KENTUCKY BANCSHARES INC /KY/
Form 10-Q
May 13, 2008

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

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 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: 000-52598

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer _ Accelerated filer _ Non-accelerated filer 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___

Number of shares of Common Stock outstanding as of April 30, 2008: 2,804,725.

KENTUCKY BANCSHARES, INC.

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Item 1 - Financial Statements

KENTUCKY BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS (unaudited)

(thousands)	3/31/2008	12/31/2007
Assets		
Cash and due from banks	$ 15,413	$ 15,446
Federal funds sold	13,451	10,361
Cash and cash equivalents	28,864	25,807
Securities available for sale	153,590	147,750
Loans	410,840	417,388
Allowance for loan losses	(5,091)	(4,879)

Net loans	405,749	412,509
Federal Home Loan Bank stock	6,468	6,468
Bank premises and equipment, net	16,899	16,323
Interest receivable	4,603	5,220
Goodwill	13,117	13,117
Other intangible assets	1,721	1,787
Mortgage servicing rights	723	697
Other assets	1,773	1,261
Total assets	$ 633,507	$ 630,939
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	$ 91,843	$ 88,521
Time deposits, $100,000 and over	78,191	78,060
Other interest bearing	318,873	319,424
Total deposits	488,907	486,005
Repurchase agreements and other borrowings	8,700	6,735
Federal Home Loan Bank advances	62,382	63,993
Subordinated debentures	7,217	7,217
Interest payable	3,749	4,984
Other liabilities	2,998	3,161
Total liabilities	573,953	572,095
Stockholders' equity		
Common stock	12,501	12,517
Additional paid-in capital	189	156
Retained earnings	46,958	46,759
Accumulated other comprehensive income (loss)	(94)	(588)
Total stockholders' equity	59,554	58,844
Total liabilities & stockholders' equity	$ 633,507	$ 630,939

See Accompanying Notes

0KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)

(thousands, except per share amounts)	Three Months Ending	
	3/31/2008	3/31/2007
INTEREST INCOME:		
Loans, including fees	$ 7,308	$ 7,957
Securities available for sale	1,650	1,572
Other	295	277
Total interest income	9,253	9,806
INTEREST EXPENSE:		
Deposits	3,506	3,794
Other	851	1,040
Total interest expense	4,357	4,834
Net interest income	4,896	4,972
Loan loss provision	400	150
Net interest income after provision	4,496	4,822
NON-INTEREST INCOME:		
Service charges	1,189	1,303
Loan service fee income	24	16
Trust department income	120	149
Securities available for sale gains (losses), net	7	(1)
Gain on sale of mortgage loans	161	66

Other	474	312
Total other income	1,975	1,845
NON-INTEREST EXPENSE:		
Salaries and employee benefits	2,649	2,776
Occupancy expenses	734	633
Amortization	67	68
Advertising and marketing	140	135
Taxes other than payroll, property and income	179	171
Other	1,193	764
Total other expenses	4,962	4,547
Income before taxes	1,509	2,120
Income taxes	316	558
Net income	$ 1,193	$ 1,562
Other Comprehensive Income, net of tax:		
Change in Unrealized Gains on Securities	492	(41)
Comprehensive Income	$ 1,685	$ 1,521
Earnings per share		
Basic	$ 0.42	$ 0.55
Diluted	0.42	0.54

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

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

	----Common Stock---- Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income
Balances, December 31, 2007	2,849,056	$ 12,517	$ 155	$ 46,759	$ (588)
Common stock issued, including tax benefit, net (including stock grants of 4,025 shares and employee gifts of 91 shares)	10,821	15	-	-	-
Stock based compensation expense	-	-	34	-	-
Common stock purchased and retired	(11,652)	(31)	-	(195)	-
Net change in unrealized gain (loss) on securities available for sale, net of tax	-	-	-	-	492
Net change in SFAS No. 158, net of tax	-	-	-	-	2
Net income	-	-	-	1,193	-
Dividends declared - $0.28 per share	-	-	-	(799)	-

Balances, March 31, 2008	2,848,225	$ 12,501	$ 189	$ 46,958	$ (94)

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(thousands)

	Three Months Ending	
	3/31/2008	3/31/2007
Cash Flows From Operating Activities		
Net Income	$ 1,193	$ 1,562
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	392	365
Securities amortization (accretion), net	(147)	(57)
Noncash compensation expense	34	25
Provision for loan losses	400	150
Securities (gains) losses, net	(7)	1
Originations of loans held for sale	(7,590)	(2,483)
Proceeds from sale of loans	7,751	2,549
Gain on sale of mortgage loans	(161)	(66)
Changes in:		
Interest receivable	617	722
Other assets	(585)	(260)
Interest payable	(1,235)	(140)
Other liabilities	(416)	(44)
Net cash from operating activities	246	2,324
Cash Flows From Investing Activities		
Purchases of securities available for sale	(43,700)	(32,251)
Proceeds from sales of securities available for sale	-	14,539
Proceeds from principal payments, maturities and calls of securities available for sale	38,759	14,019
Net change in loans	6,360	2,564
Purchases of bank premises and equipment	(861)	(274)
Net cash from investing activities	558	(1,403)
Cash Flows From Financing Activities:		
Net change in deposits	2,902	15,549
Net change in securities sold under agreements to repurchase, federal funds purchased and other borrowings	1,965	(645)
Advances from Federal Home Loan Bank	5,000	-
Payments on Federal Home Loan Bank advances	(6,604)	(3,601)
Proceeds from issuance of common stock	15	29
Purchase of common stock	(226)	-
Dividends paid	(799)	(776)
Net cash from financing activities	2,253	10,556
Net change in cash and cash equivalents	3,057	11,477
Cash and cash equivalents at beginning of period	25,807	19,011
Cash and cash equivalents at end of period	28,864	30,488

See Accompanying Notes

KENTUCKY BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates used in the preparation of the financial statements are based on various factors including the current interest rate environment and the general strength of the local economy. Changes in the overall interest rate environment can significantly affect the Company's net interest income and the value of its recorded assets and liabilities. Actual results could differ from those estimates used in the preparation of the financial statements.

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

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

New accounting pronouncements -

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The Statement is effective for fiscal years beginning after November 15, 2007. The impact of adoption on January 1, 2008 was not material.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The Statement provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new Statement is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

The Company adopted FASB Interpretation 48, Accounting for Uncertainty in Income Taxes ("FIN 48"), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no effect on the Company's financial statements, and the Company had no unrecognized tax benefits at December 31, 2007 or March 31, 2008.

The Company and its subsidiaries are subject to U.S. federal income tax. The Company is no longer subject to examination by taxing authorities for years before 2002. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Company recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Company did not have any amounts accrued for interest and penalties at December 31, 2007 or March 31, 2008.

2. INVESTMENT SECURITIES

INVESTMENT SECURITIES

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for Sale				
March 31, 2008				
U.S. government agencies	24,195	584	(26)	24,753
States and political subdivisions	62,841	1,085	(1,227)	62,699
Mortgage-backed	65,396	627	(177)	65,846
Equity securities	270	22	-	292
Total	152,702	2,318	(1,430)	153,590
December 31, 2007				
U.S. government agencies	35,535	496	(10)	36,021
States and political subdivisions	59,332	691	(662)	59,361
Mortgage-backed	52,470	218	(610)	52,078
Equity securities	270	20	-	290
Total	147,607	1,425	(1,282)	147,750

3. LOANS

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

	3/31/2008	3/31/2007
Commercial	$ 23,839	$ 25,072
Real estate construction	23,211	29,297
Real estate mortgage	270,011	293,028
Agricultural	77,218	78,424
Consumer	16,561	15,667
Total	410,840	441,488

4. EARNINGS PER SHARE

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

The factors used in the earnings per share computation follow:

(in thousands, except per share information)	Three Months Ended March 31 2008	2007
Basic Earnings Per Share		
Net Income	$1,193	$1,562
Weighted average common shares outstanding	2,841	2,862
Basic earnings per share	$ 0.42	$ 0.55
Diluted Earnings Per Share		
Net Income	$1,193	$1,562
Weighted average common shares outstanding	2,841	2,862
Add dilutive effects of assumed exercise of stock options	6	10
Weighted average common and dilutive potential common shares outstanding	2,847	2,872
Diluted earnings per share	$ 0.42	$ 0.54

Stock options for 30,300 shares of common stock for the and three months ended March 31, 2008, and for 30,500 shares of common stock for the three months ended March 31, 2007 were excluded from diluted earnings per share because their impact was antidilutive.

5. STOCK COMPENSATION

The Company has two share based compensation plans as described below.

Stock Option Plan

The Company grants certain officers and key employees stock option awards which vest and become fully exercisable at the end of five years and provides for issue of up to 220,000 options. The Company also grants certain directors stock option awards which vest and become fully exercisable immediately and provides for issue of up to 20,000 options. The exercise price of each option, which has a ten year life, was equal to the market price of the Company's stock on the date of grant.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of options granted was determined using the following weighted-average assumptions as of grant date.

	2008	2007
Weighted-average fair value of options granted during the year	$2.38	$4.22
Risk-free interest rate	2.96%	4.51%

Expected option life	8 years	8 years
Expected stock price volatility	11.05%	12.69%
Expected dividend yield	3.61%	3.48%

Summary of activity in the stock option plan for the three months ended March 31, 2008 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	58,774	$27.80		
Granted	800	31.00		
Forfeited or expired	(2,020)	28.40		
Exercised	(6,705)	22.12		
Outstanding, end of period	50,849	28.58	63.7 months	$108,517
Vested and expected to vest	50,849	28.58	63.7 months	108,517
Options exercisable at period end	42,159	28.06	60.5 months	108,517

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of our common stock as of the reporting date. The Company recorded $34 thousand in stock compensation expense during the three months ended March 31, 2008 to salaries and employee benefits.

Stock Grant Plan

On February 15, 2005, the Company's Board of Directors adopted a restricted stock grant plan. Total shares issuable under the plan are 50,000. A summary of changes in the Company's nonvested shares for the year follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2007	8,037	$ 243,494
Granted	4,025	124,755
Vested	(1,642)	(49,707)
Forfeited	-	-
Nonvested at March 31, 2008	10,420	$ 318,542

6. DIVIDENDS

Dividends per share paid for the quarter ended March 31, 2008 were $0.28 compared to $0.27 for March 31, 2007.

7. RETIREMENT PLAN

Components of Net Periodic Benefit Cost

Three months ended March 31
(in thousands)

Pension Benefits

	2008	2007

Service cost	$ 121	$ 114
Interest cost	112	101
Expected return on plan assets	(120)	(109)
(Gain) loss amortization	4	8
Net Periodic Benefit Cost	$ 117	$ 114

Employer Contributions

The estimates are based on assuming the Company's 2008 annual contribution to the Pension Plan is to be zero. No contributions to the Pension Plan were made for the quarter ended March 31, 2008, and the Company anticipates making its annual contribution, if any, in the third quarter of 2008.

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

Forward-Looking Statements

This discussion contains forward-looking statements under the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. Words such as "believes," "anticipates," "expects," "intends," "plans," "targeted," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements included herein will prove to be accurate. Factors that could cause actual results to differ from the results discussed in the forward-looking statements include, but are not limited to: economic conditions (the Company and its bank operate in areas affected by various markets); competition for the Company's customers from other providers of financial and mortgage services; government legislation and regulation (which changes from time to time and over which the Company has no control); changes in interest rates (both generally and more specifically mortgage interest rates); material unforeseen changes in the liquidity, results of operations, or financial condition of the Company's customers; and other risks detailed in the Company's filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond the control of the Company. The Company undertakes no obligation to update or revise forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Summary

Kentucky Bancshares, Inc. recorded net income of $1.2 million, or $.42 basic earnings per share and $.42 diluted earnings per share for the three months ended March 31, 2008 compared to $1.6 million, or $.55 basic earnings per share and $.54 diluted earnings per share for the three month period ending March 31, 2007. The first three months earnings reflects a decrease of 23.6% compared to the same time period in 2007, due primarily to an increase in the loan loss provision of $250 thousand, an increase in other expenses of $415 thousand and a reduction in income tax expense of $242 thousand.

Return on average assets was 0.75% for the three months ended March 31, 2008 and 0.97% for the three month period ended March 31, 2007. Return on average equity was 8.0% for the three month period ended March 31, 2008 and 11.1% for the same period in 2007.

Loans decreased $6.5 million from $417.3 million on December 31, 2007 to $410.8 million on March 31, 2008. Decreases in commercial, real estate construction, real estate mortgage and agricultural loans were offset slightly by an increase in consumer loans. Management attributes the decline in loans to the slow down in the real estate economy and to competitive pressures.

Total deposits increased from $486.0 million on December 31, 2007 to $488.9 million on March 31, 2008, an increase of $2.9 million. This increase is primarily the result of an increase in non-interest bearing deposits.

Net Interest Income

Net interest income was $4.9 million for the three months ended March 31, 2008 compared to $5.0 million for the three months ended March 31, 2007, a decrease of 1.5%. The interest spread was 3.26% for the first three months of 2008 comparable to 3.26% for the same period in 2007. Net interest margins have thusfar remained flat in 2008 compared to 2007.

For the first three months, the yield on assets decreased from 6.62% in 2007 to 6.34% in 2008. The cost of liabilities decreased from 3.36% in 2007 to 3.08% in 2008. Year to date average loans are down $30.9 million, or 7.0% from March 31, 2007 to March 31, 2008. Loan interest income has decreased $649 thousand for the first three months of 2008 compared to the first three months of 2007. Year to date average deposits increased from March 31, 2007 to March 31, 2008, up $3.0 million, or 0.6%. The slight increase is a result of growth in non-interest bearing deposits. Interest bearing deposits, including time deposits, have remained relatively flat for the first three months of 2008. Deposit interest expense has decreased $288 thousand for the first three months of 2008 compared to the same period in 2007.

Non-Interest Income

Non-interest income increased $130 thousand for the three months ended March 31, 2008 compared to the same period in 2007 to $2.0 million, due primarily to an increase in brokerage income of $89 thousand and increase in the gain on the sale of mortgage loans of $95 thousand. These increases were partially offset by a decrease in overdraft income of $110 thousand for the first three months of 2008 compared to the same time period in 2007.

Gain on sale of mortgage loans increased from $66 thousand in the first three months of 2007 to $161 thousand during the first three months of 2008. The volume of mortgage loan originations and sales is generally inverse to rate changes. A change in the mortgage loan rate environment can have a significant impact on the related gain on sale of mortgage loans.

Non-Interest Expense

Total non-interest expenses increased $415 thousand for the three month period ended March 31, 2008 compared to the same period in 2007.

For the comparable three month periods, salaries and benefits decreased $127 thousand, a decrease of 4.6%. Incentives decreased $164 thousand, due to the lower level of net income reported by the Company.

Occupancy expenses increased $101 thousand to $734 thousand for the first three months of 2008 compared to the same time period in 2007. The increase in year to date 2008 is mainly attributable to two additional facilities; the first being opened in the fourth quarter of 2007 and the second being opened during the first quarter of 2008. The relocation of the Nicholasville branch, scheduled to be complete in the fourth quarter of 2008, is expected to result in a slight increase in occupancy expense starting in the first quarter of 2009.

Other expenses increased $429 thousand for the three months ended March 31, 2008 compared to the same time period in 2007. The year to date increase is mainly a result of an increase of data processing fees of $185 thousand and an increase in legal and professional fees of $60 thousand. In August 2007, the Company starting outsourcing its account processing to Fiserv, Inc. causing the data processing to be more in 2008 compared to 2007. Higher legal and professional fees are mainly a result of outsourcing loan review and other corporate matters.

Income Taxes

The effective tax rate for the three months ended March 31, 2008 was 21% compared to 26% in 2007. These rates are less than the statutory rate as a result of the tax-free securities and loans held by the Company. The current period rate is lower due to the lower level of income for 2008.

Stock Repurchase Program

On October 25, 2000, the Company announced that its Board of Directors approved a stock repurchase program to purchase up to 100,000 shares of its outstanding common stock. On November 11, 2002, the Board of Directors approved and authorized the Company's repurchase of an additional 100,000 shares. Shares will be purchased from time to time in the open market depending on market prices and other considerations. Through March 31, 2008 155,661 shares have been purchased under the program. The most recent share repurchase occurred on April 28, 2008. The repurchase program has had a positive effect on earnings per share calculations.

Liquidity and Funding

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

Cash and cash equivalents were $28.9 million as of March 31, 2008 compared to $25.8 million at December 31, 2007. The increase in cash and cash equivalents is mainly attributable to an increase in federal funds sold resulting primarily from a decrease in loan demand. In addition to cash and cash equivalents, the securities portfolio provides an important source of liquidity. Securities available for sale totaled $153.6 million at March 31, 2008. The available for sale securities are available to meet liquidity needs on a continuing basis. The Company expects the customers' deposits to be adequate to meet its funding demands.

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

Management is aware of the challenge of funding sustained loan growth. Therefore, in addition to deposits, other sources of funds, such as Federal Home Loan Bank (FHLB) advances, may be used. The Company relies on FHLB advances for both liquidity and asset/liability management purposes. These advances are used primarily to fund long-term fixed rate residential mortgage loans. As of March 31, 2008, we have sufficient collateral to borrow an additional $47 million from the FHLB. In addition, as of March 31, 2008, over $48 million is available in overnight borrowing through various correspondent banks. In light of this, management believes there is sufficient liquidity to meet all reasonable borrower, depositor and creditor needs in the present economic environment.

Non-Performing Assets

As of March 31, 2008, the Company's non-performing loans totaled $6.5 million or 1.32% of loans compared to $7.3 million or 1.57% of loans at December 31, 2007. (See table below) The Company experienced a decrease of $2.6 million in non-accrual loans from December 31, 2007 to March 31, 2008, mainly from a commercial real estate loan moving from non-accrual to accrual during the quarter. As of March 31, 2008, non-accrual loans include $2.2 million in loans secured by 1-4 family residential real estate and $862 thousand in real estate construction. Real estate loans composed 98% of the non-performing loans as of March 31, 2008 and 98% as of December 31, 2007. Forgone interest income on the non-accrual loans for both 2008 and 2007 is immaterial.

Nonperforming Assets

	3/31/08	12/31/07
	(in thousands)	
Non-accrual Loans	$ 3,780	$ 6,358
Accruing Loans which are Contractually past due 90 days or more	1,648	195
Total Nonperforming and Restructured	5,428	6,553
Other Real Estate	1,095	768
Total Nonperforming and Restructured Loans and Other Real Estate	$ 6,523	$ 7,321
Nonperforming and Restructured Loans as a Percentage of Loans	1.32%	1.57%
Nonperforming and Restructured Loans and Other Real Estate as a Percentage of Total Assets	1.03%	1.16%
Allowance as a Percentage of Period-end Loans	1.24%	1.17%
Allowance as a Percentage of Non-performing and Restructured Loans	94%	74%

Provision for Loan Losses

The loan loss provision for the first three months was $400 thousand for 2008 and $150 thousand for the same period in 2007. The current level of nonperforming loans has caused management to increase the 2008 provision in order to maintain an allowance for loan losses that is representative of the risk of loss based on the quality of loans currently in the portfolio. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Net charge-offs for the three month period ended March 31, 2008 were $188 thousand compared to $98 thousand for the same period in 2007. Future levels of charge-offs will be determined by the particular facts and circumstances surrounding individual loans. Management believes the current loan loss allowance is sufficient to meet probable incurred loan losses.

Loan Losses

Three Months Ended March 31, 2008
(in thousands)

	2008	2007
Balance at Beginning of Period	$ 4,879	$ 4,991
Amounts Charged-off:		
Real Estate Construction	125	-
Real Estate Mortgage	24	56
Agricultural	12	-
Consumer	358	221
Total Charged-off Loans	519	277
Recoveries on Amounts Previously Charged-off:		
Commercial	4	1
Real Estate Construction	2	5
Real Estate Mortgage	7	2
Agricultural	29	15
Consumer	289	156
Total Recoveries	331	179
Net Charge-offs	188	98
Provision for Loan Losses	400	150
Balance at End of Period	5,091	5,043
Loans		
Average	411,258	442,181
At March 31	410,840	441,488
As a Percentage of Average Loans:		
Net Charge-offs	0.05%	0.02%
Provision for Loan Losses	0.10%	0.03%
Allowance as a Multiple of Net Charge-offs	6.8	12.9

Item 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

Using interest rate shock simulations, the following table depicts the change in net interest income resulting from 100 and 300 basis point changes in rates on the Company's interest earning assets and interest bearing liabilities. The projections are based on balance sheet growth assumptions and repricing opportunities for new, maturing and adjustable rate amounts. As of March 31, 2008 the projected percentage changes are within the Board approved limits. This period's volatility is slightly lower compared to the same period a year ago. The projected net interest income report summarizing the Company's interest rate sensitivity as of March 31, 2008 is as follows:

(dollars in thousands)
PROJECTED NET INTEREST INCOME

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

Year One (4/08 - 3/09)

Net interest income	$21,052	$21,807	$22,534	$22,861	$23,256
Net interest income dollar change	(1,482)	(727)	N/A	327	722
Net interest income percentage change	-6.6%	-3.2%	N/A	1.5%	3.2%
Board approved limit	>-10.0%	>-4.0%	N/A	>-4.0%	>-10.0%

The projected net interest income report summarizing the Company's interest rate sensitivity as March 31, 2007 is as follows:

(dollars in thousands)
PROJECTED NET INTEREST INCOME

Change in basis points:	- 300	- 100	Level Rates	+ 100	+ 300
Year One (4/07 - 3/08)					
Net interest income	$21,125	$21,798	$22,565	$23,198	$23,808
Net interest income dollar change	(1,440)	(767)	N/A	633	1,243
Net interest income percentage change	-6.4%	-3.4%	N/A	2.8%	5.5%
Board approved limit	>-10.0%	>-4.0%	N/A	>-4.0%	>-10.0%

These projected changes in net interest income as of March 31, 2008 are slightly lower when compared to the projected changes in net interest income as March 31, 2007 for the 100 and 300 basis point changes. Projections from March 31, 2008, year one reflected a decline in net interest income of 3.2% with a 100 basis point decline compared to the 3.4% decline in 2007. The 100 basis point increase in rates reflected a 1.5% increase in net interest income in 2008 compared to 2.8% in 2007.

EVE applies discounting techniques to future cash flows to determine the present value of assets, liabilities, and therefore equity. Based on applying these techniques to the March 31, 2008 balance sheet, a 300 basis point increase in rates results in an 18% decline in EVE. A 300 basis point decrease in rates results in a 20% increase in EVE. These are within the Board approved limits.

Item 4 - CONTROLS AND PROCEDURES

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

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

Part II – Other Information

Item 1. Legal Proceedings

The Company is not a party to any material legal proceedings.

Item 1A. Risk Factors

There have been no material changes in risk factors, as previously disclosed in the December 31, 2007 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans Or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans of Programs
1/1/08 – 1/31/08	80	$31.93	80	51,508 shares
2/1/08 – 2/29/08	3,027	31.38	3,027	48,481 shares
3/1/08 – 3/31/08	4,142	31.10	4,142	44,339 shares
Total	7,249		7,249	44,339 shares

On October 25, 2000, the Company announced that its Board of Directors approved a stock repurchase program. The Company is authorized to purchase up to 100,000 shares of its outstanding common stock. On November 11, 2002, the Board of Directors approved and authorized the Company's repurchase of an additional 100,000 shares. Shares will be purchased from time to time in the open market depending on market prices and other considerations. Through March 31, 2008 155,661 shares have been purchased.

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

10.1 Kentucky Bancshares, Inc. 1993 Employee Stock Ownership Incentive Plan

10.2 Kentucky Bancshares, Inc. 1993 Non-Employee Directors Stock Ownership Incentive Plan

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

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

32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

KENTUCKY BANCSHARES, INC.

Date ______5/13/08________ __/s/Louis Prichard_______________
Louis Prichard, President and C.E.O.

Date ______5/13/08________ __/s/Gregory J. Dawson____________
Gregory J. Dawson, Chief Financial Officer

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