FIRST NATIONAL LINCOLN CORP /ME/
Form 10-K
March 14, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

x 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 0-26589

FIRST NATIONAL LINCOLN CORPORATION

(Exact name of Registrant as specified in its charter)

MAINE 01-0404322

(State or other jurisdiction of incorporation or organization)(I.R.S. Employer Identification No.)

MAIN STREET, DAMARISCOTTA, MAINE 04543

(Address of principal executive offices) (Zip code)

(207) 563-3195

Registrant s telephone number, including area code

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

Common Stock, $.01 par value per share

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 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [_] Accelerated filer x Non-accelerated filer [_]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes [_] No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter.

Common Stock, $.01 par value per share: $149,597,000

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of March 14, 2008

Common Stock: 9,707,096 shares

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ITEM 1. Discussion of Business

First National Lincoln Corporation (the Company) was incorporated under the laws of the State of Maine on January 15, 1985, for the purpose of becoming the parent holding company of The First National Bank of Damariscotta, which was chartered as a national bank under the laws of the United States on May 30, 1864. On January 14, 2005, the acquisition of FNB Bankshares (FNB) of Bar Harbor, Maine, was completed, adding seven banking offices and one investment management office in Hancock and Washington counties of Maine. FNB s subsidiary, The First National Bank of Bar Harbor, was merged into The First National Bank of Damariscotta at closing, and as of January 31, 2005, the combined banks have operated under a new name: The First, N.A. (the Bank).

As of December 31, 2007, the Company s securities consisted of one class of common stock, $.01 par value per share, of which there were 9,732,493 shares outstanding and held of record by approximately 2,200 shareholders. The common stock of the Bank is the principal asset of the Company, which has no other subsidiaries. The Bank s capital stock consists of one class of common stock of which 120,000 shares, par value $2.50 per share, are authorized and outstanding. All of the Bank s common stock is owned by the Company.

The Bank emphasizes personal service, and customers are primarily small businesses and individuals for whom the Bank offers a wide variety of services, including deposit accounts, consumer and commercial and mortgage loans. The Bank has not made any material changes in its mode of conducting business during the past five years. The banking business in the Bank s market area is seasonal with lower deposits in the winter and spring and higher deposits in the summer and fall. This swing is predictable and has not had a materially adverse effect on the Bank.

In addition to providing traditional banking services, the Company provides investment management and private banking services through First Advisors, which is an operating division of the Bank. First Advisors is focused on taking advantage of opportunities created as the larger banks have altered their personal service commitment to clients not meeting established account criteria. First Advisors is able to offer a comprehensive array of private banking, financial planning, investment management and trust services to individuals, businesses, non-profit organizations and municipalities of varying asset size, and to provide the highest level of personal service. The staff includes investment and trust professionals with extensive experience.

The financial services landscape has changed considerably over the past five years in the Bank s primary market area. Two large out-of-state banks have continued to experience local change as a result of mergers and acquisitions at the regional and national level. Credit unions have continued to expand their membership and the scope of banking services offered. Non-banking entities such as brokerage houses, mortgage companies and insurance companies are offering very competitive products. Many of these entities and institutions have resources substantially greater than those available to the Bank and are not subject to the same regulatory restrictions as the Company and the Bank.

In November of 1999, Congress adopted the Gramm-Leach-Bliley Financial Modernization Act (GLBA). This legislation breaks down the firewalls separating related business in order to create more competition and a level playing field. The Act eliminated depression-era restrictions which separate the business of banking from the business of insurance and securities underwriting, and also resulted in modifications to protect consumers and streamline regulation. While the Company views this legislation as an opportunity to offer a more comprehensive range of financial products and services, at the same time it has provided additional competition in the marketplace.

The Company believes that there will continue to be a need for a bank in the Bank s primary market area with local management having decision-making power and emphasizing loans to small and medium-sized businesses and to individuals. The Bank has concentrated on extending business loans to such customers in the Bank s primary market area and to extending investment and trust services to clients with accounts of all sizes. The Bank s Management also makes decisions based upon, among other things, the knowledge of the Bank s employees regarding the communities and customers in the Bank s primary market area. The individuals employed by the Bank, to a large extent, reside near the branch offices and thus are generally familiar with their communities and customers. This is important in local decision-making and allows the Bank to respond to customer questions and concerns on a timely basis and fosters quality customer service.

The Bank has worked and will continue to work to position itself to be competitive in its market area. The Bank s ability to make decisions close to the marketplace, Management s commitment to providing quality banking products, the caliber of the professional staff, and the community involvement of the Bank s employees are all factors affecting the Bank s ability to be competitive. If the Company and the Bank are unable to compete successfully, however, the business and operations could be adversely affected.

Supervision and Regulation

The Company is a financial holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the Act), and section 225.82 of Regulation Y issued by the Board of Governors of the Federal Reserve

System (the Federal Reserve Board), and is required to file with the Federal Reserve Board an annual report and other information required pursuant to the Act. The Company is subject to examination by the Federal Reserve Board.

The Act requires the prior approval of the Federal Reserve Board for a financial holding company to acquire or hold more than a 5% voting interest in any bank, and controls interstate banking activities. The Act restricts First National Lincoln Corporation s non-banking activities to those which are determined by the Federal Reserve Board to be closely related to banking. The Act does not place territorial restrictions on the activities of non-bank subsidiaries of financial holding companies. The majority of the Company s cash revenues are generally derived from dividends paid to the Company by the Bank. These dividends are subject to various legal and regulatory restrictions which are summarized in Note 19 to the accompanying financial statements.

The Bank is regulated by the Office of the Comptroller of the Currency (OCC) and is subject to the provisions of the National Bank Act. As a result, it must meet certain liquidity and capital requirements, which are discussed in the following sections.

Customer Information Security

The FDIC, the OCC and other bank regulatory agencies have published guidelines establishing standards for safeguarding nonpublic personal information about customers that implement provisions of the GLBA (the Guidelines). Among other things, the Guidelines require each financial institution, under the supervision and ongoing oversight of its Board of Directors or an appropriate committee thereof, to develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against any anticipated threats or hazards to the security or integrity of such information, and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

Privacy

The FDIC, the OCC and other regulatory agencies have published privacy rules pursuant to provisions of the GLBA (Privacy Rules). The Privacy Rules, which govern the treatment of nonpublic personal information about consumers by financial institutions, require a financial institution to provide notice to customers (and other consumers in some circumstances) about its privacy policies and practices, describe the conditions under which a financial institution may disclose nonpublic personal information to nonaffiliated third parties, and provide a method for consumers to prevent a financial institution from disclosing that information to most nonaffiliated third parties by opting-out of that disclosure, subject to certain exceptions.

USA Patriot Act

The USA Patriot Act of 2001, designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system, has significant implications for depository institutions, broker-dealers and other businesses involved in the transfer of money. The USA Patriot Act, together with the implementing regulations of various federal regulatory agencies, have caused financial institutions, including the Bank, to adopt and implement additional or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity and currency transaction reporting, customer identity verification and customer risk analysis. The statute and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions, and require the Federal Reserve Board (and other federal banking agencies) to evaluate the effectiveness of an applicant in combating money laundering activities when considering applications filed under Section 3 of the BHC Act or under the Bank Merger Act.

The Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (SOX) implements a broad range of corporate governance and accounting measures for public companies (including publicly-held bank holding companies such as the Company) designed to promote honesty and transparency in corporate America and better protect investors from the type of corporate wrongdoings that occurred at Enron and WorldCom, among other companies. SOX principal provisions, many of which have been implemented through regulations released and policies and rules adopted by the securities exchanges in 2003 and 2004, provide for and include, among other things:

The creation of an independent accounting oversight board;

Auditor independence provisions which restrict non-audit services that accountants may provide to their audit clients;

Additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements;

- The forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer s securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement;
- An increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with the public company s independent auditors;
- Requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer;
- Requirements that companies disclose whether at least one member of the audit committee is a financial expert (as such term is defined by the SEC) and if not, why not;
- Expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods;
- A prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions, such as the Bank, on nonpreferential terms and in compliance with other bank regulatory requirements;
- Disclosure of a code of ethics and filing a Form 8-K in the event of a change or waiver of such code; and
- A range of enhanced penalties for fraud and other violations.

The Company complies with, the provisions of SOX and its underlying regulations. Management believes that such compliance efforts have strengthened the Company s overall corporate governance structure and does not expect that such compliance has to date, or will in the future have, a material impact on the Company s results of operations or financial condition.

Capital Requirements and FDICIA

The OCC has established guidelines with respect to the maintenance of appropriate levels of capital by FDIC-insured banks. The Federal Reserve Board has established substantially identical guidelines with respect to the maintenance of appropriate levels of capital, on a consolidated basis, by bank holding companies. If a banking organization s capital levels fall below the minimum requirements established by such guidelines, a bank or bank holding company will be expected to develop and implement a plan acceptable to the FDIC or the Federal Reserve Board, respectively, to achieve adequate levels of capital within a reasonable period, and may be denied approval to acquire or establish additional banks or non-bank businesses, merge with other institutions or open branch facilities until such capital levels are achieved. Federal legislation requires federal bank regulators to take prompt corrective action with respect to insured depository institutions that fail to satisfy minimum capital requirements and imposes significant restrictions on such institutions. See Prompt Corrective Action below.

Leverage Capital Ratio

The regulations of the OCC require national banks to maintain a minimum Leverage Capital Ratio or Tier 1 Capital (as defined in the Risk-Based Capital Guidelines discussed in the following paragraphs) to Total Assets of 4.0%. Any bank experiencing or anticipating significant growth is expected to maintain capital well above the minimum levels. The Federal Reserve Board s guidelines impose substantially similar leverage capital requirements on bank holding companies on a consolidated basis.

Risk-Based Capital Requirements

The regulations of the OCC also require national banks to maintain minimum capital levels measured as a percentage of such banks risk-adjusted assets. A bank s qualifying total capital (Total Capital) for this purpose may include two components: Core (Tier 1) Capital and Supplementary (Tier 2) Capital. Core Capital consists primarily of common stockholders equity, which generally includes common stock, related surplus and retained earnings, certain non-cumulative perpetual preferred stock and related surplus, and minority interests in the equity accounts of consolidated subsidiaries, and (subject to certain limitations) mortgage servicing rights and purchased credit card relationships, less all other intangible assets (primarily goodwill). Supplementary Capital elements include, subject to certain limitations, a portion of the allowance for losses on loans and leases, perpetual preferred stock that does not qualify for inclusion in Tier 1 capital, long-term preferred stock with an original maturity of at least 20 years and related surplus, certain forms of perpetual debt and mandatory convertible securities, and certain forms of subordinated debt and intermediate-term preferred stock.

The risk-based capital rules assign a bank s balance sheet assets and the credit equivalent amounts of the bank s off-balance sheet obligations to one of four risk categories, weighted at 0%, 20%, 50% or 100%, respectively. Applying these risk-weights to each category of the bank s balance sheet assets and to the credit equivalent amounts of the bank s off-balance sheet obligations and summing the totals results in the amount of the bank s total Risk-Adjusted Assets for purposes of the risk-based capital requirements. Risk-Adjusted Assets can either exceed or be less than reported balance sheet assets, depending on the risk profile of the banking organization. Risk-Adjusted Assets for institutions such as the Bank

will generally be less than reported balance sheet assets because its retail banking activities include proportionally

more residential mortgage loans and certain investment securities with a lower risk weighting and relatively smaller off-balance sheet obligations.

The risk-based capital regulations require all banks to maintain a minimum ratio of Total Capital to Risk-Adjusted Assets of 8.0%, of which at least one-half (4.0%) must be Core (Tier 1) Capital. For the purpose of calculating these ratios: (i) a banking organization s Supplementary Capital eligible for inclusion in Total Capital is limited to no more than 100% of Core Capital; and (ii) the aggregate amount of certain types of Supplementary Capital eligible for inclusion in Total Capital is further limited. For example, the regulations limit the portion of the allowance for loan losses eligible for inclusion in Total Capital to 1.25% of Risk-Adjusted Assets. The Federal Reserve Board has established substantially identical risk-based capital requirements, which are applied to bank holding companies on a consolidated basis. The risk-based capital regulations explicitly provide for the consideration of interest rate risk in the overall evaluation of a bank s capital adequacy to ensure that banks effectively measure and monitor their interest rate risk, and that they maintain capital adequate for that risk. A bank deemed by its federal banking regulator to have excessive interest rate risk exposure may be required to maintain additional capital (that is, capital in excess of the minimum ratios discussed above). The Bank believes, based on its level of interest rate risk exposure, that this provision will not have a material adverse effect on it.

On December 31, 2007, the Company s consolidated Total and Tier 1 Risk-Based Capital Ratios were 11.07% and 10.21%, respectively, and its Leverage Capital Ratio was 7.22%. Based on the above figures and accompanying discussion, the Company exceeds all regulatory capital requirements and is considered well capitalized.

Prompt Corrective Action.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires, among other things, that the federal banking regulators take prompt corrective action with respect to, and imposes significant restrictions on, any bank that fails to satisfy its applicable minimum capital requirements. FDICIA establishes five capital categories consisting of well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under applicable regulations, a bank that has a Total Risk-Based Capital Ratio of 10.0% or greater, a Tier 1 Risk-Based Capital Ratio of 6.0% or greater and a Leverage Capital Ratio of 5.0% or greater, and is not subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure is deemed to be well capitalized. A bank that has a Total Risk-Based Capital Ratio of 8.0% or greater, a Tier 1 Risk-Based Capital Ratio of 4.0% or greater and a Leverage Capital Ratio of 4.0% (or 3% for banks with the highest regulatory examination rating that are not experiencing or anticipating significant growth or expansion) or greater and does not meet the definition of a well capitalized bank is considered to be adequately capitalized. A bank that has a Total Risk-Based Capital Ratio of less than 8.0% or has a Tier 1 Risk-Based Capital Ratio that is less than 4.0%, except as noted above, a Leverage Capital Ratio of less than 4.0% is considered undercapitalized. A bank that has a Total Risk-Based Capital Ratio of less than 6.0%, or a Tier 1 Risk-Based Capital Ratio that is less than 3.0% or a Leverage Capital Ratio that is less than 3.0% is considered to be significantly undercapitalized, and a bank that has a ratio of tangible equity to total assets equal to or less than 2% is deemed to be critically undercapitalized. A bank may be deemed to be in a capital category lower than is indicated by its actual capital position if it is determined to be in an unsafe or unsound condition or receives an unsatisfactory examination rating. FDICIA generally prohibits a bank from making capital distributions (including payment of dividends) or paying management fees to controlling stockholders or their affiliates if, after such payment, the bank would be undercapitalized.

Under FDICIA and the applicable implementing regulations, an undercapitalized bank will be (i) subject to increased monitoring by its primary federal banking regulator; (ii) required to submit to its primary federal banking regulator an acceptable capital restoration plan (guaranteed, subject to certain limits, by the bank s holding company) within 45 days of being classified as undercapitalized; (iii) subject to strict asset growth limitations; and (iv) required to obtain prior regulatory approval for certain acquisitions, transactions not in the ordinary course of business, and entries into new lines of business. In addition to the foregoing, the primary federal banking regulator may issue a prompt corrective action directive to any undercapitalized institution. Such a directive may (i) require sale or re-capitalization of the bank, (ii) impose additional restrictions on transactions between the bank and its affiliates, (iii) limit interest rates paid by the bank on deposits, (iv) limit asset growth and other activities, (v) require divestiture of subsidiaries, (vi) require replacement of directors and officers, and (vii) restrict capital distributions by the bank s parent holding company. In addition to the foregoing, a significantly undercapitalized institution may not award bonuses or increases in compensation to its senior executive officers until it has submitted an acceptable capital restoration plan and received approval from its primary federal banking regulator.

Not later than 90 days after an institution becomes critically undercapitalized, the primary federal banking regulator for the institution must appoint a receiver or, with the concurrence of the FDIC, a conservator, unless the agency, with the concurrence of the FDIC, determines that the purpose of the prompt corrective action provisions would be better served by another course of action. FDICIA requires that any alternative determination be documented and reassessed

on a periodic basis. Notwithstanding the foregoing, a receiver must be appointed after 270 days unless the appropriate federal banking agency and the FDIC certify that the institution is viable and not expected to fail.

Deposit Insurance Assessments.

The Bank s deposits are insured by the Bank Insurance Fund of the FDIC to the legal maximum of $100,000 generally ($250,000 for retirement accounts) for each insured depositor. The Federal Deposit Insurance Act, as amended by the Federal Deposit Insurance Reform Act of 2005, provides that the FDIC shall set deposit insurance assessment rates. In 2006, the former Bank Insurance Fund merged with the Savings Association Insurance Fund to create the Deposit Insurance Fund, or DIF. The Act eliminated the requirement that the FDIC set deposit insurance assessment rates on a semi-annual basis at a level sufficient to increase the ratio of BIF reserves to BIF-insured deposits to at least 1.25%. Under the Act, the FDIC annually sets the designated reserve ratio (DRR) of DIF reserves to DIF-insured deposits between 1.15% and 1.50%, subject to public comment, based on appropriate considerations including risk of losses, economic conditions such that the ratio would increase during favorable economic conditions and decrease during less favorable conditions, thus avoiding sharp swings in assessment rates. For 2007, the FDIC set the DRR at 1.25%. Although current assessment levels are low, DIF insurance assessments may be increased in the future if necessary to maintain DIF reserves at the level determined by the FDIC.

Brokered Deposits and Pass-Through Deposit Insurance Limitations.

Under FDICIA, a bank cannot accept brokered deposits unless it either (i) is Well Capitalized or (ii) is Adequately Capitalized and has received a written waiver from its primary federal banking regulator. For this purpose, Well Capitalized and Adequately Capitalized have the same definitions as in the Prompt Corrective Action regulations. See Prompt Corrective Action above. Banks that are not in the Well Capitalized category are subject to certain limits on the rates of interest they may offer on any deposits (whether or not obtained through a third-party deposit broker). Pass-through insurance coverage is not available in banks that do not satisfy the requirements for acceptance of brokered deposits for deposits of certain employee benefit plans, except that pass-through insurance coverage will be provided for employee benefit plan deposits in institutions which at the time of acceptance of the deposit meet all applicable regulatory capital requirements and send written notice to their depositors that their funds are eligible for pass-through deposit insurance. The Bank currently accepts brokered deposits.

Real Estate Lending Standards.

FDICIA requires the federal bank regulatory agencies to adopt uniform real estate lending standards. The FDIC and the OCC have adopted regulations which establish supervisory limitations on Loan-to-Value (LTV) ratios in real estate loans by FDIC-insured banks, including national banks. The regulations require banks to establish LTV ratio limitations within or below the prescribed uniform range of supervisory limits.

Standards for Safety and Soundness.

Pursuant to FDICIA the federal bank regulatory agencies have prescribed, by regulation, standards and guidelines for all insured depository institutions and depository institution holding companies relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; (v) asset growth; and (vi) compensation, fees and benefits. The compensation standards prohibit employment contracts, compensation or benefit arrangements, stock option plans, fee arrangements or other compensatory arrangements that would provide excessive compensation, fees or benefits, or that could lead to material financial loss. In addition, the federal bank regulatory agencies are required by FDICIA to prescribe standards specifying; (i) maximum classified assets to capital ratios; (ii) minimum earnings sufficient to absorb losses without impairing capital; and (iii) to the extent feasible, a minimum ratio of market value to book value for publicly-traded shares of depository institutions and depository institution holding companies.

Consumer Protection Provisions.

FDICIA also includes provisions requiring advance notice to regulators and customers for any proposed branch closing and authorizing (subject to future appropriation of the necessary funds) reduced insurance assessments for institutions offering lifeline banking accounts or engaged in lending in distressed communities. FDICIA also includes provisions requiring depository institutions to make additional and uniform disclosures

to depositors with respect to the rates of interest, fees and other terms applicable to consumer deposit accounts.

FDIC Waiver of Certain Regulatory Requirements.

The FDIC issued a rule, effective on September 22, 2003, that includes a waiver provision which grants the FDIC Board of Directors extremely broad discretionary authority to waive FDIC regulatory provisions that are not specifically mandated by statute or by a separate regulation.

Impact of Monetary Policy

The monetary policies of regulatory authorities, including the Federal Reserve Board, have a significant effect on the operating results of banks and bank holding companies. Through open market securities transactions and changes in its discount rate and reserve requirements, the Board of Governors exerts considerable influence over the cost and availability of funds for lending and investment. The nature of future monetary policies and the effect of such policies on the future business and earnings of the Company and the Bank cannot be predicted. See Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations, regarding the Bank s net interest margin and the effect of interest-rate volatility on future earnings.

Employees

At December 31, 2007, the Company had 211 employees and full-time equivalency of 207 employees. The Company enjoys good relations with its employees. A variety of employee benefits, including health, group life and disability income, a defined contribution retirement plan, and an incentive bonus plan, are available to qualifying officers and employees.

Company Website

The Company maintains a website at www.fnlc.com where it makes available, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as well as all Section 16 reports on Forms 3, 4, and 5, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. The Company s reports filed with, or furnished to, the SEC are also available at the SEC s website at www.sec.gov. Information contained on the Company s website does not constitute a part of this report.

ITEM 1A. Risk Factors

The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us and our business. If any of these risks were to occur, our business, financial condition or results of operations could be materially and adversely affected.

Competition

We face significant competition for banking services in coastal Maine, the primary market in which we operate. Competition in the local banking industry may limit our ability to attract and retain customers. We may face competition now and in the future from the following: other banking institutions, including larger regional and national commercial banking organizations; savings banks; credit unions; other financial institutions; and non-bank financial services companies.

In particular, our competitors include major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous banking locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits, which enable them to serve the credit needs of larger customers. We also face competition from out-of-state financial intermediaries that have opened loan production offices or solicit deposits through the internet. If we are unable to attract and retain banking customers we may be unable to continue our loan growth and level of deposits and our results of operations and financial condition may otherwise be negatively affected.

In the past, we have expanded our operations into non-banking activities such as asset management and wealth advisory services. We may have difficulty competing with more established providers of these products and services due to the intense competition in these service sectors. In addition, we may be unable to attract and retain non-banking customers due to our lack of market and product knowledge or other industry specific matters or an inability to attract and retain qualified, experienced employees. Our failure to attract and retain customers with respect to these non-banking activities could negatively impact our future earnings.

Interest Rate Risk

Our main source of income is net interest income, which is equal to the difference between the interest income received on loans, investment securities and other interest-bearing assets and the interest expense incurred in connection with deposits, borrowings and other interest-bearing liabilities. As a result, our net interest income can be affected by changes in market interest rates. These rates are highly sensitive to many factors beyond our control, including general economic conditions, both domestic and foreign, and the monetary and fiscal policies of various governmental and

regulatory authorities. We have asset and liability management policies that attempt to minimize the potential adverse effects of changes in interest rates on our net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. However, even with these policies in place, we cannot provide assurance that changes in interest rates will not negatively impact our operating results. For a further discussion on the Company s exposure to interest rate risk, see Item 7A: Quantitative and Qualitative Disclosures about Market Risk.

Furthermore, our banking business is affected not only by general economic conditions, but also by the monetary policies of the Federal Reserve Board. Changes in monetary or legislative policies may affect the interest rates we must offer to attract deposits and the interest rates we can charge on our loans, as well as the manner in which we offer deposits and make loans. These monetary policies have had, and are expected to continue to have, significant effects on the operating results of depository institutions, including the Bank. Increases in interest rates also may reduce the demand for loans and, as a result, the amount of loan and commitment fees the Bank receives.

Credit Risk

A number of factors can impact the ability of borrowers to repay their current loan obligations, which could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to our allowance for loan losses. If customers default on the repayment of their loans, our profitability could be adversely affected. A borrower s default on its obligations under one or more of our loans may result in lost principal and interest income and increased operating expenses as a result of the allocation of management time and resources to the collection and work-out of the loans. If collection efforts are unsuccessful or acceptable workout arrangements cannot be reached, we may have to write-off the loans in whole or in part. Although we may acquire any real estate or other assets that secure the defaulted loans through foreclosure or other similar remedies, the amount owed under the defaulted loans may exceed the value of the assets acquired.

Management periodically makes a determination of our allowance for loan losses based on available information, including the quality of our loan portfolio, economic conditions, the value of the underlying collateral and the level of our non-accruing loans. If assumptions prove to be incorrect, our allowance may not be sufficient. Increases in this allowance will result in an expense for the period. If, as a result of general economic conditions or an increase in non-performing loans, Management determines that an increase in our allowance for loan losses is necessary, we may incur additional expenses.

As an integral part of their examination process, bank regulatory agencies periodically review our allowance for loan losses and the value we attribute to real estate acquired through foreclosure or other similar remedies. These regulatory agencies may require us to adjust our determination of the value of these items. These adjustments could negatively impact our results of operations or financial condition.

Because we serve primarily individuals and smaller businesses located in coastal Maine, the ability of customers to repay their loans is impacted by the economic conditions in this area. In addition, our ability to continue to originate loans may be impaired by adverse changes in local and regional economic conditions. These events also could have an adverse effect on the value of our collateral and our financial condition.

In the course of business, we may acquire, through foreclosure, properties securing loans that are in default. In commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, we might be required to remove these substances from the affected properties at our sole cost and expense. The cost of this removal could exceed the value of the affected properties. We may not have adequate remedies against the prior owners or other responsible parties and could find it difficult or impossible to sell the affected properties. The occurrence of one or more of these events could adversely affect our financial condition or operating results.

Liquidity and Funding

We have traditionally obtained funds principally through deposits and borrowings. As a general matter, deposits are a lower cost source of funds than borrowings, because interest rates paid for deposits are typically less than interest rates charged for borrowings. If, as a result of competitive pressures, market interest rates, general economic conditions or other events, the balance of our deposits decreases relative to our overall banking operations, we may have to rely more heavily on borrowings as a source of funds in the future. Such an increased reliance on borrowings could have a negative impact on our results of operations or financial condition.

In addition, fluctuations in interest rates may result in disintermediation, which is the flow of funds away from depository institutions into direct investments that pay higher rates of return, and may affect the value of our investment securities and other interest-earning assets.

Regulation

Bank holding companies and nationally chartered banks operate in a highly regulated environment and are subject to supervision and examination by various regulatory agencies. The Company is subject to the Bank Holding Company Act of 1956, as amended, and to regulation and supervision by the Federal Reserve Board, or FRB. The Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency, or the OCC. The cost of compliance

with regulatory requirements may adversely affect our results of operations or financial condition. Federal and state laws and regulations govern numerous matters including: changes in the ownership or control of banks and bank holding companies; maintenance of adequate capital and the financial condition of a financial institution; permissible types, amounts and terms of extensions of credit and investments; permissible non-banking activities; the level of reserves against deposits; and restrictions on dividend payments.

The OCC possesses cease and desist powers to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the Federal Reserve Board possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we may conduct our business and obtain financing.

Under regulatory capital adequacy guidelines and other regulatory requirements, we must meet guidelines that include quantitative measures of assets, liabilities, and certain off-balance sheet items, subject to qualitative judgments by regulators about components, risk weightings and other factors. If we fail to meet these minimum capital guidelines and other regulatory requirements, our financial condition would be materially and adversely affected. Our failure to maintain the status of well capitalized under our regulatory framework could affect the confidence of our customers in us, thus compromising our competitive position. In addition, failure to maintain the status of well capitalized under our regulatory framework or well managed under regulatory examination procedures could compromise our status as a bank holding company and related eligibility for a streamlined review process for acquisition proposals.

Electronic Systems

We rely heavily on communications and information systems to conduct our business. Any failure or interruptions or breach in security of these systems could result in disruptions to our customer relationship management, general ledger, deposits, servicing or loan origination systems. The occurrence of any failures or interruptions could result in a loss of customer business and have a material adverse effect on our results of operations and financial condition.

ITEM 1B. Unresolved Staff Comments

None

ITEM 2. Properties

The principal office of the Company and the Bank is located in Damariscotta, Maine. The Bank operates 14 full-service banking offices in four counties in the Mid-Coast and Down East regions of Maine:

Lincoln County	**Knox County**	**Hancock County**	**Washington County**
Boothbay Harbor	Camden	Bar Harbor	Eastport
Damariscotta	Rockland	Blue Hill	Calais
Waldoboro	Rockport	Ellsworth	
Wiscasset		Northeast Harbor	
		Southwest Harbor	

First Advisors, the investment management and trust division of the Bank, operates from two offices in Bar Harbor, and Damariscotta. The Bank also maintains an Operations Center in Damariscotta.

The Company owns all of its facilities except for the land on which the Ellsworth branch is located, and except for the Camden, Calais, Northeast Harbor, and Southwest Harbor drive-up facilities, for which the Bank entered into long-term leases. Management believes that the Bank s current facilities are suitable and adequate in light of its current needs and its anticipated needs over the near term.

ITEM 3. Legal Proceedings

There are no material pending legal proceedings to which the Company or the Bank is a party or to which any of its property is subject, other than routine litigation incidental to the business of the Bank. None of these proceedings is expected to have a material effect on the financial condition of the Company or of the Bank.

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 5. Market for Registrant s Common Equity and Related Shareholder Matters

The common stock of First National Lincoln Corporation (ticker symbol FNLC) trades on the NASDAQ National Market System. The following table reflects the high and low prices of actual sales in each quarter of 2007 and 2006. Such quotations do not reflect retail mark-ups, mark-downs or brokers commissions.

	2007		2006	
	High	**Low**	High	Low
1st Quarter	**$16.84**	**$15.64**	$17.89	$17.10
2nd Quarter	**17.00**	**15.50**	17.72	16.45
3rd Quarter	**17.50**	**13.60**	17.99	16.62
4th Quarter	**15.95**	**14.20**	17.40	16.39

The last transaction of the Company s stock on the NASDAQ National Market System during 2007 was on December 31 at $14.64 per share. There are no warrants outstanding with respect to the Company s common stock, and the Company has no securities outstanding which are convertible into common equity.

The table below sets forth the cash dividends declared in the last two fiscal years:

Date Declared	**Amount Per Share**	**Date Payable**
March 16, 2006	$0.145	April 28, 2006
June 15, 2006	$0.150	July 31, 2006
September 21, 2006	$0.155	October 31, 2006
December 21, 2006	$0.160	January 31, 2007
March 22, 2007	$0.165	April 30, 2007
June 21, 2007	$0.170	July 31, 2007
September 19, 2007	$0.175	October 31, 2007
December 20, 2007	$0.180	January 31, 2008

The ability of the Company to pay cash dividends depends on receipt of dividends from the Bank. Dividends may be declared by the Bank out of its net profits as the directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits of that year plus retained net profits of the preceding two years. Based upon this restriction, the amount available for dividends in 2008 will be that year s net income plus $9.9 million. The payment of dividends from the Bank to the Company may be additionally restricted if the payment of such dividends resulted in the Bank failing to meet regulatory capital requirements.

The Bank is also required to maintain minimum amounts of capital-to-total-risk-weighted-assets, as defined by banking regulators. At December 31, 2007, the Bank was required to have minimum Tier 1 and Tier 2 risk-based capital ratios of 4.00% and 8.00%, respectively. The Bank s actual ratios were 10.13% and 10.99%, respectively, as of December 31, 2007.

Unregistered Sales of Equity Securities

The Company issues shares to the Bank s 401k Investment and Savings Plan pursuant to an exemption from registration under the Securities Act of 1933, as amended (the Securities Act), contained in Section 3(a)(11) thereof and Rule 147 promulgated thereunder. Sales in 2007 are presented in the following table:

Month	**Shares**	**Average Price**	**Proceeds**
January 2007	1,191	16.61	19,785
February 2007	1,381	16.54	22,848
March 2007	776	16.19	12,555
April 2007	957	16.02	15,327
May 2007	484	16.13	7,812
June 2007	353	16.18	5,705
July 2007	320	16.48	5,268
August 2007	535	15.17	8,115
September 2007	319	14.95	4,773
October 2007	317	15.25	4,837
November 2007	243	15.15	3,674
December 2007	186	14.72	2,738
Total	**7,061**	**$16.06**	**$113,000**

Repurchase of Shares and Use of Proceeds

On July 21, 2006, the Company announced that its Board of Directors had authorized a program for the repurchase of up to 250,000 shares of the Company s common stock or approximately 2.5% of the outstanding shares. This program ended in August of 2007, with 126,334 shares repurchased under the program at an average price of $16.93 and at a total cost of $2.1 million.

On August 16, 2007, the Company announced that its Board of Directors had authorized a new program for the repurchase of up to 300,000 shares of the Company s common stock or approximately 3.1% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company s stock and the level of stock issuances under the Company s employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of December 31, 2007, the Company had repurchased 90,564 shares under the new repurchase plan at an average price of $15.17 and at a total cost of $1.4 million.

The following table details repurchases under both programs for the year ended December 31, 2007:

Month	**Total Number of Shares Purchased**	**Average Price Paid Per Share**	**Total Number of Shares Purchased as Part of a Publicly Announced Plan or Pro**
January 2007	5,210	16.49	5,210
February 2007	808	16.50	808
March 2007	650	16.31	650
April 2007	91	15.97	91
May 2007	11,803	16.13	11,803
June 2007	735	15.66	735
July 2007	-	-	-
August 2007	3,859	15.73	3,859
September 2007	1	15.08	1
October 2007	1	15.35	1
November 2007	76,655	15.21	76,655
December 2007	10,047	14.65	10,047

Total	**109,860**	**15.35**	**109,860**

ITEM 6. Selected Financial Data

Dollars in thousands,	Years ended December 31,				
except for per share amounts	**2007**	2006	2005	2004	2003
Summary of Operations					
Interest Income	**$71,721**	$ 64,204	$ 50,431	$ 30,528	$ 27,540
Interest Expense	**39,885**	33,589	18,848	9,024	9,796
Net Interest Income	**31,836**	30,615	31,583	21,504	17,744
Provision for Loan Losses	**1,432**	1,325	200	880	907
Non-Interest Income	**10,145**	10,306	9,034	4,667	5,148
Non-Interest Expense	**22,183**	22,439	22,518	13,371	11,600
Net Income	**13,101**	12,295	12,843	8,509	7,427
Per Common Share Data					
Net Income					
Basic	**$ 1.34**	$ 1.25	$ 1.32	$ 1.16	$ 1.02
Diluted	**1.34**	1.25	1.30	1.14	1.00
Cash Dividends (Declared)	**0.69**	0.61	0.53	0.45	0.38
Book Value	**11.58**	10.98	10.52	7.18	6.57
Market Value	**14.64**	16.72	17.58	17.45	16.63
Financial Ratios					
Return on Average Equity	**11.89%**	11.63%	12.98%	17.10%	16.39%
Return on Average Tangible Equity	**15.89**	15.75	17.81	17.36	16.39
Return on Average Assets	**1.13**	1.14	1.36	1.41	1.41
Average Equity to Average Assets	**9.53**	9.81	10.44	8.22	8.58
Average Tangible Equity to Average Assets	**7.13**	7.24	7.61	8.27	8.58
Net Interest Margin (Tax-Equivalent)	**3.13**	3.24	3.84	3.94	3.73
Dividend Payout Ratio (Declared)	**51.49**	48.80	40.15	38.62	37.13
Allowance for Loan Losses/Total Loans	**0.74**	0.76	0.79	0.99	1.05
Non-Performing Loans to Total Loans	**0.31**	0.42	0.40	0.34	0.39
Non-Performing Assets to Total Assets	**0.23**	0.32	0.30	0.25	0.29
Efficiency Ratio (Tax-equivalent)	**50.16**	52.12	52.89	48.78	48.32
At Year End					
Total Assets	**$1,223,250**	$1,104,869	$1,042,209	$ 634,238	$ 568,812
Total Loans	**920,164**	838,145	772,338	478,332	398,895
Total Investment Securities	**221,815**	180,549	183,981	126,827	136,689
Total Deposits	**781,280**	805,235	713,964	369,844	359,077
Total Borrowings	**316,719**	179,862	215,189	207,206	157,822
Total Shareholders Equity	**112,668**	107,327	103,452	52,815	47,718
				High	Low
Market price per common share of stock during 2007				$17.50	$13.60

ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

First National Lincoln Corporation (the Company) was incorporated in the State of Maine on January 15, 1985, and is the parent holding company of The First, N.A. (the Bank). The Company generates almost all of its revenues from the Bank, which was chartered as a national bank under the laws of the United States on May 30, 1864. The Bank, which has fourteen offices along coastal Maine, emphasizes personal service to the communities it serves, concentrating primarily on small businesses and individuals.

The Bank offers a wide variety of traditional banking services and derives the majority of its revenues from net interest income the spread between what it earns on loans and investments and what it pays for deposits and borrowed funds. While net interest income typically increases as earning assets grow, the spread can vary up or down depending on the level and direction of movements in interest rates. Management believes the Bank has modest exposure to changes in interest rates, as discussed in Interest Rate Risk Management elsewhere in Management s Discussion. In addition, the banking business in the Bank s market area historically has been seasonal with lower deposits in the winter and spring and higher deposits in the summer and fall. This seasonal swing is fairly predictable and has not had a materially adverse effect on the Bank.

Non-interest income is the Bank s secondary source of revenue and includes fees and service charges on deposit accounts, fees for processing merchant credit card receipts, income from the sale and servicing of mortgage loans, and income from investment management and private banking services through First Advisors, a division of the Bank.

Critical Accounting Policies

Management s discussion and analysis of the Company s financial condition and results of operations is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, the valuation of mortgage servicing rights, goodwill and the valuation of stock options. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results are likely to differ from the amounts derived from Management s estimates and assumptions, and such differences could be substantial.

The allowance for loan losses is a critical accounting policy that requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management s evaluation of the level of the allowance required in relation to the estimated loss exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it for adequacy by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management s estimation of probable losses. The use of different estimates or assumptions could produce different provisions for loan losses. The allowance for loan losses is discussed in more detail in the Assets and Asset Quality section of this report.

The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 0.25% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value which is recorded on the balance sheet. This includes an evaluation for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. The use of different assumptions could produce a different valuation.

The valuation of goodwill is a critical accounting policy. Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) from the acquisition of FNB Bankshares in 2005 as well as the core deposit intangible related to the same acquisition. The core deposit intangible is amortized on a straight-line basis over ten years. The straight-line basis is used because the Company does not expect significant run off in the core deposits which were acquired. The Company periodically evaluates intangible assets for impairment on the basis of whether these assets are fully recoverable from projected, undiscounted net cash flows of the acquired company.

The value of stock options is a critical accounting policy. The Company established a shareholder-approved stock option plan in 1995, under which the Company may grant options to its employees for up to 600,000 shares of common stock. Only incentive stock options may be granted under the plan. The option price of each option grant is determined

by the Options Committee of the Board of Directors, and in no instance shall be less than the fair market value on the date of the grant. An option s maximum term is ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from date of grant. As of January 16, 2005, all options under this plan had been granted. The Company applies the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment , to stock-based employee compensation for fiscal years beginning on or after January 1, 2006.

Results of Operations

For First National Lincoln Corporation, 2007 operating results were greatly improved over 2006. The driving force for our increase in earnings was net interest income. A primary factor for this was growth in earning assets. At the same time, the lowering of rates by the Federal Open Market Committee (FOMC) was positive for the Company. As in previous years, expense control continued to be a major factor in our performance in 2007.

Net Interest Income

Net interest income in 2007 was $31.8 million, an increase of $1.2 million or 4.0% from the $30.6 million posted by the Company in 2006. The primary factor for the increase in net interest income during 2007 compared to 2006 was the $124.6 million or 12.2% growth in earning assets in 2007, with total loans increasing $82.0 million or 9.8% and investments increasing $41.3 million or 22.9%. In addition, the lowering of rates by the FOMC in 2007 was positive for FNLC, resulting in lower funding costs from a restructuring of a significant portion of our wholesale funding and improved net interest margins in the third and fourth quarters.

The following tables present changes in interest income and expense attributable to changes in interest rates, volume, and rate/volume[1] for interest-earning assets and interest-bearing liabilities. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate.

Year ended December 31, 2007 compared to 2006				
Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$ (64)	$ (64)	$ 64	$ (64)
Investment securities	1,044	482	46	1,572
Loans held for sale	5	15	31	51
Loans	4,165	1,761	133	6,059
Total interest income	5,150	2,194	274	7,618
Interest expense				
Deposits	1,067	2,760	114	3,941
Borrowings	1,897	368	90	2,355
Total interest expense	2,964	3,128	204	6,296
Change in net interest income	$ 2,186	$ (934)	$ 70	$ 1,322

Year ended December 31, 2006 compared to 2005				
Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$ 23	$ 10	$ 18	$ 51
Investment securities	1,749	109	21	1,879
Loans held for sale	(3)	4	(1)	-
Loans	6,266	5,017	730	12,013
Total interest income	8,035	5,140	768	13,943
Interest expense				
Deposits	2,868	7,791	1,656	12,315
Borrowings	(185)	2,705	(94)	2,426
Total interest expense	2,682	10,496	1,562	14,741

Change in net interest income	$ 5,353	$ (5,356)	$ (794)	$ (798)

[1] *Represents the change attributable to a combination of change in rate and change in volume.*

The following table presents, for the years ended December 31, 2007, 2006, and 2005, the interest earned on or paid for each major asset and liability category, respectively, the average yield for each major asset and liability category, and the net yield between assets and liabilities. Tax-exempt income has been calculated on a tax-equivalent basis using a 35% rate. Unrecognized interest on non-accrual loans is not included in the amount presented, but the average balance of non-accrual loans is included in the denominator when calculating yields.

	2007		2006		2005	
Dollars in thousands	**Amount of interest**	**Average Yield/Rate**	**Amount of interest**	**Average Yield/Rate**	Amount of interest	Average Yield/Rate
Interest on earning assets						
Interest-bearing deposits	**$ -**	**0.00%**	$ 64	5.41%	$ 13	3.00%
Investments	**12,582**	**5.98%**	11,010	5.73%	9,131	5.66%
Loans held for sale	**53**	**8.43%**	14	6.93%	14	5.63%
Loans	**61,167**	**7.01%**	55,096	6.79%	43,083	6.08%
Total interest-earning assets	**73,802**	**6.81%**	66,184	6.58%	52,241	6.00%
Interest-bearing liabilities						
Deposits	**29,745**	**3.93%**	25,804	3.55%	13,489	2.25%
Other borrowings	**10,140**	**4.71%**	7,785	4.49%	5,359	2.99%
Total interest-bearing liabilities	**39,885**	**4.10%**	33,589	3.73%	18,848	2.42%
Net interest income	**$ 33,917**		$ 32,595		$ 33.393	
Interest rate spread		**2.71%**		2.85%		3.58%
Net interest margin		**3.13%**		3.24%		3.84%

Tax-exempt interest income amounted to $3.9 million for the year ended December 31, 2007, $3.7 million for the year ended December 31, 2006, and $3.4 million for the year ended December 31, 2005. The following table presents the effect of tax-exempt income on the calculation of the net interest margin, using a 35.0% tax rate in 2007, 2006 and 2005.

	For the Years Ended December 31,		
Dollars in thousands	**2007**	2006	2005
Net interest income as presented	**$31,836**	$30,615	$31,583
Effect of tax-exempt income	**2,081**	1,980	1,810
Net interest income, tax equivalent	**$33,917**	$32,595	$33,393

Non-Interest Income

Non-interest income decreased $0.2 million or 1.6% from $10.3 million in 2006 to $10.1 million in 2007. The decrease in non-interest income was due to lower investment management and fiduciary income, which decreased by 11.0%, service charges on deposit accounts, which decreased by 0.4%, and other operating income, which decreased by 0.5%.

Non-Interest Expense

Non-interest expense declined $0.2 million or 1.1% in 2007 from $22.4 million in 2006 to $22.2 million in 2007. During 2007, the Company aggressively sought to control operating expense. The Company saw a decrease in furniture and equipment expense as well as in other operating expense.

Provision to the Allowance for Loan Losses

The Company s provision to the allowance for loan losses was $1.4 million in 2007 compared to $1.3 million in 2006. The amount of provision made during the years ending 2007 and 2006 was to maintain the allowance for loan losses at an adequate level given continued growth in our loan portfolio and our level of chargeoffs. The Company s level of chargeoffs as a percentage of loans outstanding was lower in 2007 than in

2006, remaining historically low at 0.11% of total loans.

Net Income

Net income for 2007 was $13.1 million a 6.6% or $0.8 million increase from net income of $12.3 million that was posted in 2006. Earnings per share on a fully diluted basis were $1.34, up $0.09 or 7.2% from the $1.25 reported for the year ended December 31, 2006. Higher net interest income and lower non-interest expense were the primary factors for the increase in net income.

Key Ratios

Return on average assets in 2007 was 1.13%, down from the 1.14% posted in 2006. Return on average tangible equity was 15.89% in 2007, compared to 15.75% in 2006 and 17.81% in 2005, while return on average equity was 11.89% in 2007, compared to 11.63% in 2006 and 12.98% in 2005. The substantial difference between return on average tangible equity and average equity is due to the addition of goodwill related to the acquisition of FNB Bankshares in 2005. In 2007, the Company s dividend payout ratio (the ratio of dividends declared to net income) was 51.49%, compared to 48.80% in 2006 and 40.15% in 2005.

The Company s efficiency ratio a benchmark measure of the amount spent to generate a dollar of income was 50.16% in 2007 compared to 59.47% for the Bank s peer group, on average. In 2006, the Bank s efficiency ratio was 52.12% compared to 56.21% for the Bank s peer group, on average The efficiency ratio is calculated by dividing the Company s operating expenses (which excludes the provision for loan losses) by the total of net interest income on a tax-equivalent basis before provision for loan losses and other operating income (which excludes securities gains).

Investment Management and Fiduciary Activities

As of December 31, 2007, First Advisors, the Bank s private banking and investment management division, had assets under management with a market value of $261.0 million, consisting of 1,020 trust accounts, estate accounts, agency accounts, and self-directed individual retirement accounts. This compares to December 31, 2006, when 1,054 accounts with a market value of $351.2 million were under management. The decline in market value and number of accounts during 2007 was the result of a reorganization of this part of the Bank that included downsizing the number of offices and officers, which in turn led to an anticipated loss of assets under management.

Average Daily Balance Sheets

The following table shows the Company s average daily balance sheets for the years ended December 31, 2007, 2006 and 2005.

	Years ended December 31,		
In thousands of dollars	**2007**	2006	2005
Assets			
Cash and due from banks	**$ 19,978**	$ 21,227	$ 21,895
Interest-bearing deposits	**-**	1182	432
Investments			
U.S. Treasury securities & government agency securities	**110,637**	88,132	66,674
Obligations of states and political subdivisions	**61,189**	57,241	52,524
Other securities	**38,537**	46,780	42,068
Total investments	**210,363**	192,153	161,266
Loans held for sale	**623**	202	257
Loans			
Commercial	**354,235**	329,195	286,754
Consumer	**59,711**	47,578	35,464
State and municipal	**26,722**	22,107	21,833
Real estate	**432,342**	412,785	364,557
Total loans	**873,010**	811,665	708,608
Allowance for loan losses	**(6,634)**	(6,176)	(6,450)
Net loans	**866,376**	805,489	702,158
Premises and equipment, net	**15,664**	16,250	16,670
Goodwill	**15,037**	14,020	26,815
Other assets	**27,684**	27,684	18,059
Total assets	**$ 1,155,725**	$ 1,078,207	$ 947,552
Liabilities and shareholders equity			
Deposits			
Demand	**$ 61,678**	$ 62,571	$ 60,102
NOW	**102,083**	101,103	109,048
Money market	**125,370**	126,837	115,359
Savings	**91,967**	102,683	112,376
Certificates of deposit	**323,367**	164,988	119,595
Certificates of deposit over $100,000	**114,764**	231,867	143,557
Total deposits	**819,229**	790,049	660,037
Borrowed funds	**215,403**	173,200	179,409
Other liabilities	**10,951**	9,199	9,189
Total liabilities	**$ 1,045,583**	$ 972,448	$ 848,635
Common stock	**98**	99	98
Additional paid-in capital	**45,644**	46,776	46,599
Retained earnings	**64,085**	58,275	50,689
Unrealized gain on securities available for sale	**574**	609	1,531
Unrealized loss on post-retirement benefit cost	**(259)**	-	-
Total shareholders equity	**110,142**	105,759	98,917
Total liabilities and shareholders equity	**$ 1,155,725**	$ 1,078,207	$ 947,552

Assets and Asset Quality

Asset growth was strong in 2007, with the loan portfolio increasing by $82.0 million or 9.8%, while the investment portfolio increased $41.3 million or 22.9% over December 31, 2006. Total assets increased by 10.7% or $118.4 million from $1.10 billion at December 31, 2006, to $1.22 billion at December 31, 2007. This increase in earning assets contributed to net interest income increasing $1.2 million or 4.0% during 2007 when compared to 2006.

Although the Bank s loan delinquency ratio increased to 2.27% in 2007, compared to 1.50% on December 31, 2006 and 1.17% on December 31, 2005, it compares well to its peers. In Management s opinion, there has been no pattern or trend in loan delinquencies which is of concern.

Investment Activities

During 2007, the Company s investment portfolio increased 22.9% to end the year at $221.8 million, compared to $180.5 million on December 31, 2006. The Company s investment securities are classified into two categories: securities available for sale and securities to be held to maturity. Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Company s funds management strategy, and may be sold in response to changes in interest rates, changes in prepayment risk, changes in liquidity needs, to increase capital ratios, or for other similar reasons. Securities to be held to maturity consist primarily of debt securities that the Company has acquired solely for long-term investment purposes, rather than for trading or future sale. For securities to be categorized as held to maturity, Management must have the intent and the Company must have the ability to hold such investments until their respective maturity dates. The Company does not hold trading account securities.

All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company s general policy that investments for either portfolio be limited to government debt obligations, time deposits, banker s acceptances, corporate bonds and commercial paper with one of the three highest ratings given by a nationally recognized rating agency.

The Company s investment portfolio is primarily in U.S. Government agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio s overall yield while not materially adding to the Company s level of interest rate risk. The following table sets forth the Company s investment securities at their carrying amounts as of December 31, 2007, 2006, and 2005.

Dollars in thousands	**2007**	2006	2005
Securities available for sale			
U.S. Treasury and agency	**$ -**	$ 4,967	$ 9,101
Mortgage-backed securities	**1,322**	1,571	1,980
State and political subdivisions	**10,855**	11,073	11,782
Corporate securities	**14,727**	18,349	20,353
Federal Home Loan Bank stock	**12,569**	7,586	10,294
Federal Reserve Bank stock	**662**	662	653
Other equity securities	**326**	607	580
	$ 40,461	$ 44,815	$ 54,743
Securities to be held to maturity			
U.S. Treasury and agency	**$ 95,009**	$ 46,192	$ 42,274
Mortgage-backed securities	**30,786**	33,379	33,670
State and political subdivisions	**53,914**	47,549	44,685
Corporate securities	**1,645**	8,614	8,609
	181,354	135,734	129,238
Total securities	**$ 221,815**	$ 180,549	$ 183,981

The following table sets forth certain information regarding the yields and expected maturities of the Company s investment securities as of December 31, 2007. Yields on tax-exempt securities have been computed on a tax-equivalent basis using a tax rate of 35%. Mortgage-backed securities are presented according to their final contractual maturity date, while the calculated yield takes into effect the intermediate cashflows from repayment of principal which results in a much shorter average life.

	Available For Sale		**Held to Maturity**	
	Fair			
Dollars in thousands	Value	Yield to maturity	Amortized Cost	Yield to maturity
U.S. Treasury & Agency				
Due in 1 year or less	$ -	0.00%	$ -	0.00%
Due in 1 to 5 years	-	0.00%	3,000	4.03%
Due in 5 to 10 years	-	0.00%	7,000	5.26%
Due after 10 years	-	0.00%	85,009	6.49%
Total	-	0.00%	95,009	6.32%
Mortgage-Backed Securities				
Due in 1 year or less	5	11.68%	60	3.26%
Due in 1 to 5 years	249	1.61%	2,241	3.80%
Due in 5 to 10 years	155	7.00%	3,871	4.51%
Due after 10 years	913	3.00%	24,615	5.36%
Total	1,322	3.24%	30,787	5.14%
State & Political Subdivisions				
Due in 1 year or less	-	0.00%	-	0.00%
Due in 1 to 5 years	494	6.71%	4,602	7.27%
Due in 5 to 10 years	10,361	7.39%	11,397	6.62%
Due after 10 years	-	0.00%	37,914	6.50%
Total	10,855	7.36%	53,913	6.59%
Corporate Securities				
Due in 1 year or less	1,001	7.03%	495	8.10%
Due in 1 to 5 years	11,572	7.74%	150	4.00%
Due in 5 to 10 years	1,095	7.90%	1,000	4.00%
Due after 10 years	1,059	6.28%	-	0.00%
Total	14,727	7.60%	1,645	5.23%
Equity Securities	13,557	5.94%	-	-
	$40,461	6.84%	$181,354	6.19%

Lending Activities

The loan portfolio experienced solid growth during 2007, with the most significant increase seen in commercial real estate loans. Total loans were $920.2 million at December 31, 2007, a 9.8% increase from total loans of $838.1 million at December 31, 2006. This continues the loan growth trend experienced by the Company over the past ten years. The following tables summarize the Bank s loan portfolio as of December 31, 2007, 2006, 2005, 2004, and 2003.

	As of December 31,									
Dollars in thousands	**2007**		2006		2005		2004		2003	
Commercial										
Real estate	**$119,675**	**13.0%**	$ 94,765	11.3%	$ 79,135	10.2%	$ 47,082	9.8%	$ 40,521	10.2%
Other	**251,489**	**27.3%**	236,637	28.2%	233,806	30.3%	110,811	23.2%	97,487	24.4%
Residential real estate										
Term	**442,407**	**48.1%**	421,967	50.4%	390,995	50.6%	278,879	58.3%	223,251	56.0%
Construction	**5,269**	**0.6%**	5,394	0.6%	8,997	1.2%	1,067	0.2%	2,483	0.6%
Consumer	**66,539**	**7.2%**	55,658	6.7%	39,135	5.1%	26,769	5.6%	26,123	6.5%
Municipal	**34,785**	**3.8%**	23,724	2.8%	20,270	2.6%	13,724	2.9%	9,030	2.3%
Total loans	**$920,164**	**100%**	$838,145	100%	$772,338	100%	$478,332	100%	$398,895	100%

The following table sets forth certain information regarding the contractual maturities of the Bank s loan portfolio as of December 31, 2007.

Dollars in thousands	< 1 Year	1 - 5 Years	5 - 10 Years	> 10 Years	Total
Commercial real estate	$ 468	$ 1,154	$ 5,338	$ 106,749	$ 113,709
commercial other	8,209	70,368	39,147	139,668	257,392
Residential real estate	530	3,726	28,874	409,980	443,110
Residential construction	-	4,739	-	-	4,739
Consumer	214	21,733	11,402	33,080	66,429
Municipal	-	14,375	6,013	14,397	34,785
Totals	$ 9,421	$ 116,095	$ 90,774	$ 703,874	$ 920,164

The following table provides a listing of loans by category, excluding loans held for sale, between variable and fixed rates as of December 31, 2007.

Dollars in thousands	Amount	% of total
Variable-rate loans		
Commercial loans	$ 322,837	35.1%
State and municipal loans	4,729	0.5%
Consumer loans	3,053	0.3%
Equity loans	71,749	7.8%
Residential adjustable-rate mortgages	278,456	30.3%
Total variable-rate loans	680,824	74.0%
Fixed-rate loans	239,340	26.0%
Total loans	$ 920,164	100.00%

Loan Concentrations

As of December 31, 2007, the Bank did not have any concentration of loans in one particular industry that exceeded 10% of its total loan portfolio.

Loans Held for Sale

The volume of residential mortgages sold into the secondary market during 2007 was higher than that sold in 2006 due to higher origination. This resulted in higher levels of non-interest income for mortgage origination and servicing. Loans held for sale are carried at the lower of cost or market value, with a balance of $1.8 million at December 31, 2007 compared with $0.5 million at December 31, 2006.

Allowance for Loan Losses and Loan Loss Experience

The allowance for loan losses represents the amount available for credit losses inherent in the Company s loan portfolio. Loans are charged off when they are deemed uncollectible, after giving consideration to factors such as the customer s financial condition, underlying collateral and guarantees, as well as general and industry economic conditions.

Adequacy of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectibility of specific loans when determining the adequacy of the allowance for loan losses, Management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, and economic trends. The adequacy of the allowance for loan losses is assessed by an allocation process whereby specific loss allocations are made against certain adversely classified loans, and general loss allocations are made against segments of the loan portfolio which have similar attributes. The Company s historical loss experience, industry trends, and the impact of the local and regional economy on the Company s borrowers, were considered by Management in determining the adequacy of the allowance for loan losses.

The allowance for loan losses is increased by provisions charged against current earnings. Loan losses are charged against the allowance when Management believes that the collectibility of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. While Management uses available information to assess possible losses on loans, future additions to the allowance may be necessary based on increases in non-performing loans, changes in economic conditions, growth in loan portfolios, or for other reasons. Any future additions to the allowance would be recognized in the period in which they were determined to be necessary. In addition, various regulatory agencies periodically review the Company s allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to record additions to the allowance based on judgments different from those of Management.

Credit quality of the commercial portfolios is quantified by a corporate credit rating system designed to parallel regulatory criteria and categories of loan risk. Individual loan officers monitor their loans to ensure appropriate rating assignments and adjustments are made on a timely basis. Risk ratings and quality of the commercial loan portfolio are also assessed on a regular basis by an independent loan review consulting firm. Ongoing portfolio trend analyses and individual credit reviews to evaluate loan risk and compliance with corporate lending policies are also performed. The level of allowance allocable to each group of risk-rated loans is then determined by applying a loss factor that estimates the amount of probable loss in each category. The assigned loss factor for each risk rating is based upon Management s assessment of historical loss data, portfolio characteristics, economic trends, overall market conditions and past experience.

Consumer loans, which include residential mortgages, home equity loans/lines, and direct/indirect loans, are generally evaluated as a group based on product type and on the basis of delinquency data and other credit data available due to the large number of such loans and the relatively small size of individual credits. Allocations for these loan categories are principally determined by applying loss factors that represent Management s estimate of inherent losses. In each category, inherent losses are estimated based upon Management s assessment of historical loss data, portfolio characteristics, economic trends, overall market conditions and past experience. In addition, certain loans in these categories may be individually risk-rated if considered necessary by Management.

The other method used to allocate the allowance for loan losses entails the assignment of reserve amounts to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At December 31, 2007, impaired loans with specific reserves totaled $1.3 million (all of these loans were

on non-accrual status) and the amount of such reserves was $0.6 million. This compares to impaired loans with specific reserves of $1.1 million at December 31, 2006 (all of these loans were on non-accrual status) and the amount of such reserves was $0.2 million.

All of these analyses are reviewed and discussed by the Directors Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. As a result of these analyses, the Company has concluded that the level of the allowance for loan losses was adequate as of December 31, 2007. Although the level of the allowance for loan losses is lower than the average of the Bank s peers as a percentage of total loans, Management views the level of the allowance for loan losses as adequate as a result of the relatively high percentage of residential real estate loans in the portfolio in comparison to the peer group s average and overall credit quality in the portfolio.

The following table reflects the Bank s allowance for loan losses by category of loan as of December 31, 2007, 2006, 2005, 2004, and 2003. The unallocated portion of the allowance for loan losses is a general reserve that is not allocated to a specific portion of the loan portfolio. The commercial category includes commercial real estate loans. The percentages represent the proportion of each category to the total amount of loans outstanding at each date.

	As of December 31,									
Dollars in thousands	**2007**		2006		2005		2004		2003	
Real estate	**$ 781**	**49%**	$ 749	51%	$ 798	52%	$ 856	58%	$ 690	56%
Commercial	**4,678**	**44%**	4,503	42%	3,983	43%	2,509	36%	2,237	37%
Consumer	**1,098**	**7%**	1,008	7%	1,043	5%	711	6%	752	7%
Unallocated	**243**	**-**	104	-	262	-	638	-	521	-
Total	**$6,800**	**100%**	$6,364	100%	$6,086	100%	$4,714	100%	$4,200	100%

During 2007, a provision of $1.4 million was made to the allowance for loan losses, compared to a provision of $1.3 million in 2006, and $0.2 million in 2005. In Management s opinion, the level of provision in 2007 was appropriate given the overall credit quality of the portfolio. Net loans charged off in 2007 were $1.0 million, or 0.11% of average loans outstanding for the year. This compares to net loan chargeoffs of $1.0 million or 0.13% in 2006 and $0.9 million or 0.12% in 2005.

The following table summarizes the activity with respect to loan losses for the years ended December 31, 2007, 2006, 2005, 2004 and 2003.

	Years ended December 31,				
Dollars in thousands	**2007**	2006	2005	2004	2003
Balance at beginning of year	**$6,364**	$6,086	$4,714	$4,200	$3,700
Acquisition of FNB Bankshares	**-**	-	2,066		
Loans charged off:					
Commercial[1]	**867**	851	501	260	184
Real estate mortgage	**13**	42	270	-	19
Consumer[2]	**457**	420	281	180	352
Total	**1,337**	1,313	1,052	440	555
Recoveries on loans previously charged off					
Commercial[1]	**145**	93	51	14	52
Real estate mortgage	**4**	16	-	-	2
Consumer	**192**	157	107	60	94
Total	**341**	266	158	74	148
Net loans charged off	**996**	1,047	894	366	407
Provision for loan losses	**1,432**	1,325	200	880	907
Balance at end of year	**$6,800**	$6,364	$6,086	$4,714	$4,200
Ratio of net loans charged off to average loans outstanding	**0.11%**	0.13%	0.12%	0.08%	0.10%
Ratio of allowance for loan losses to total loans outstanding	**0.74%**	0.76%	0.79%	0.99%	1.05%

[1] *Includes commercial real estate loans*

[2] *Includes home equity lines of credit*

Non-Performing Assets

The Bank s overall loan delinquency ratio increased to 2.27% at December 31, 2007, versus 1.50% at December 31, 2006. In Management s opinion, there has been no pattern or trend in non-performing assets of concern. The increase in 2007 was related to isolated circumstances involving a small number of borrowers, and the levels at December 31, 2007, 2006, 2005, 2004 and 2003 are in line with Management s opinion of a normal range of delinquency rates for the Bank.

The following table sets forth a summary of loans delinquent more than ninety days by category, total loans carried on a non-accrual basis, and income not recognized from non-accrual loans as of December 31, 2007, 2006, 2005, 2004 and 2003.

	As of December 31,				
Dollars in thousands	**2007**	2006	2005	2004	2003
Commercial real estate and business	**$ 2,745**	$ 3,390	$ 2,022	$ 1,580	$ 1,320
Residential real estate	**2,055**	540	934	270	517
Consumer	**354**	302	464	32	78
Total	**$ 5,154**	$ 4,232	$ 3,420	$ 1,882	$ 1,915
Non-accrual loans included in above total	**$ 2,867**	$ 3,485	$ 3,095	$ 1,601	$ 1,537
Income not recognized from non-accrual loans	**283**	396	202	189	85

The Bank places a loan on non-accrual status only after a careful review of the loan circumstances and a determination that payment in full of principal and/or interest is not expected. Income not recognized from non-accrual loans represents the interest income, as of the end of each period, that would have been recorded on loans placed on non-accrual status if they were current in accordance with their original terms. None of these amounts were included in interest income for the same periods.

At December 31, 2007, there were two properties owned with a net OREO balance of $0.8 million compared to December 31, 2006 when there were also two properties owned with a net OREO balance of $1.1 million and December 31, 2005 as of which no properties were owned. Other real estate owned and repossessed assets (OREO) are comprised of properties or other assets acquired through a foreclosure proceeding, or acceptance of a deed or title in lieu of foreclosure.

Funding, Liquidity and Capital Resources

The Company s principal sources of funding are deposits and borrowed funds from the Federal Home Loan Bank of Boston. The Company has a comprehensive liquidity management program. It maintains adequate funding for its assets by acquiring deposits in its local market as well as through wholesale sources. The Bank s liquidity position is further supplemented with securities repurchase agreements with certain brokers and $10.0 million in credit lines with correspondent banks.

While the Bank maintains a securities available for sale portfolio to enhance its overall liquidity position, its present policy is not to liquidate securities to meet short-term liquidity needs. Instead, the Bank uses Federal Home Loan Bank advances or securities repurchase agreements for this purpose. At December 31, 2007, the Company had a net unrealized gain of $0.4 million (net of $0.2 million in deferred income taxes) on securities available for sale.

Deposit balances generally increase during the summer and autumn months of each year due to increased seasonal business activity and also fluctuate throughout the year as a result of changes in volume of wholesale certificates of deposit due to variations in rates available from several wholesale funding sources. In 2007, the maximum amount of deposits at any month end was $877.4 million on July 31, 2007. This balance is somewhat higher than the $781.3 million on December 31, 2007, as a result of regular seasonal inflows of core deposits and shifts in the Bank s wholesale funding mix.

As of December 31, 2007, the Bank had primary sources of liquidity of $84.5 million, or 7.07% of its assets. It is Management s opinion that this is adequate. The Bank has established guidelines for liquidity management, with policies and procedures prescribed in its funds management policy. The Bank has not experienced any recent significant deposit trends which would have a material effect on the Bank s liquidity position.

Deposits

Although average deposits increased slightly in 2007, the Bank saw a $24.0 million or 3.0% decrease in deposits from year end 2006 to year end 2007, compared to a 12.8% increase in 2006. The decline in deposits from December 31, 2006 to December 31, 2007 was the result of a shift from wholesale certificates of deposit to repurchase agreements and Federal Home Loan Bank borrowings because of more favorable interest rates available with these sources of funding.

The following table sets forth the average daily balance for the Bank s principal deposit categories for each period:

	Years ended December 31,			% growth
Dollars in thousands	**2007**	2006	2005	2007 vs. 2006
Demand deposits	**$ 61,678**	$ 62,571	$ 60,102	-1.45%
NOW accounts	**102,083**	101,103	109,048	0.96%
Money market accounts	**125,370**	126,837	115,359	-1.17%
Savings	**91,967**	102,683	112,376	-11.65%
Certificates of deposit	**438,131**	396,855	263,152	9.42%
Total Deposits	**$ 819,229**	$ 790,049	$ 660,037	