

COMMUNITY BANCORP /VT

Form 10-Q

May 15, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2008

OR

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

For the transition period from _____ to _____

Commission File Number 000-16435

COMMUNITY BANCORP.

Vermont
(State of Incorporation)

03-0284070
(IRS Employer Identification Number)

4811 US Route 5, Derby, Vermont
(Address of Principal Executive Offices)

05829
(zip code)

Registrant's Telephone Number: (802) 334-7915

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 for such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes (X) No ()

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer () Accelerated filer ()
Non-accelerated filer () (Do not check if a smaller reporting company) Smaller reporting company (X)

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

At May 13, 2008, there were 4,416,027 shares outstanding of the Corporation's common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements (Unaudited)

The following are the unaudited consolidated financial statements for Community Bancorp. and Subsidiary, "the Company".

COMMUNITY BANCORP. AND SUBSIDIARY Consolidated Balance Sheets	March 31 2008 (Unaudited)	December 31 2007	March 31 2007 (Unaudited)
Assets			
Cash and due from banks	\$ 8,704,470	\$ 17,486,535	\$ 8,750,703
Federal funds sold and overnight deposits	1,075,224	2,785,988	1,242,023
Total cash and cash equivalents	9,779,694	20,272,523	9,992,726
Securities held-to-maturity (fair value \$44,281,000 at 03/31/08, \$34,273,000 at 12/31/07, and \$20,911,000 at 03/31/07)	44,211,914	34,310,833	20,788,310
Securities available-for-sale	38,366,253	46,876,771	21,717,027
Restricted equity securities, at cost	3,456,850	3,456,850	2,308,950
Loans held-for-sale	1,294,564	685,876	528,872
Loans	357,467,878	355,885,207	266,475,860
Allowance for loan losses	(2,969,847)	(3,026,049)	(2,295,985)
Unearned net loan fees	(385,293)	(443,372)	(585,079)
Net loans	354,112,738	352,415,786	263,594,796
Bank premises and equipment, net	15,966,624	16,361,152	12,418,999
Accrued interest receivable	2,619,771	2,304,055	1,799,659
Bank owned life insurance	3,591,861	3,559,376	0
Core deposit intangible	3,952,950	4,161,000	0
Goodwill	10,560,339	10,347,455	0
Other assets	7,175,651	7,279,941	5,602,488
Total assets	\$ 495,089,209	\$ 502,031,618	\$ 338,751,827
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Demand, non-interest bearing	\$ 48,820,207	\$ 64,019,707	\$ 46,801,261
NOW and money market accounts	131,991,064	120,993,657	72,457,733
Savings	50,165,818	46,069,943	40,098,014
Time deposits, \$100,000 and over	59,049,571	58,860,374	33,957,887
Other time deposits	120,502,762	126,276,429	97,699,320
Total deposits	410,529,422	416,220,110	291,014,215
Federal funds purchased and other borrowed funds	16,476,000	13,760,000	40,000
Repurchase agreements	14,820,990	17,444,933	14,457,778
Capital lease obligations	940,704	943,227	0
Junior subordinated debentures	12,887,000	12,887,000	0
Accrued interest and other liabilities	4,715,341	5,855,988	2,255,765
Total liabilities	460,369,457	467,111,258	307,767,758
Shareholders' Equity			
Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding at 03/31/08 and 12/31/07, and no shares issued and outstanding at 03/31/07	2,500,000	2,500,000	0
Common stock - \$2.50 par value; 10,000,000 shares authorized at 03/31/08 and 12/31/07, and 6,000,000 shares authorized at 03/31/07; and 4,626,095 shares issued at 03/31/08, 4,609,268 shares issued at 12/31/07, and 4,354,946 shares issued at 03/31/07	11,565,237	11,523,170	10,887,365
Additional paid-in capital	25,197,645	25,006,439	22,175,854
Retained earnings (accumulated deficit)	(2,128,563)	(1,597,682)	733,787

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Accumulated other comprehensive income (loss)	208,210	111,210	(198,205)
Less: treasury stock, at cost; 210,101 shares at 03/31/08 and 12/31/07 and 209,510 shares at 03/31/07	(2,622,777)	(2,622,777)	(2,614,732)
Total shareholders' equity	34,719,752	34,920,360	30,984,069
Total liabilities and shareholders' equity	\$ 495,089,209	\$ 502,031,618	\$ 338,751,827

COMMUNITY BANCORP. AND SUBSIDIARY

Consolidated Statements of Income

(Unaudited)

For The First Quarter Ended March 31,

	2008	2007
Interest income		
Interest and fees on loans	\$ 6,127,296	\$ 4,763,196
Interest on debt securities		
Taxable	495,453	207,770
Tax-exempt	395,161	206,790
Dividends	59,660	49,957
Interest on federal funds sold and overnight deposits	58,518	32,245
Total interest income	7,136,088	5,259,958
Interest expense		
Interest on deposits	2,906,304	1,903,355
Interest on federal funds purchased and other borrowed funds	144,358	7,714
Interest on repurchase agreements	77,378	82,120
Interest on junior subordinated debentures	292,523	0
Total interest expense	3,420,563	1,993,189
Net interest income	3,715,525	3,266,769
Provision for loan losses	62,499	37,500
Net interest income after provision	3,653,026	3,229,269
Non-interest income		
Service fees	524,152	324,023
Income on bank owned life insurance	32,485	0
Other income	339,137	379,323
Total non-interest income	895,774	703,346
Non-interest expense		
Salaries and wages	1,648,910	1,131,174
Employee benefits	613,047	431,599
Occupancy expenses, net	859,087	606,142
Other expenses	1,456,076	981,079
Total non-interest expense	4,577,120	3,149,994
(Loss) income before income taxes	(28,320)	782,621
Income tax (benefit) expense	(245,368)	107,365
Net Income	\$ 217,048	\$ 675,256
Earnings per common share	\$ 0.05	\$ 0.16
Weighted average number of common shares used in computing earnings per share	4,405,237	4,342,230
Dividends declared per common share	\$ 0.17	\$ 0.16
Book value per common share on shares outstanding at March 31,	\$ 7.86	\$ 7.12

All share and per share data for prior periods restated to reflect a 5% stock dividend declared in June 2007.

COMMUNITY BANCORP. AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the Three Months Ended March 31,

	2008	2007
Cash Flow from Operating Activities:		
Net Income	\$ 217,048	\$ 675,256
Adjustments to Reconcile Net Income to Net Cash (Used in) Provided by Operating Activities:		
Depreciation and amortization	277,762	231,854
Provision for loan losses	62,499	37,500
Deferred income taxes	(157,562)	(31,521)
Net gain on sale of loans	(80,912)	(57,644)
Gain on investment in Trust LLC	(18,604)	(44,709)
Amortization (accretion) of bond premium (discount), net	(107,614)	4,966
Proceeds from sales of loans held for sale	6,745,555	5,759,917
Originations of loans held for sale	(7,273,331)	(5,664,845)
Decrease in taxes payable	(231,722)	(211,114)
Increase in interest receivable	(315,716)	(132,524)
Decrease (increase) in mortgage servicing rights	48,023	(5,990)
Increase in other assets	(958,048)	(10,770)
Increase in bank owned life insurance	(32,485)	0
Amortization of core deposit intangible	208,050	0
Amortization of limited partnerships	100,500	97,530
Decrease in unamortized loan fees	(58,079)	(47,026)
Decrease in interest payable	(71,103)	(69,581)
Increase (decrease) in accrued expenses	623,172	(212,535)
(Decrease) increase in other liabilities	(631,880)	32,019
Net cash (used in) provided by operating activities	(1,654,447)	350,783
Cash Flows from Investing Activities:		
Investments – held-to-maturity		
Maturities and paydowns	1,358,968	2,869,900
Purchases	(11,260,049)	(2,588,344)
Investments – available-for-sale		
Sales and maturities	9,765,102	1,000,000
Purchases	(1,000,000)	0
Proceeds from redemption of restricted equity securities	0	519,300
Decrease in limited partnership contributions payable	0	(236,094)
Investments in limited partnership	0	(222,000)
(Increase) decrease in loans, net	(1,726,267)	2,233,881
Capital expenditures, net of proceeds from sale of bank premises and equipment	119,115	(316,829)
Recoveries of loans charged off	24,895	10,649
Net cash (used in) provided by investing activities	(2,718,236)	3,270,463

Cash Flows from Financing Activities:		
Net decrease in demand, NOW, money market and savings accounts	(106,218)	(7,919,989)
Net decrease in time deposits	(5,584,470)	(2,053,990)
Net decrease in repurchase agreements	(2,623,943)	(2,626,168)
Net increase in short-term borrowings	10,716,000	0
Repayments on long-term borrowings	(8,000,000)	0
Common share dividends paid	(521,515)	(494,983)
Net cash used in financing activities	(6,120,146)	(13,095,130)
Net decrease in cash and cash equivalents	(10,492,829)	(9,473,884)
Cash and cash equivalents:		
Beginning	20,272,523	19,466,610
Ending	\$ 9,779,694	\$ 9,992,726
Supplemental Schedule of Cash Paid During the Period		
Interest	\$ 3,491,666	\$ 2,062,770
Income taxes	\$ 105,000	\$ 350,000
Supplemental Schedule of Noncash Investing and Financing Activities:		
Change in unrealized gain on securities available-for-sale	\$ 146,970	\$ 109,786
Common Share Dividends Paid		
Dividends declared	\$ 747,929	\$ 702,136
Decrease (increase) in dividends payable attributable to dividends declared	6,859	(2,587)
Dividends reinvested	(233,273)	(204,566)
	\$ 521,515	\$ 494,983

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION AND CONSOLIDATION

The interim consolidated financial statements of Community Bancorp. and Subsidiary are unaudited. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments necessary for fair presentation of the financial condition and results of operations of the Company contained herein have been made. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2007 contained in the Company's Annual Report on Form 10-K.

NOTE 2. 5% STOCK DIVIDEND

In June 2007, the Company declared a 5% stock dividend payable August 15, 2007 to shareholders of record as of July 15, 2007. As a result of this stock dividend, all per share data and weighted average number of shares for prior periods have been restated.

NOTE 3. RECENT ACCOUNTING DEVELOPMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard, (SFAS) No. 157, "Fair Value Measurements", which provides enhanced guidance for using fair value to measure assets and liabilities. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted SFAS 157 effective January 1, 2008. Additional information regarding the Company's fair value measurements under SFAS 157 is contained in Note 8. FASB Staff Position No. FAS 157-2 delays the measurement of goodwill and other intangible assets measured at fair value on a nonrecurring basis until the first quarter of 2009.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", which gives entities the option to measure eligible financial assets and financial liabilities at fair value on an instrument by instrument basis. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. SFAS No. 159 contains provisions to apply the fair value option to existing eligible financial instruments at the date of adoption. This statement is effective as of the beginning of an entity's first fiscal year after November 15, 2007, with provisions for early adoption. To date the Company has not applied the fair value option to any financial instruments; therefore, SFAS No. 159 has not had any impact on the Company's financial statements.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings, in which the SEC Staff expresses its views concerning written loan commitments accounted for as derivatives or at fair value through earnings, as permitted by SFAS No. 159. It is the Staff's position that expected net future cash flows from servicing a loan should be included in the fair value measurement of a loan commitment when it qualifies for derivative accounting under SFAS No. 133 or at fair value through earnings, as permitted by SFAS No. 159. Implementation of SAB No. 109 did not have a material effect on the financial condition or results of operations of the Company.

In December 2007, FASB revised SFAS No. 141, "Business Combinations" (SFAS No.141R). This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. SFAS 141R recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase. Additionally, SFAS 141R defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquiree achieves control and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. Accordingly, SFAS did not apply to the Company's acquisition of LyndonBank completed at year-end 2007, but would apply to business combinations (if any) in 2009 and subsequent years.

In December 2007, FASB issued SFAS No. 160, "Non controlling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin (ARB) No. 51". This statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding non controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement amends ARB No. 51 to establish accounting and reporting standards for the non controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company currently has one unconsolidated subsidiary, CMTV Statutory Trust I, which was created in 2007 in connection with the Company's \$12.5 million trust preferred securities financing. The Company is currently evaluating the impact of SFAS No. 160 but does not expect it will have a material effect on its financial condition or results of operations.

In March 2008, FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133". This statement requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of SFAS No. 161 but does not expect it will have a material effect on its financial condition or results of operations.

NOTE 4. INCOME TAXES

In July 2006, FASB issued Financial Accounting Standards Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. Effective January 1, 2007, the Company adopted FIN 48. The implementation of FIN 48 did not have a material impact on the Company's financial statements.

The Company's income tax returns for the years ended December 31, 2004, 2005, 2006 and 2007 are open to audit under the statute of limitations by the Internal Revenue Service. The Company's policy is to record interest and penalties related to uncertain tax positions as part of its provision for income taxes. A late estimated tax payment for the first quarter of 2006 resulted in penalty and interest of \$15,208 which is reflected in the provision for income taxes for 2007.

NOTE 5. EARNINGS PER SHARE

Earnings per common share amounts are computed based on the weighted average number of shares of common stock issued during the period (retroactively adjusted for stock splits and stock dividends) and reduced for shares held in Treasury.

NOTE 6. COMPREHENSIVE INCOME

Accounting principles generally require recognized revenue, expenses, gains, and losses to be included in net income. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on available-for-sale securities, are not reflected in the statement of income, but the cumulative effect of such items from period-to-period is reflected as a separate component of the equity section of the balance sheet (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income, comprises the Company's total comprehensive income.

The Company's total comprehensive income for the comparison periods is calculated as follows:

For the first quarter ended March 31,	2008	2007
Net income	\$ 217,048	\$ 675,256
Other comprehensive income, net of tax:		
Unrealized holding gain on available-for-sale securities arising during the period	146,970	109,786
Tax effect	(49,970)	(37,327)
Other comprehensive income, net of tax	97,000	72,459
Total comprehensive income	\$ 314,048	\$ 747,715

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NOTE 7. MERGER AND INTANGIBLE ASSETS

On December 31, 2007, the Company completed its acquisition of LyndonBank, Lyndonville, Vermont, through the merger of LyndonBank with and into Community National Bank, the Company's wholly-owned subsidiary. The aggregate purchase price was approximately \$26.7 million in cash. To finance a portion of the acquisition costs, the Company issued \$12.5 million of trust preferred securities and 25 shares of non-cumulative perpetual preferred stock for gross sale proceeds of \$2.5 million.

The transaction was accounted for as a purchase and, accordingly, the operations of LyndonBank are included in the Company's consolidated financial statements from the date of the acquisition. The purchase price has been allocated to assets acquired and liabilities assumed based on estimates of fair value at the date of acquisition. The excess of purchase price over the fair value of net tangible and intangible assets acquired has been recorded as goodwill. During the first quarter of 2008, the Company received valuations on bank premises and equipment to determine fair value and make the necessary adjustments to bank premises and equipment, goodwill and the related deferred tax liability. The adjustment to goodwill was an increase of \$212,884.

The purchase price allocation, including adjustments described above, was as follows:

Cash and cash equivalents	\$ 12,079,764
Federal Home Loan Bank stock	1,006,700
Investments	23,541,893
Loans, net	94,898,984
Bank premises and equipment	3,906,979
Prepaid expenses and other assets	4,785,076
Identified intangible assets	4,161,000
Goodwill	10,560,339
Deposits	(110,125,692)
Borrowings	(14,269,911)
Long-term debt	(943,227)
Accrued expenses and other liabilities	(2,886,859)
Aggregate purchase price	\$ 26,715,046

The \$4.2 million of acquired intangible assets is the core deposit intangible and is subject to amortization over the weighted-average life of the core deposit base which was determined to be approximately 10 years.

The goodwill is not deductible for tax purposes.

NOTE 8. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Company adopted SFAS No. 157, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS No. 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction

between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts, residential mortgage servicing rights, and impaired loans.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interest in securitizations, and highly-structured or long-term derivative contracts.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Assets measured at fair value on a recurring basis at March 31, 2008 are summarized below:

	Level 1	Level 2	Level 3	Fair Value
Assets:				
Securities available for sale	\$ 4,742,550	\$ 33,623,703	\$ 0	\$ 38,366,253
Mortgages held-for-sale	0	1,294,564	0	1,294,564
Mortgage servicing rights	0	1,207,259	0	1,207,259
Total	\$ 4,742,550	\$ 36,125,526	\$ 0	\$ 40,868,076

The fair value of securities available for sale equals quoted market prices, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. Level 1 securities include U.S. Government Bonds and certain preferred stock. Level 2 securities include asset-backed securities including obligations of government sponsored entities, mortgage backed securities, municipal bonds and equity securities.

The fair value of loans held-for-sale is based upon an actual purchase and sale agreement between the Company and an independent market participant. The sale is executed within a reasonable period following quarter end at the stated fair value.

Mortgage servicing rights are initially recorded at estimated fair value and are then periodically measured for impairment by projecting and discounting future cash flows associated with servicing at market rates. The projection of cash flows is a Level 2 measurement, incorporating assumptions of changes in cash flows due to estimated prepayments, estimated costs to service and estimates of other servicing income. Market assumptions are used and primarily include discount rates and expected prepayments. As of March 31, 2008, the Company's mortgage servicing rights measured at fair value totaled \$1.2 million. During the first quarter of 2008, the Company recorded \$30,037 of non-interest expense related to the impairment of mortgage servicing rights.

Assets measured at fair value on a nonrecurring basis and reflected in the balance sheet at March 31, 2008 are summarized below:

	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ 0	\$ 381,863	\$ 0	\$ 381,863

Impaired loans are measured at fair value on a nonrecurring basis. Loans which are deemed to be impaired are primarily valued at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be level 2 inputs. These adjustments to fair value usually result from application of lower of cost or fair value accounting or write-downs of individual assets due to impairment.

NOTE 9. LEGAL PROCEEDINGS

The Company's subsidiary, Community National Bank, as successor by merger to LyndonBank, is a defendant in an action filed in Quebec, Canada by a Canadian attorney who previously had been retained by LyndonBank to represent the bank in connection with a loan collection matter. The plaintiff-attorney alleges that he is entitled to approximately \$30,500 (CAN) (approximately \$30,400 USD at the current exchange rate), which represents legal fees equal to 5% of the assessed value of the real property collateral, plus expenses. The Bank disputes the amount of his claim as well as the existence of any percentage fee arrangement. The Bank has retained new Canadian counsel in connection with this matter which is defending the action. Pending resolution of the claim, the Bank will be required to place in escrow approximately \$93,400 (CAN) (approximately \$93,135 USD), representing the net proceeds previously received by LyndonBank from the sale of real property collateral in the collection matter (now concluded). Although the Company does not believe that an adverse resolution of this claim would have a material adverse effect on the Company's consolidated financial condition, such a resolution could have a material adverse effect on the Company's consolidated results of operations in the annual or quarterly period in which the adverse resolution occurred.

In addition to the foregoing matter, in the normal course of business the Company and its subsidiary are involved in litigation that is considered incidental to their business. Management does not expect that any such litigation will be material to the Company's consolidated financial condition or results of operations.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS for the Period Ended March 31, 2008

FORWARD-LOOKING STATEMENTS

The Company's Management's Discussion and Analysis of Financial Condition and Results of Operations may contain certain forward-looking statements about the Company's operations, financial condition and business. When used therein, the words "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements contained in this discussion include, but are not limited to, management's expectations as to future asset growth, income trends, results of operations and other matters reflected in

the Overview section, estimated contingent liability related to the Company's participation in the Federal Home Loan Bank (FHLB) Mortgage Partnership Finance (MPF) program, assumptions made within the asset/liability management process, and management's expectations as to the future interest rate environment and the Company's related liquidity level. Although these statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (1) competitive pressures increase among financial services providers in the Company's northern New England market area or in the financial services industry generally, including competitive pressures from nonbank financial service providers, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems, which erode the competitive advantage of in-market branch facilities; (2) interest rates change in such a way as to reduce the Company's margins; (3) general economic or monetary conditions, either nationally or regionally, are less favorable than expected, resulting in a deterioration in credit quality or a diminished demand for the Company's products and services; (4) changes in laws or government rules, or the way in which courts interpret those laws or rules, adversely affect the Company's business; and (5) unanticipated difficulties, expenses or delays might arise in the integration of LyndonBank's operations or we may not fully realize the anticipated benefits of the acquisition or realize them within expected timeframes.

A NOTE TO READER.

The Company's acquisition of LyndonBank became effective on December 31, 2007. Accordingly, the Company's first quarter 2008 results discussed in this report are of the merged institution of Community National Bank and the former LyndonBank. The comparative period information in this report as of March 31, 2007 and for the quarter then ended does not include data for LyndonBank.

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OVERVIEW

After months of extensive planning and testing, the computer systems of Community National Bank and the former LyndonBank were merged. March 24, 2008, all 14 Community National Bank branches opened on the same computer system. The cost associated with the conversion and other merger related expenses significantly affected first quarter earnings.

Net income for the first quarter of 2008 was \$217,048 or \$0.05 per share versus \$675,256 or \$0.15 per share for the same period last year. Net interest income for the first quarter of 2008 was \$3.72 million compared to \$3.27 million for the first quarter of 2007. The increase was due to the growth in the balance sheet from the acquisition of Lyndonbank on December 31, 2007, offset somewhat by the compression of the net interest margin due to the declining interest rates during the quarter and the amortization of the fair value adjustments of the loans and deposits. Prolonged low interest rates will continue to pose challenges to the Company's ability to increase net interest income.

Total assets at March 31, 2008 were \$495.1 million compared to \$502.0 million at December 31, 2007 and \$338.8 million at March 31, 2007. The increase in assets when the merger transaction was completed, net of cash paid, was \$128.5 million. The assets acquired at December 31, 2007, net of fair value adjustments, were net loans of \$94.9 million, investments of \$24.6 million, fixed assets of \$3.9 million and \$4.8 million in other assets. Contributing to the increase in assets year-to-year is an increase in Community National Bank's municipal investments of \$23.4 million. With out the acquired loans, the loan portfolio would have decreased by \$2.2 million. Loan demand followed the normal cyclical pattern during the first quarter with lower loan demand at the beginning of the year and increasing toward the end of the quarter.

Non-interest income for the first quarter of 2008 was \$895,774 compared to \$703,346 for the first quarter of 2007. While the merger resulted in an increase in service charges on deposit accounts in the first quarter of 2008, 2007 included fee income from the credit card portfolio that was sold in the third quarter of 2007. Non-interest expenses were \$4.8 million for the first quarter of 2008 compared to \$3.2 million for the same period in 2007. Contributing significantly to the increase in non-interest expenses in 2008 were one-time merger related expenses in the first quarter of approximately \$450,000, including the cost of the computer conversion and termination of contracts and service agreements of LyndonBank. The regulatory environment continues to increase operating costs and place extensive burden on management resources to comply with rules such as Sarbanes-Oxley Act of 2002, the US Patriot Act and the Bank Secrecy Act to protect the U.S. Financial system and the customer from fraud, identity theft, anti-money laundering, and terrorism.

The following pages describe our first quarter financial results in much more detail. Please take the time to read them to more fully understand the three months ended March 31, 2008 in relation to the 2007 comparison periods. The discussion below should be read in conjunction with the Consolidated Financial Statements of the Company and related notes included in this report and with the Company's Annual Report on Form 10-K for the year ended December 31, 2007. This report includes forward-looking statements within the meaning of the Securities and Exchange Act of 1934 (the "Exchange Act").

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared according to 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 in the consolidated financial statements and related notes. The Securities

and Exchange Commission (SEC) has defined a company's critical accounting policies as the ones that are most important to the portrayal of the Company's financial condition and results of operations, and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Because of the significance of these estimates and assumptions, there is a high likelihood that materially different amounts would be reported for the Company under different conditions or using different assumptions or estimates.

Management evaluates on an ongoing basis its judgment as to which policies are considered to be critical. Management believes that the calculation of the allowance for loan losses (ALL) is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the ALL, management considers historical experience as well as other factors including the effect of changes in the local real estate market on collateral values, current economic indicators and their probable impact on borrowers and changes in delinquent, non-performing or impaired loans. Management's estimates used in calculating the ALL may increase or decrease based on changes in these factors, which in turn will affect the amount of the Company's provision for loan losses charged against current period income. Actual results could differ significantly from these estimates under different assumptions, judgments or conditions.

Occasionally, the Company acquires property in connection with foreclosures or in satisfaction of debt previously contracted. To determine the value of property acquired in foreclosure, management often obtains independent appraisals for significant properties. Because the extent of any recovery on these loans depends largely on the amount the Company is able to realize upon liquidation of the underlying collateral, the recovery of a substantial portion of the carrying amount of foreclosed real estate is susceptible to changes in local market conditions. The amount of the change that is reasonably possible cannot be estimated. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Companies are required to perform periodic reviews of individual securities in their investment portfolios to determine whether decline in the value of a security is other than temporary. A review of other-than-temporary impairment requires companies to make certain judgments regarding the materiality of the decline, its effect on the financial statements and the probability, extent and timing of a valuation recovery and the company's intent and ability to hold the security. Pursuant to these requirements, management assesses valuation declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition, business prospects or other factors or market-related factors, such as interest rates. Declines in the fair value of securities below their cost that are deemed to be other than temporary are recorded in earnings as realized losses.

Under current accounting rules, mortgage servicing rights associated with loans originated and sold, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheet. Mortgage servicing rights are amortized into non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. The value of capitalized servicing rights represents the present value of the future servicing fees arising from the right to service loans in the portfolio. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of fair value and impairment, if any, is recognized through a valuation allowance and is recorded as amortization of other assets. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and loan prepayments. Events that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. In conjunction with the implementation of SFAS No. 156, "Accounting for Servicing of Financial Assets-an Amendment to FASB Statement No. 140", the Company implemented changes to its valuation analysis, through the guidance of a third party provider.

Accounting for a business combination requires the application of the purchase method of accounting. Under the purchase method, the Company is required to record the net assets and liabilities acquired through the merger at fair market value, with the excess of the purchase price over the fair market value of the net assets recorded as goodwill and evaluated annually for impairment. Management acknowledges the determination of fair value requires the use of assumptions, including discount rates, changes in which could significantly affect fair values.

Management utilizes numerous techniques to estimate the carrying value of various assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. Management acknowledges that the use of different estimates or assumptions could produce different estimates of carrying values.

RESULTS OF OPERATIONS

The first quarter of 2008 was the first quarter of combined operations following the Company's acquisition of LyndonBank, which became effective on December 31, 2007. Accordingly, in the discussion that follows prior period income and expense figures are for the Company, and do not include LyndonBank's results of operations.

The Company's net income for the first quarter of 2008 was \$217,048, representing a decrease of \$458,208, or 67.9% over net income of \$675,256 for the first quarter of 2007. This resulted in earnings per share of \$0.05 and \$0.15, respectively, for the first quarters of 2008 and 2007. Core earnings (net interest income) for the first quarter of 2008 increased \$448,756, or 13.7% over the first quarter of 2007. Interest income on loans, the major component of interest income, increased \$1.4 million or 28.6%, and interest and dividend income on investments increased \$485,757 or 105.0%. Interest expense on deposits, the major component of interest expense, increased \$1.0 million, or 52.7%, between periods and interest on federal funds purchased and other borrowed funds increased \$136,644. All of these increases are the result of increases in earning assets and interest bearing liabilities through the Company's recent merger with LyndonBank. As a result of the merger, the Company is required to amortize the fair value adjustments of the loans and deposits against net interest income. The loan fair value adjustment was a net premium, therefore creating a decrease of \$115,724 in interest income for the first quarter of 2008. The amortization of the core deposit intangible and the certificate of deposit fair value adjustment resulted in \$273,050 of additional interest expense for the first quarter of 2008. The Company incurred some expenses during the first quarter of 2008 that were a direct result of the merger, including costs to terminate service contracts held by the former LyndonBank, costs of outside contracts to complete the computer and network conversions, the cost of a communication booklet for the customers, and salary and wages for the personnel needed to complete the merger and the conversion of computer systems.

Return on average assets (ROA), which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity (ROE), which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings. ROA and ROE were significantly lower in the first quarter of 2008 compared to 2007, reflecting the effect of merger-related expenses. The following table shows these ratios annualized for the comparison periods.

For the first quarter ended March 31,	2008	2007
Return on Average Assets	0.17%	.78%
Return on Average Equity	2.50%	9.21%

INTEREST INCOME LESS INTEREST EXPENSE (NET INTEREST INCOME)

Net interest income, the difference between interest income and interest expense, represents the largest portion of the Company's earnings, and is affected by the volume, mix, and rate sensitivity of earning assets and interest bearing

liabilities, market interest rates and the amount of non-interest bearing funds which support earning assets. The three tables below provide a visual comparison of the consolidated figures, and are stated on a tax equivalent basis assuming a federal tax rate of 34%. The Company's corporate tax rate is 34%, therefore, to equalize tax-free and taxable income in the comparison, we must divide the tax-free income by 66%, with the result that every tax-free dollar is equal to \$1.52 in taxable income.

Tax-exempt income is derived from municipal investments, which comprise the entire held-to-maturity portfolio of \$44.2 million, along with a small portfolio within the available-for-sale portfolio amounting to approximately \$1.2 million. The Company also has Agency Stock in its available-for-sale portfolio amounting to \$1.3 million that carries a 70% tax exemption on the interest income generated. Both of these available-for-sale portfolios were acquired through the merger with LyndonBank.

The following table shows the reconciliation between reported net interest income and tax equivalent, net interest income for the three month comparison periods of 2008 and 2007:

For the three months ended March 31,	2008	2007
Net interest income as presented	\$ 3,715,525	\$ 3,266,769
Effect of tax-exempt income	203,568	106,528
Net interest income, tax equivalent	\$ 3,919,093	\$ 3,373,297

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AVERAGE BALANCES AND INTEREST RATES

The table below presents average earning assets and average interest-bearing liabilities supporting earning assets. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield for the 2008 and 2007 comparison periods. Loans are stated before deduction of non-accrual loans, unearned discount and allowance for loan losses. Average earning assets and liabilities for the 2007 comparison period do not include the earning assets and liabilities of LyndonBank.

	For the Three Months Ended:					
	Average Balance	2008 Income/ Expense	Rate/ Yield	Average Balance	2007 Income/ Expense	Rate/ Yield
EARNING ASSETS						
Loans (gross)	\$ 356,296,534	\$ 6,127,296	6.92%	\$ 268,765,407	\$ 4,763,196	7.19%
Taxable Investment Securities	40,640,048	495,453	4.90%	21,771,660	207,770	3.87%
Tax Exempt Investment Securities	41,801,655	598,729	5.76%	20,863,909	313,318	6.09%
Federal Funds Sold	0	0	0.00%	0	0	0.00%
Interest Earning Deposit Accounts	3,977,863	58,518	5.92%	2,606,060	32,245	5.02%
Other Investments	3,843,850	59,660	6.24%	2,348,080	49,957	8.63%
TOTAL	\$ 446,559,950	\$ 7,339,656	6.61%	\$ 316,355,116	\$ 5,366,486	6.88%
INTEREST BEARING LIABILITIES & EQUITY						
NOW & Money Market Funds	\$ 119,486,783	\$ 846,944	2.87%	\$ 75,401,509	\$ 442,389	