

AMES NATIONAL CORP  
Form 10-Q  
May 07, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]

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

For the quarterly period ended March 31, 2010

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

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

Commission File Number 0-32637

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

IOWA  
(State or Other Jurisdiction of Incorporation or  
Organization)

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

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

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

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

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

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

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

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

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

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

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

COMMON STOCK, \$2.00 PAR VALUE  
(Class)

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

## AMES NATIONAL CORPORATION

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(unaudited)

ASSETS	March 31, 2010	December 31, 2009
Cash and due from banks	\$25,422,556	\$ 18,796,664
Interest bearing deposits in financial institutions	34,097,282	24,776,088
Securities available-for-sale	419,052,593	418,655,018
Loans receivable, net	408,906,164	415,434,236
Loans held for sale	1,708,365	1,023,200
Bank premises and equipment, net	11,780,912	11,909,404
Accrued income receivable	6,450,914	5,710,226
Deferred income taxes	3,228,044	3,867,523
Other real estate owned	11,140,683	10,480,449
Other assets	4,567,509	4,916,991
<b>Total assets</b>	<b>\$926,355,022</b>	<b>\$ 915,569,799</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
<b>Deposits</b>		
Demand, noninterest bearing	\$94,569,046	\$99,918,848
NOW accounts	195,451,550	197,393,459
Savings and money market	191,829,393	184,631,343
Time, \$100,000 and over	92,014,067	87,054,194
Other time	149,641,257	153,166,105
<b>Total deposits</b>	<b>723,505,313</b>	<b>722,163,949</b>
Federal funds purchased and securities sold under agreements to repurchase	44,557,180	40,489,505
Short-term borrowings	101,535	138,874
FHLB advances and other long-term borrowings	38,500,000	36,500,000
Dividend payable	1,037,620	943,292
Accrued expenses and other liabilities	3,331,051	2,994,291
<b>Total liabilities</b>	<b>811,032,699</b>	<b>803,229,911</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$2 par value, authorized 18,000,000 shares; 9,432,915 shares issued and outstanding	18,865,830	18,865,830
Additional paid-in capital	22,651,222	22,651,222
Retained earnings	69,935,681	67,703,701
Accumulated other comprehensive income-net unrealized gain on securities available-for-sale	3,869,590	3,119,135
<b>Total stockholders' equity</b>	<b>115,322,323</b>	<b>112,339,888</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$926,355,022</b>	<b>\$ 915,569,799</b>

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME  
(unaudited)Three Months Ended  
March 31,  
2010                      2009

## Interest and dividend income:

Loans, including fees	\$6,099,479	\$6,611,175
Securities:		
Taxable	1,827,521	2,111,495
Tax-exempt	1,365,582	1,278,656
Federal funds sold	-	11,075
Interest bearing deposits	130,113	105,071
Total interest and dividend income	9,422,695	10,117,472

## Interest expense:

Deposits	1,662,354	2,441,530
Other borrowed funds	403,158	468,384
Total interest expense	2,065,512	2,909,914

Net interest income	7,357,183	7,207,558
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Provision for loan losses	323,798	229,654
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Net interest income after provision for loan losses	7,033,385	6,977,904
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## Noninterest income:

Trust department income	530,716	382,552
Service fees	399,823	421,450
Securities gains (losses), net	536,983	(350,675 )
Other-than-temporary impairment of investment securities	-	(22,661 )
Gain on sales of loans held for sale	153,536	262,906
Merchant and ATM fees	165,387	146,010
Other	171,320	166,390
Total noninterest income	1,957,765	1,005,972

## Noninterest expense:

Salaries and employee benefits	2,598,039	2,346,759
Data processing	450,964	478,635
Occupancy expenses	401,154	392,804
FDIC insurance assessments	313,357	479,911
Other real estate owned	56,353	426,844
Other operating expenses	713,072	701,467
Total noninterest expense	4,532,939	4,826,420

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Income before income taxes	4,458,211	3,157,456
Provision for income taxes	1,188,611	716,316
Net income	\$3,269,600	\$2,441,140
Basic and diluted earnings per share	\$0.35	\$0.26
Dividends declared per share	\$0.11	\$0.10
Comprehensive income	\$4,020,055	\$1,046,046

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

	Three Months Ended March 31,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$3,269,600	\$2,441,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	323,798	229,654
Provision (credit) for off-balance sheet commitments	13,000	(5,000 )
Amortization and (accretion), net	636,519	(8,219 )
Depreciation	181,712	216,076
Provision for deferred taxes	198,735	701,262
Securities losses (gains), net	(536,983 )	350,675
Other-than-temporary impairment of investment securities	-	22,661
Impairment of other real estate owned	-	320,282
Gain on sale of other real estate owned	(11,754 )	-
Change in assets and liabilities:		
Decreases (increase) in loans held for sale	(685,165 )	473,020
Decrease (increase) in accrued income receivable	(740,688 )	439,498
Decrease in other assets	346,202	634,412
Increase in accrued expenses and other liabilities	323,760	336,288
Net cash provided by operating activities	3,318,736	6,151,749
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of securities available-for-sale	(48,046,365)	(42,606,042)
Proceeds from sale of securities available-for-sale	11,881,313	10,783,617
Proceeds from maturities and calls of securities available-for-sale	36,859,140	23,910,121
Net increase in interest bearing deposits in financial institutions	(9,321,194 )	(2,233,435 )
Net increase in federal funds sold	-	(32,241,000)
Net decrease in loans	5,502,745	14,512,896
Net proceeds for the sale of other real estate owned	51,216	254,728
Purchase of bank premises and equipment, net	(49,940 )	(52,821 )
Improvements in other real estate owned	1,833	1,125
Net cash used in investing activities	(3,121,252 )	(27,670,811)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase in deposits	1,341,364	20,246,750
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	4,067,675	(700,565 )
Payments on short-term borrowings, net	(37,339 )	(691,049 )
Proceeds from FHLB advances	2,500,000	2,500,000
Payments on FHLB advances	(500,000 )	(4,500,000 )
Dividends paid	(943,292 )	(2,641,216 )
Net cash provided by financing activities	6,428,408	14,213,920

Net increase (decrease) in cash and cash equivalents	6,625,892	(7,305,142 )
<b>CASH AND DUE FROM BANKS</b>		
Beginning	18,796,664	24,697,591
Ending	\$25,422,556	\$17,392,449

Continued

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

Three Months Ended  
 March 31,  
 2010                      2009

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments (receipt) for:

Interest	\$2,116,133	\$3,052,441
Income taxes	696,462	(918,253 )

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES

Transfer of loans to other real estate owned	\$701,529	\$491,516
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See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

1. Significant Accounting Policies

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

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

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

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

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

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

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

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



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

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

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

New Accounting Pronouncements

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

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

2. Dividends

On February 10, 2010, the Company declared a cash dividend on its common stock, payable on May 17, 2010 to stockholders of record as of May 3, 2010, equal to \$0.11 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended March 31, 2010 and 2009 were 9,432,915. The Company had no potentially dilutive securities outstanding during the periods presented.

4. Off-Balance Sheet Arrangements

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

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## 5. Fair Value of Financial Instruments

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

	March 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$25,422,556	\$25,423,000	\$18,796,664	\$18,797,000
Federal funds sold	-	-	-	-
Interest-bearing deposits	34,097,282	34,097,000	24,776,088	24,766,000
Securities available-for-sale	419,052,593	419,053,000	418,655,018	418,655,000
Loans receivable, net	408,906,164	404,202,000	415,434,236	411,344,000
Loans held for sale	1,708,365	1,708,000	1,023,200	1,023,000
Accrued income receivable	6,450,914	6,451,000	5,710,226	5,710,000
Financial liabilities:				
Deposits	\$723,505,313	\$726,225,000	\$722,163,949	\$725,840,000
Federal funds purchased and securities sold under agreements to repurchase	44,557,180	44,557,000	40,489,505	40,490,000
Other short-term borrowings	101,535	102,000	138,874	139,000
Long-term borrowings	38,500,000	43,369,000	36,500,000	41,504,000
Accrued interest payable	1,041,493	1,041,000	1,092,191	1,092,000

The methodology used to determine fair value as of March 31, 2010 did not change from the methodology used in the Annual Report.

## 6. Fair Value Measurements

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

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

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

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

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

Description	Total	Quoted Prices in		
		Active markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2010				
U.S. treasury	\$ 520,000	\$ 520,000	\$ -	\$ -
U.S. government agencies	106,521,000	-	106,521,000	-
U.S. government mortgage-backed securities	96,716,000	-	96,716,000	-
State and political subdivisions	185,068,000	-	185,068,000	-
Corporate bonds	22,282,000	-	22,282,000	-
Equity securities, financial industry common stock	2,722,000	2,722,000	-	-
Equity securities, other	5,224,000	2,028,000	3,196,000	-
	\$ 419,053,000	\$ 5,270,000	\$ 413,783,000	\$ -
December 31, 2009				
U.S. treasury	\$ 525,000	\$ 525,000	\$ -	\$ -
U.S. government agencies	106,640,000	-	106,640,000	-
U.S. government mortgage-backed securities	101,589,000	-	101,589,000	-
State and political subdivisions	178,052,000	-	178,052,000	-
Corporate bonds	24,300,000	-	24,300,000	-
Equity securities, financial industry common stock	2,347,000	2,347,000	-	-
Equity securities, other	5,202,000	2,023,000	3,179,000	-
	\$ 418,655,000	\$ 4,895,000	\$ 413,760,000	\$ -

(a) Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the securities credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include U.S. government agency securities, mortgage-backed securities (including pools and collateralized mortgage obligations), municipal bonds, and corporate debt securities. There were no transfers between level one and two classifications. The Company's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.



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

Description	Total	Quoted Prices in Active markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2010				
Loans	\$ 4,233,000	\$ -	\$ -	\$ 4,233,000
Other real estate owned	11,141,000	-	-	11,141,000
Total	\$ 15,374,000	\$ -	\$ -	\$ 15,374,000
December 31, 2009				
Loans	\$ 4,807,000	\$ -	\$ -	\$ 4,807,000
Other real estate owned	10,480,000	-	-	10,480,000
Total	\$ 15,287,000	\$ -	\$ -	\$ 15,287,000

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

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## 7. Debt and Equity Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2010:				
U.S. treasury	\$499,192	\$21,204	\$-	\$520,396
U.S. government agencies	105,772,396	860,397	(111,601 )	106,521,192
U.S. government mortgage-backed securities	94,620,853	2,138,723	(43,356 )	96,716,220
State and political subdivisions	182,213,004	3,202,778	(348,328 )	185,067,454
Corporate bonds	21,004,062	1,322,612	(44,801 )	22,281,873
Equity securities, financial industry common stock	3,402,389	-	(681,148 )	2,721,241
Equity securities, other	5,398,491	17,700	(191,974 )	5,224,217
	\$412,910,387	\$7,563,414	\$(1,421,208)	\$419,052,593

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

Non-interest income for the three months ended March 31, 2010 and 2009 was primarily impacted by net security gains (losses) of approximately \$537,000 and (\$351,000), respectively.

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

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2010:						
Securities available for sale:						
U.S. government agencies	\$30,896,708	\$(100,993 )	\$457,446	\$(10,608 )	\$31,354,154	\$(111,601 )
U.S. government mortgage-backed securities	11,653,483	(43,356 )	-	-	11,653,483	(43,356 )
State and political subdivisions	24,153,227	(297,395 )	2,588,170	(50,933 )	26,741,397	(348,328 )
Corporate obligations	1,466,747	(25,309 )	732,818	(19,492 )	2,199,565	(44,801 )
Equity securities, financial industry common stock	-	-	2,721,241	(681,148 )	2,721,241	(681,148 )
Equity securities, other	-	-	1,996,518	(191,974 )	1,996,518	(191,974 )
	\$68,170,165	\$(467,053 )	\$8,496,193	\$(954,155 )	\$76,666,358	\$(1,421,208)

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

At March 31, 2010, debt securities have unrealized losses of \$548,086. These losses are generally due to changes in interest rates or general market conditions. In analyzing an issuers' financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond ratings agencies have occurred and industry analysts' reports. Unrealized losses on equity securities totaled \$873,122 as of March 31, 2010. Management analyzed the financial condition of the equity issuers and considered the general market conditions and other factors in concluding that the unrealized losses on equity securities were not other-than-temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could lead to additional impairment charges, thereby materially affecting the amounts reported in the Company's financial statements.



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## 8. Impaired Loans and Allowance for Loan Losses

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment. Impairment of \$819,000 and \$999,000 is included in the allowance for loan losses as of March 31, 2010 and December 31, 2009, respectively. The following is a recap of impaired loans at March 31, 2010 and December 31, 2009:

	March 31, 2010	December 31, 2009
Impaired loans without a valuation allowance	\$3,017,000	\$ 4,381,000
Impaired loans with a valuation allowance	5,052,000	5,806,000
Total impaired loans	\$8,069,000	\$ 10,187,000
Valuation related to impaired loans	\$819,000	\$ 999,000
Total nonaccrual loans	\$8,310,000	\$ 10,187,000
Total loans past due ninety days or more and still accruing	\$107,000	\$ 121,000
	Three Months Ended March 31, 2010	2009
Average investments in impaired loans	\$9,128,000	\$7,378,000
Interest income that would have been recognized on impaired loans	\$118,000	\$136,000
Interest income recorded on impaired loans	\$98,000	\$21,000

Changes in the allowance for loan losses were as follows for the three months ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	2009
Balance, beginning	\$ 7,651,510	\$ 6,779,215
Loans charged-off	(315,131 )	(96,963 )
Recoveries of loans charged-off	21,397	20,375
Net charge offs	(293,734 )	(76,588 )
Provision for loan losses	323,798	229,654
Balance, ending	\$ 7,681,574	\$ 6,932,281

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9. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. There were no significant events or transactions occurring after March 31, 2010, but prior to May 6, 2010 that provided additional evidence about conditions that existed at March 31, 2010. There were no events or transactions that provided evidence about conditions that did not exist at March 31, 2010.

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

Overview

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

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and trust services. The Banks also offer investment services through a third-party broker dealer. The Company employs eleven individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 183 full-time equivalent individuals employed by the Banks.

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

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

The Company had net income of \$3,270,000, or \$0.35 per share, for the three months ended March 31, 2010, compared to net income of \$2,441,000, or \$0.26 per share, for the three months ended March 31, 2009. Total equity capital as of March 31, 2010 totaled \$115.3 million or 12.4% of total assets.

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The Company's earnings for the first quarter increased \$828,000 from the \$2,441,000 earned a year ago. The higher quarterly earnings can be primarily attributed to increased securities gains, lower other real estate owned expenses and lower FDIC insurance assessments, offset in part by an increase in salaries and employee benefits. For the three months ended March 31, 2010, securities gain were \$537,000 as compared to securities losses of \$351,000 for the three month ended March 31, 2009. The decrease in other real estate costs of \$370,000 is due primarily to write downs in 2009, with no write downs in 2010. The decrease in the FDIC insurance assessments of \$167,000 is due primarily to lower quarterly deposit assessments. FDIC insurance assessments are expected to negatively impact future operating results if bank failures continue to erode the FDIC insurance fund. For the three months ended March 31, 2010, 41 banks have failed compared to 140 bank failures for the year ended December 31, 2009.

Net loan charge-offs for the quarter totaled \$294,000, compared to net charge-offs of \$77,000 in the first quarter of 2009. The provision for loan losses for the first quarter of 2010 totaled \$324,000 compared to the provision for loan losses of \$230,000 for the same period in 2009. This increase in the provision for loan losses was due primarily to the continuing weakness in general economic conditions, offset in part by decreases in outstanding loans and the specific allowance for loan losses on impaired loans.

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

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

Challenges

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

- In March of 2009, the OCC imposed individual minimum capital ratios requiring First National to maintain, on an ongoing basis, Tier One Leverage Capital of 9% of Adjusted Total Assets and Total Risk Based Capital of 11% of Risk Weighted Assets. As of March 31, 2010, First National exceeded these capital ratios. Failure to maintain the individual minimum capital ratios could result in additional regulatory action against First National.
- Interest rates are likely to increase as the economy continues its gradual recovery and an increasing interest rate environment may present a challenge to the Company. Increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense may increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.



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- The Company's market in central Iowa has numerous banks, credit unions, and investment and insurance companies competing for similar business opportunities. This competitive environment will continue to put downward pressure on the Banks' net interest margins and thus affect profitability. Strategic planning efforts at the Company and Banks continue to focus on capitalizing on the Banks' strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.
- The Company's equity securities portfolio (held at the holding company level and excluding equity holding by the Banks) is \$4.7 million as of March 31, 2010. The Company invests a portion of its' capital that may be utilized for future expansion in a portfolio of primarily financial and utility stocks. The Company has focused on stocks that have historically paid dividends in an effort to lessen the negative effects of a bear market. The strategy, however, did not prove successful in 2010 and 2009 as problems due to the national recession caused a significant decline in the market value and dividend rates of the Company's equity securities. Unrealized losses in the Company's equity portfolio totaled \$873,000 and \$1.3 million (at the holding company level on an unconsolidated basis) as of March 31, 2010 and December 31, 2009, respectively. The Company had no realized losses in its equity portfolio during the three months ended March 31, 2010, compared to realized losses of \$53,000 during the three months ended March 31, 2009 (at the holding company level on an unconsolidated basis). Additionally, the Company recognized no impairment losses in the equity portfolio during the three months ended March 31, 2010 and 2009. It is possible that the Company may incur impairment losses in the remainder of 2010 which would have a negative impact on the Company's earnings for the year.
- Loans amounted to \$408.9 million and \$415.4 million as of March 31, 2010 and December 31, 2009, respectively. The loan portfolio decreased 1.6% during the three months ended March 31, 2010. The decline in the loan portfolio is primarily due to the decrease in loan volume due to a weakening of loan demand as payments and prepayments exceeded originations. The declines occurred primarily in the commercial operating and commercial real estate loan portfolios. A continued decline in the loan portfolio would have a negative impact on the Company's earnings for the year.
- The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated in recent years and significantly contributed to the Company's increased level of non-performing loans, other real estate owned and related costs since 2007. The Company has \$8,975,000 in other real estate owned in the Des Moines market. The Company has \$3.4 million in impaired loans with four Des Moines development companies with specific reserves totaling \$350,000. The Company has additional customer relationships with real estate developers in the Des Moines area that may become impaired in the future if economic conditions do not improve or become worse. The Company has a limited number of such credits and is actively engaged with the customers to minimize credit risk.
- Other real estate owned amounted to \$11.1 million and \$10.5 million as of March 31, 2010 and December 31, 2009, respectively. Other real estate owned costs amounted to \$56,000 and \$427,000 for the three months ended March 31, 2010 and 2009, respectively. Management obtains independent appraisals or performs evaluations to determine that these properties are carried at the lower of the new cost basis or fair value less cost to sell. It is at least reasonably possible that change in fair values will occur in the near term and that such changes could have a negative impact on the Company's earnings.
- The FDIC imposes an assessment against all depository institutions for deposit insurance. Notably, the FDIC has the authority to increase insurance assessments. FDIC insurance assessments amounted to \$313,000 and \$480,000 for the three months ended March 31, 2010 and 2009, respectively. For the three months ended March 31, 2010, 41 banks failed as compared 140 bank failures for the year ended December 31, 2009. In 2011, the FDIC has a scheduled assessment increase for all FDIC insured institutions. An increase in FDIC deposit assessments will have a negative impact on the Company's earnings.



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• The Company operates in a highly regulated environment and is subject to extensive regulation, supervision and examination. Applicable laws and regulations may change, and there is no assurance that such changes will not adversely affect the Company's business. In this respect potentially landscape-changing legislative proposals have been introduced in Congress and by regulatory agencies with respect to their respective regulatory powers. Such regulation and supervision govern the activities in which an institution may engage and are intended primarily for the protection of the Bank, its depositors and the FDIC. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, or legislation, including but not limited to changes in the regulations governing banks, could have a material impact on the Company's operations. It is unknown at this time to what extent legislation will be passed into law or regulatory proposals will be adopted, or the effect that such passage or adoption will have on the banking industry or the Company.

## Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 8,012 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

## Selected Indicators for the Company and the Industry

	Quarter Ended March 31, 2010			2009			Year Ended December 31, 2008			2007		
	Company	Company	Industry *	Company	Industry	Company	Company	Industry	Company	Industry		
Return on average assets	1.43 %	1.02 %	0.09 %	0.74 %	0.12 %	1.30 %	0.81 %					
Return on average equity	11.46 %	8.31 %	0.90 %	5.89 %	1.24 %	9.89 %	7.75 %					
Net interest margin	3.78 %	3.78 %	3.47 %	3.94 %	3.18 %	3.39 %	3.29 %					
Efficiency ratio	48.66 %	63.87 %	55.53 %	67.40 %	59.02 %	53.71 %	59.37 %					
Capital ratio	12.51 %	12.32 %	8.65 %	12.57 %	7.49 %	13.20 %	7.98 %					

\*Latest available data



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Key performances indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.43% and 1.15%, respectively, for the three month periods ending March 31, 2010 and 2009. The increase in this ratio in 2010 from the previous period is primarily the result of higher net income.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was 11.46% and 9.32%, respectively for the three month periods ending March 31, 2010 and 2009. The increase in this ratio in 2010 from the previous period is primarily the result of higher net income.

- Net Interest Margin

The net interest margin for the three months ended March 31, 2010 was 3.78% compared to 3.97% for the three months ended March 31, 2009. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings. This decrease is primarily the result of lower yields on interest earning assets, offset in part by lower cost of funds on deposits and other borrowings and an increase in the average balance of securities available-for-sale. The lower yields and cost of funds were due primarily to lower market interest rates as interest earning assets and interest-bearing liabilities are repricing.

- Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 48.7% and 58.8% for the three months ended March 31, 2010 and 2009, respectively. The improvement in the efficiency ratio in 2010 from the previous period is primarily the result of securities gains in 2010 as compared to securities losses in 2009 and decreased expenses related to other real estate owned and FDIC insurance assessments.

- Capital Ratio

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

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### Industry Results

The FDIC Quarterly Banking Profile reported the following results for the fourth quarter of 2009:

#### Fourth Quarter Earnings Are Slightly Above Break-Even

The benefits of a recovering economy and stable financial markets in year-over-year comparisons were evident in the performance of insured depository institutions in the fourth quarter. The small profit reported by the industry in the quarter essentially represented break-even performance, but it contrasted sharply with the record quarterly loss posted in the fourth quarter of 2008. Fourth quarter bank net income for the industry was \$914 million, compared with a \$37.8 billion net loss a year earlier. While much of the year-over-year earnings improvement was concentrated among the largest banks, there was also evidence of a broader improving trend. For the first time in three years, more than half of insured institutions reported year-over-year improvement in net income. The percentage of institutions reporting a net loss for the quarter was lower than a year ago. The average return on assets (ROA) for all four of the asset size groups featured in the Quarterly Banking Profile was better than a year ago, although only the largest size group—institutions with more than \$10 billion in assets—had a positive average ROA for the quarter.

#### Revenues Rebound from Fourth Quarter 2008

A number of factors contributed to the year-over-year improvement in quarterly earnings. Noninterest income was \$21.7 billion (53.2%) higher than in the fourth quarter of 2008, as several categories of noninterest income that were negative a year ago swung back into positive territory. Trading revenues totaled \$2.8 billion in the quarter, compared with \$9.2 billion in trading losses a year earlier. Servicing income also rebounded strongly, from a \$390 million loss a year ago to a gain of \$8.0 billion. Loan sales produced \$1.3 billion in gains, versus \$1.3 billion in losses in the fourth quarter of 2008. Another significant contribution to the improvement in earnings came from a \$16.2 billion (14.2%) decline in noninterest expense. This decline was the result of an \$18.1 billion (77.2%) reduction in charges for goodwill impairment and other intangible asset expenses. Quarterly loan-loss provisions posted a year-over-year decline for the first time since the third quarter of 2006, falling by \$10.0 billion (14.1%). Provisions remained above \$60 billion for the fifth consecutive quarter, but the \$61.1 billion that institutions set aside in the quarter was the smallest quarterly total since the third quarter of 2008. Realized gains on securities and other assets totaled \$158 million, an \$8.7 billion improvement over the \$8.6 billion in realized losses reported by the industry a year ago. Net interest income was higher than a year ago but only by \$1.7 billion (1.8%).

#### Margins Register Improvement

The average net interest margin (NIM) in the fourth quarter was 3.49%, slightly lower than the 3.51% reported in the third quarter but higher than the 3.33% average in the fourth quarter of 2008. The quarter-over-quarter decline was concentrated among larger institutions. More than half of all institutions (55.5%) reported higher NIMs compared to third quarter levels. Also, quarterly NIMs at a majority of institutions (53.0%) increased from a year ago, with larger institutions reporting the biggest gains. Margin improvements helped offset declines in interest-bearing assets. Earning assets declined by \$138.8 billion (1.2%) during the fourth quarter and fell by \$477.2 billion (4.1%) for the full year.

#### Full Year Earnings Remain Well below Historical Norms

Full-year 2009 net income was \$12.5 billion, up from \$4.5 billion in 2008, but well below the \$100 billion in net income the industry reported for 2007. Increased noninterest income, higher net interest income, and lower realized losses on securities and other assets outstripped increased noninterest expenses and higher loan loss provisions to produce the increase in earnings. Noninterest income was \$52.8 billion (25.4%) higher than in 2008, with trading

revenue registering a \$26.6 billion improvement. Net interest income was \$38.1 billion (10.6%) higher, as the full-year industry NIM rose for the first time in seven years. The average NIM in 2009 was 3.47%, the highest annual average since 2005. Realized losses on securities and other assets fell from \$15.4 billion in 2008 to \$1.4 billion in 2009. These positive contributions to the rise in full year earnings were partially offset by a \$71.5 billion (40.6%) increase in loan loss provisions and a \$16.3 billion (4.4%) increase in noninterest expense. More than one in four institutions (29.5%) reported negative net income for the year, up from 24.8% in 2008. This is the highest proportion of unprofitable institutions in any year since at least 1984. The average ROA in 2009 was 0.09%, up from 0.03% in 2008. As was the case in 2008, full-year industry earnings for 2009 (which consist of calendar-year net income of 8,012 insured institutions filing December 31 financial reports) would have been significantly lower if losses experienced by institutions that failed during the year were reflected in year-end reporting.

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### Loan Losses Rise for Twelfth Consecutive Quarter

Asset quality indicators worsened in the fourth quarter. Net charge-offs (NCOs) totaled \$53.0 billion, an increase of \$14.4 billion (37.2%) over the same period in 2008. The annualized net charge-off rate rose to 2.89%, up from 1.95% a year earlier and 2.72% in the third quarter of 2009. This is the highest quarterly NCO rate reported by the industry in the 26 years for which quarterly NCO data are available. NCOs in all major loan categories increased from a year ago. The largest increases occurred in residential mortgage loans, where NCOs rose by \$3.3 billion (47.7%); credit cards (up by \$2.7 billion, or 41.4%); loans to commercial and industrial (C&I) borrowers (up \$2.3 billion, or 37.0%); home equity loans (up \$1.9 billion, or 58.6%); and real estate loans secured by nonfarm nonresidential properties (up \$1.9 billion, or 130.9%). This is the 12th consecutive quarter that NCOs have posted a year-over-year increase.

### Growth in Noncurrent Loans Slows

Noncurrent loans and leases continued to rise through the end of the year, with a few notable exceptions. The total amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) increased by \$24.3 billion (6.6%) in the fourth quarter, to \$391.3 billion, or 5.37% of all loans and leases at year end. This is the highest level for the industry's noncurrent rate in the 26 years that all insured institutions have reported noncurrent loan data. The increase in noncurrent loans in the quarter was largely driven by noncurrent residential mortgage loans, which rose by \$23.2 billion (14.9%). Much of this increase—\$19.1 billion—consisted of rebooked GNMA mortgages that have government guarantees. The amount of real estate loans secured by nonfarm nonresidential real estate properties that were noncurrent rose by \$4.5 billion (12.2%). In contrast, noncurrent C&I loans declined by \$3.5 billion (7.7%), and noncurrent real estate construction and development (C&D) loans fell by \$2.0 billion (2.7%). This was the first time in three years that noncurrent C&I loans have declined and the first time in four years that noncurrent C&D loans have fallen.

### Reserves Exceed Three Percent of Total Loans

Reserves for loan and lease losses increased by only \$7.0 billion (3.2%) in the fourth quarter, as institutions added \$8.1 billion more in loss provisions to their reserves than they took out in net charge-offs. The average coverage ratio of reserves to noncurrent loans and leases fell from 60.1% to 58.1%, ending the year at the lowest level since midyear 1991. In contrast, the industry's ratio of reserves to total loans and leases rose from 2.97% to 3.12% during the quarter, and is now at its highest level since the creation of the FDIC. During 2009, 119 institutions filed year-to-date financial reports for one or more quarters of the year before their failure. Together, these institutions reported more than \$8.2 billion in net losses through the first three quarters of 2009 that are not included in full-year earnings for the industry. These losses are reflected in the published quarterly industry earnings totals for the first three quarters of 2009. In addition, under purchase accounting rules, income and expenses that have been booked by acquired institutions are reset to zero as of the date when a change in ownership occurs; previously accrued income and expenses are reflected as adjustments to the assets, equity capital, and reserves of acquired institutions and are not included in the subsequent reporting of year-to-date income and expense.

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Capital Ratios Improve

The industry's capital also registered relatively slow growth in the quarter. Bank equity increased by only \$4.1 billion (0.3%), the smallest increase in the last four quarters. Leverage capital (as defined for Prompt Correc