $277 thousand being expensed for the write-downs of other real estate owned properties in 2010 and $0 being expensed in 2011. In addition, the rents earned on other real estate properties increased $77 thousand from last year to $153 thousand.

Income Taxes

The effective tax rate for the three months ended March 31, 2011 was 14.0% compared to 4.9% in 2010. These rates are less than the statutory rate as a result of the tax-free securities and loans and tax credits generated by certain investments held by the Company. The rates for 2011 are higher due to the higher level of income for 2011. Tax-exempt interest income decreased $51 thousand for the first three months of 2011 compared to the first three months of 2010.

Liquidity and Funding

Liquidity is the ability to meet current and future financial obligations. The Company?s primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of investment securities and FHLB borrowings.

Liquidity risk is the possibility that we may not be able to meet our cash requirements. Management of liquidity risk includes maintenance of adequate cash and sources of cash to fund operations and to meet the needs of borrowers, depositors and creditors. Excess liquidity has a negative impact on earnings as a result of the lower yields on short-term assets.

Cash and cash equivalents were $14.6 million as of March 31, 2011 compared to $17.6 million at December 31, 2010. The decrease in cash and cash equivalents is mainly attributable to a decrease in federal funds sold of $5.0 million resulting primarily from an increase in our loan portfolio and an increase in our cash and ?due from? accounts with correspondent banks. In addition to cash and cash equivalents, the securities portfolio provides an important source of liquidity. Securities available for sale totaled $176.3 million at March 31, 2011 compared to $176.9 million at December 31, 2010. The available for sale securities are available to meet liquidity needs on a continuing basis. We expect our customers? deposits to be adequate to meet our funding demands.

Generally, we rely upon net cash inflows from financing activities, supplemented by net cash inflows from operating activities, to provide cash used in our investing activities. As is typical of many financial institutions, significant financing activities include deposit gathering and the use of short-term borrowings, such as federal funds purchased and securities sold under repurchase agreements along with long-term debt. Our primary investing activities include purchasing investment securities and loan originations.

For the first three months of 2011, deposits have increased $1.4 million. The Company has been able to keep its investment portfolio relatively flat with a $549 thousand decrease in the security portfolio while the loan portfolio increased $2.4 million. In addition, the Company has paid down FHLB advances by $6.6 million during the first three months of 2011 and will continue to pay those down as they mature.

Management is aware of the challenge of funding sustained loan growth. Therefore, in addition to deposits, other sources of funds, such as Federal Home Loan Bank (FHLB) advances, may be used. We rely on FHLB advances for both liquidity and asset/liability management purposes. These advances are used primarily to fund long-term fixed rate residential mortgage loans. As of March 31, 2011, we have sufficient collateral to borrow an additional $14 million from the FHLB. In addition, as of March 31, 2011, over $29 million is available in overnight borrowing through various correspondent banks and the Company has access to $194 million in brokered deposits. In light of this, management believes there is sufficient liquidity to meet all reasonable borrower, depositor and creditor needs in the present economic environment.

Capital Requirements

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company?s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company?s and the Bank?s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and Bank capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of March 31, 2011 and December 31, 2010, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

The most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution?s category.

The Company?s and the Bank?s actual amounts and ratios are presented in the table below:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisio	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
March 31, 2011						
Consolidated						
Total Capital (to Risk-Weighted Assets)	$ 61,928	13.4%	$ 36,887	8%	$ N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	56,201	12.2	18,444	4	N/A	N/A
Tier I Capital (to Average Assets)	56,201	8.7	25,995	4	N/A	N/A
Bank Only						
Total Capital (to Risk-Weighted Assets)	$ 63,449	13.8%	$ 36,898	8%	$ 46,122	10%
Tier I Capital (to Risk-Weighted Assets)	57,722	12.5	18,449	4	27,673	6
Tier I Capital (to Average Assets)	57,722	8.9	25,986	4	32,482	5
December 31, 2010						
Consolidated						
Total Capital (to Risk-Weighted Assets)	$ 60,500	13.1%	$ 36,823	8%	N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	55,489	12.1	18,412	4	N/A	N/A
Tier I Capital (to Average Assets)	55,489	8.5	26,218	4	N/A	N/A
Bank Only						
Total Capital (to Risk-Weighted Assets)	$ 62,143	13.5%	$ 36,810	8%	$ 46,013	10%
Tier I Capital (to Risk-Weighted Assets)	57,131	12.4	18,405	4	27,608	6
Tier I Capital (to Average Assets)	57,131	8.7	26,208	4	32,760	5

Non-Performing Assets

As of March 31, 2011, our non-performing assets totaled $20.7 million or 3.16% of assets compared to $21.6 million or 3.28% of assets at December 31, 2010 (See table below.) We experienced a decrease of $2.0 million in non-accrual loans from December 31, 2010 to March 31, 2011, due to a decrease in non-accrual loans secured by real estate of $1.9 million. As of March 31, 2011, non-accrual loans include $3.3 million in loans secured by real estate construction, $1.7 million in loans secured by farmland, $3.3 million in loans secured by 1-4 family residential properties, $1.6 million in loans secured by multi-family real estate and $565 thousand in loans secured by non-farm & non-residential real estate. Real estate loans composed 99.7% of the non-performing loans as of March 31, 2011 and December 31, 2010. Forgone interest income on the non-accrual loans was $54 thousand for the first three months of 2011 compared to $253 thousand for the same time period in 2010. Accruing loans that are contractually 90 days or more past due as of March 31, 2011 totaled $701 thousand compared to $706 thousand at December 31, 2010, a decrease of $5 thousand. The total nonperforming loans decreased $2.0 million from December 31, 2010 to March 31, 2011, resulting in a decrease in the ratio of nonperforming loans to loans of 50 basis points to 2.70%. In addition, the amount the Company has booked as ?Other Real Estate? has increased $1.1 million from December 31, 2010 to March 31, 2011. As of March 31, 2011, the amount booked as ?Other Real Estate? totaled $9.5 million compared to $8.4 million at December 31, 2010. The overall increase is largely attributed to one loan customer who specialized in commercial & land development properties that totaled $1.6 million that was previously on non-accrual. In March 2011, $1.1 million of the outstanding loan balance was repossessed and booked into Other Real Estate Owned leaving $287 thousand of the loan included in non-accrual loans, and this is fully reserved for as of March 31, 2011. The allowance as a percentage of non-performing and restructured loans and Other Real Estate Owned increased from 23% at December 31, 2010 to 27% at March 31, 2011.

Nonperforming Assets

	3/31/11	12/31/10
	(in thousands)	
Non-accrual Loans	$ 10,468	$ 12,479
Accruing Loans which are Contractually past due 90 days or more	701	706
Total Nonperforming Loans	11,169	13,185
Other Real Estate	9,550	8,424
Total Nonperforming Loans and Other Real Estate	$ 20,719	$ 21,609
Nonperforming Loans as a Percentage of Loans	2.70%	3.20%
Nonperforming Loans and Other Real Estate as a Percentage of Total Assets	3.16%	3.28%
Allowance as a Percentage of Period-end Loans	1.36%	1.20%
Allowance as a Percentage of Non-performing Loans and Other Real Estate	27%	23%

We maintain a ?watch list? of agricultural, commercial, real estate mortgage, and real estate construction loans and review those loans on a regular basis. Generally, assets are designated as ?watch list? loans to ensure more frequent monitoring. If we determine that there is serious doubt as to performance in accordance with original terms of the contract, then the loan is generally downgraded and often placed on non-accrual status. We review and evaluate nonaccrual loans, past due loans, and loans graded substandard or worse on a regular basis to determine if specific allocations are needed.

Provision for Loan Losses

The loan loss provision for the first three months was $750 thousand for 2011 and $450 thousand for 2010. The increase of $300 thousand for the loan loss provision in 2011 compared to 2010 is largely due to reserving for two loans that are expected to be charged off during the second quarter of 2011 with projected losses estimated to be $377 thousand. Based on recent information obtained (i.e., signed sales contract, a decrease in occupancy levels during the first quarter of 2011, etc.) these losses are $288 thousand greater than calculated at December 31, 2010. Management evaluates the loan portfolio by reviewing the historical loss rate for each respective loan type and assigns risk multiples to certain categories to account for qualitative factors including current economic conditions. The average loss rates are reviewed for trends in the analysis, as well as comparisons to peer group loss rates. Management makes allocations within the allowance for loan losses for specifically classified loans regardless of loan amount, collateral or loan type. Loan categories are evaluated utilizing subjective factors in addition to the historical loss calculations to determine a loss allocation for each of those types. As this analysis, or any similar analysis, is an imprecise measure of loss, the allowance is subject to ongoing adjustments. Therefore, management will often take into account other significant factors that may be necessary or prudent in order to reflect probable incurred losses in the total loan portfolio.

Net charge-offs for the three month period ended March 31, 2011 were $34 thousand compared to net charge-offs of $2.3 million for the same period in 2010. Based on our internal loan review as of December 31, 2009, an addition of $1.8 million was made to the allowance for loan losses in the fourth quarter of 2009. Many of the charged-off loans recorded in the first quarter of 2010 were directly related to the additional provision in the fourth quarter of 2009. Future levels of charge-offs will be determined by the particular facts and circumstances surrounding individual loans. Based on the above information, management believes the current loan loss allowance is sufficient to meet probable incurred loan losses.

Loan Losses	Three Months Ended March 31 (in thousands)	
	2011	2010
Balance at Beginning of Period	$ 4,925	$ 7,600
Amounts Charged-off:		
Commercial	18	19
Real Estate Construction	-	547
1-4 family residential	90	260
Multi-family residential	-	-
Non-farm & non-residential	15	1,453
Real Estate Mortgage	-	-
Agricultural	-	74
Consumer	275	236
Total Charged-off Loans	398	2,589
Recoveries on Amounts Previously Charged-off:		
Commercial	-	43
Real Estate Construction	-	-
1-4 family residential	4	6
Multi-family residential	144	-
Non-farm & non-residential	14	98
Real Estate Mortgage	-	-
Agricultural	11	8
Consumer	191	147
Total Recoveries	364	302
Net Charge-offs	34	2,287
Provision for Loan Losses	750	450
Balance at End of Period	5,641	5,763
Loans		
Average	409,449	423,164

At March 31	414,232	422,270
As a Percentage of Average Loans:		
Net Charge-offs for the period	0.01%	0.54%
Provision for Loan Losses for the period	0.18%	0.11%
Allowance as a Multiple of		
Net Charge-offs (annualized)	41.5	0.6

Item 3 ? QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Asset/Liability management control is designed to ensure safety and soundness, maintain liquidity and regulatory capital standards, and achieve acceptable net interest income. Management considers interest rate risk to be the most significant market risk. Our exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk, while at the same time, maximize income.

Management realizes certain risks are inherent and that the goal is to identify and minimize the risks. The primary tools used by management are interest rate shock and economic value of equity (EVE) simulations. We have no market risk sensitive instruments held for trading purposes.

Using interest rate shock simulations, the following table depicts the change in net interest income resulting from 100 and 300 basis point changes in rates on the Company?s interest earning assets and interest bearing liabilities. The projections are based on balance sheet growth assumptions and repricing opportunities for new, maturing and adjustable rate amounts. As of March 31, 2011, the projected percentage changes are within the Board approved limits. Although management does analyze and monitor the projected percentage change in a declining interest rate environment, due to the current rate environment many of the current deposit rates cannot decline an additional 100 basis points. Therefore, management places more emphasis in the rising rate environment scenarios. This period?s volatility is lower in each rising rate shock simulation and higher in each falling rate shock environment when compared to the same period a year ago. The projected net interest income report summarizing our interest rate sensitivity as of March 31, 2011 is as follows:

PROJECTED NET INTEREST INCOME
(dollars in thousands)

Change in basis points:	- 300	- 100	Level Rates	+ 100	+ 300
Year One (4/11 - 3/12)					
Net interest income	$23,882	$24,626	$25,132	$25,028	$24,930
Net interest income dollar change	(1,250)	(506)	N/A	(105)	(202)
Net interest income percentage change	-5.0%	-2.0%	N/A	-0.4%	-0.8%
Board approved limit	>-10.0%	>-4.0%	N/A	>-4.0%	>-10.0%

The projected net interest income report summarizing the Company's interest rate sensitivity as of March 31, 2010 is as follows:

PROJECTED NET INTEREST INCOME
(dollars in thousands)

Change in basis points:	- 300	- 100	Level Rates	+ 100	+ 300

Year One (4/10 - 3/11)					
Net interest income	$22,644	$23,402	$23,808	$24,334	$24,795
Net interest income dollar change	(1,164)	(406)	N/A	526	987
Net interest income percentage change	-4.9%	-1.7%	N/A	2.2%	4.1%
Board approved limit	>-10.0%	>-4.0%	N/A	>-4.0%	>-10.0%

Projections from March 31,, 2011, year one reflected a decline in net interest income of 2.0% with a 100 basis point decline compared to the 1.7% decline in 2010. The 100 basis point increase in rates reflected a 0.4% decrease in net interest income in 2011 compared to an increase of 2.2% in 2010.

EVE applies discounting techniques to future cash flows to determine the present value of assets, liabilities, and therefore equity. Based on applying these techniques to the March 31, 2011 balance sheet, a 100 basis point increase in rates results in an 8.3% decrease in EVE. A 100 basis point decrease in rates results in a 4.1% decrease in EVE. These are within the Board approved limits.

Item 4 ? CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our management, including the Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that the Company?s disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

We also conducted an evaluation of internal control over financial reporting to determine whether any changes occurred during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on this evaluation, there has been no such change during the quarter covered by this report.

Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Part II - Other Information

Item 1. Legal Proceedings

We are not a party to any material legal proceedings.

Item 1A. Risk Factors

A wide range of regulatory initiatives directed at the financial services industry have been proposed in recent months. One of those initiatives, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ?Dodd-Frank Act?), was signed into law by President Obama on July 21, 2010. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, establishes the new federal Bureau of Consumer Financial Protection (the ?BCFP?), and will require the BCFP and other federal agencies to implement many new rules. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting regulations will impact the Company?s business. However, compliance with these new laws and regulations will result in additional costs, which may adversely impact the Company?s results of operations, financial condition or liquidity, any of which may impact the market price of the Company?s common stock.

Other than the additional risk factor mentioned above, there are no material changes from the risk factors set forth under Part I, Item 1A ?Risk Factors? in our Annual Report on Form 10-K for the year ended December 31, 2010, which you are encouraged to carefully consider.
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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans Or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
1/1/11 ? 1/31/11	-	$ -	-	27,361 shares
2/1/11 ? 2/28/11	-	-	-	27,361 shares
3/1/11 ? 3/31/11	1,000	16.75	1,000	26,361 shares
Total	1,000		1,000	26,361 shares

On October 25, 2000, we announced that our Board of Directors approved a stock repurchase program and authorized the Company to purchase up to 100,000 shares of its outstanding common stock. On November 11, 2002, the Board of Directors approved and authorized the Company?s repurchase of an additional 100,000 shares. On May 20, 2008, the Board of Directors approved and authorized the Company to purchase an additional 100,000 shares. Shares will be purchased from time to time in the open market depending on market prices and other considerations. Through March 31, 2011, 273,639 shares have been purchased.

Item 6. Exhibits

31.1 Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certifications of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as

adopted pursuant to Section 906 of the Sarbanes-Oxley
Act of 2002.

SIGNATURES

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

KENTUCKY BANCSHARES, INC.

Date ___5/16/11_______ __/s/Louis Prichard______________
Louis Prichard, President and C.E.O.

Date ___5/16/11_______ __/s/Gregory J. Dawson___________
Gregory J. Dawson, Chief Financial Officer

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