KENTUCKY BANCSHARES INC /KY/
Form 10-Q
August 14, 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 June 30, 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 shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No X _

Number of shares of Common Stock outstanding as of June 30, 2008: 2,757,965.

KENTUCKY BANCSHARES, INC.

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Item 1 - Financial Statements

KENTUCKY BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS (unaudited)

(thousands)	6/30/2008	12/31/2007
Assets		
Cash and due from banks	$ 15,226	$ 15,446
Federal funds sold	98	10,361
Cash and cash equivalents	15,324	25,807
Securities available for sale	160,963	147,750
Mortgage loans held for sale	80	-
Loans	418,820	417,388
Allowance for loan losses	(5,394)	(4,879)
Net loans	413,426	412,509
Federal Home Loan Bank stock	6,641	6,468
Bank premises and equipment, net	17,146	16,323
Interest receivable	4,846	5,220
Goodwill	13,117	13,117
Other intangible assets	1,655	1,787
Mortgage servicing rights	730	697
Other assets	2,577	1,261
Total assets	$ 636,505	$ 630,939

Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	$ 93,376	$ 88,521
Time deposits, $100,000 and over	72,365	78,060
Other interest bearing	289,458	319,424
Total deposits	455,199	486,005
Repurchase agreements and other borrowings	14,060	6,735
Federal Funds Purchased	10,853	-
Federal Home Loan Bank advances	87,016	63,993
Subordinated debentures	7,217	7,217
Interest payable	3,165	4,984
Other liabilities	2,894	3,161
Total liabilities	580,404	572,095
Stockholders' equity		
Common stock	12,104	12,517
Additional paid-in capital	223	156
Retained earnings	45,440	46,759
Accumulated other comprehensive income (loss)	(1,666)	(588)
Total stockholders' equity	56,101	58,844
Total liabilities & stockholders' equity	$ 636,505	$ 630,939

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)

(thousands, except per share amounts)	Six Months Ending	
	6/30/2008	6/30/2007
INTEREST INCOME:		
Loans, including fees	$ 14,083	$ 16,094
Securities available for sale	3,589	3,184
Other	256	562
Total interest income	17,928	19,840
INTEREST EXPENSE:		
Deposits	6,202	7,710
Other	1,793	2,011
Total interest expense	7,995	9,721
Net interest income	9,933	10,119
Loan loss provision	900	320
Net interest income after provision	9,033	9,799
NON-INTEREST INCOME:		
Service charges	2,560	2,773
Loan service fee income	45	32
Trust department income	270	274
Securities available for sale gains (losses), net	15	3
Gain on sale of mortgage loans	278	210
Other	867	645
Total other income	4,035	3,937
NON-INTEREST EXPENSE:		
Salaries and employee benefits	5,230	5,382
Occupancy expenses	1,378	1,243
Amortization	133	136
Advertising and marketing	253	270
Taxes other than payroll, property and income	358	342
Other	2,264	1,575

Total other expenses	9,616	8,948
Income before taxes	3,452	4,788
Income taxes	773	1,308
Net income	$ 2,679	$ 3,480
Other Comprehensive Income, net of tax:		
Change in Unrealized Gains on Securities	(851)	(1,381)
Comprehensive Income	$ 1,828	$ 2,099
Earnings per share		
Basic	$ 0.95	$ 1.22
Diluted	0.95	1.21

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)

(thousands, except per share amounts)	Three Months Ending	
	6/30/2008	6/30/2007
INTEREST INCOME:		
Loans, including fees	$ 6,775	$ 8,137
Securities available for sale	1,855	1,612
Other	45	285
Total interest income	8,675	10,034
INTEREST EXPENSE:		
Deposits	2,696	3,916
Other	942	971
Total interest expense	3,638	4,887
Net interest income	5,037	5,147
Loan loss provision	500	170
Net interest income after provision	4,537	4,977
NON-INTEREST INCOME:		
Service charges	1,371	1,470
Loan service fee income	21	16
Trust department income	150	125
Securities available for sale gains (losses), net	8	4
Gain on sale of mortgage loans	117	144
Other	393	333
Total other income	2,060	2,092
NON-INTEREST EXPENSE:		
Salaries and employee benefits	2,581	2,606
Occupancy expenses	644	610
Amortization	66	68
Advertising and marketing	113	135
Taxes other than payroll, property and income	179	171
Other	1,071	811
Total other expenses	4,654	4,401
Income before taxes	1,943	2,668
Income taxes	457	750
Net income	$ 1,486	$ 1,918
Other Comprehensive Income, net of tax:		
Change in Unrealized Gains on Securities	(1,342)	(1,339)

Comprehensive Income	$ 144	$ 579
Earnings per share		
Basic	$ 0.53	$ 0.67
Diluted	0.53	0.67

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

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

	----Common Stock----		Additional		Accumulated Other
	Shares	Amount	Paid-in Capital	Retained Earnings	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	-	-	68	-	-
Common stock purchased and retired	(101,912)	(428)	-	(2,414)	-
Net change in unrealized gain (loss) on securities available for sale, net of tax	-	-	-	-	(850)
Net change in SFAS No. 158, net of tax	-	-	-	-	(228)
Net income	-	-	-	2,679	-
Dividends declared - $0.56 per share	-	-	-	(1,584)	-
Balances, June 30, 2008	2,757,965	$ 12,104	$ 223	$ 45,440	$ (1,666)

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(thousands)

	Six Months Ending 6/30/2008	Six Months Ending 6/30/2007
Cash Flows From Operating Activities		
Net Income	$ 2,679	$ 3,480
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	797	736
Securities amortization (accretion), net	(165)	(78)
Noncash compensation expense	68	50
Provision for loan losses	900	320
Securities (gains) losses, net	(15)	(3)
Originations of loans held for sale	(13,503)	(5,936)
Proceeds from sale of loans	13,701	6,017
Federal Home Loan Bank stock dividends	(173)	-
Losses (gains) on sale of bank premises and equipment	(5)	-
Gain on sale of mortgage loans	(278)	(210)
Changes in:		
Interest receivable	374	535
Other assets	(1,449)	(320)
Interest payable	(1,819)	87
Other liabilities	(57)	153
Net cash from operating activities	1,055	4,831
Cash Flows From Investing Activities		
Purchases of securities available for sale	(63,690)	(39,763)
Proceeds from sales of securities available for sale	-	19,324
Proceeds from principal payments, maturities and calls of securities available for sale	49,369	21,768
Net change in loans	(1,817)	13,257
Purchases of bank premises and equipment	(1,402)	(1,456)
Proceeds from the sale of bank premises and equipment	5	-
Net cash from investing activities	(17,535)	13,130
Cash Flows From Financing Activities:		
Net change in deposits	(30,806)	23,196
Net change in securities sold under agreements to repurchase, federal funds purchased and other borrowings	15,478	749
Advances from Federal Home Loan Bank	35,000	-
Payments on Federal Home Loan Bank advances	(11,964)	(10,372)
Proceeds from note payable	5,000	-
Payment on note payable	(2,300)	(500)
Proceeds from issuance of common stock	15	32
Purchase of common stock	(2,842)	(378)
Dividends paid	(1,584)	(1,548)
Net cash from financing activities	5,997	11,179
Net change in cash and cash equivalents	(10,483)	29,140
Cash and cash equivalents at beginning of period	25,807	19,011
Cash and cash equivalents at end of period	15,324	48,151

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 June 30, 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 June 30, 2008.

2. INVESTMENT SECURITIES

INVESTMENT SECURITIES

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

Available for Sale	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2008				
U.S. government agencies	18,758	400	(140)	19,018
States and political subdivisions	65,677	636	(1,284)	65,029
Mortgage-backed	77,404	239	(1,013)	76,630
Equity securities	270	16	-	286
Total	162,109	1,291	(2,437)	160,963
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)

	6/30/2008	12/31/2007
Commercial	$ 21,847	$ 22,924
Real estate construction	21,850	26,172
Real estate mortgage	274,074	270,494
Agricultural	82,976	80,774
Consumer	18,073	17,024
Total	418,820	417,388

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)	Six Months Ended June 30 2008	2007
Basic Earnings Per Share		
Net Income	$2,679	$3,480
Weighted average common shares outstanding	2,819	2,860
Basic earnings per share	$ 0.95	$ 1.22
Diluted Earnings Per Share		
Net Income	$2,679	$3,480
Weighted average common shares outstanding	2,819	2,860
Add dilutive effects of assumed exercise of stock options	4	10
Weighted average common and dilutive potential common shares outstanding	2,823	2,870
Diluted earnings per share	$ 0.95	$ 1.21

(in thousands, except per share information)	Three Months Ended June 30 2008	2007
Basic Earnings Per Share		
Net Income	$1,486	$1,918
Weighted average common shares outstanding	2,797	2,858
Basic earnings per share	$ 0.53	$ 0.67
Diluted Earnings Per Share		
Net Income	$1,486	$1,918
Weighted average common shares outstanding	2,797	2,858
Add dilutive effects of assumed exercise of stock options	3	10
Weighted average common and dilutive potential common shares outstanding	2,800	2,868
Diluted earnings per share	$ 0.53	$ 0.67

Stock options for 31,900 shares of common stock for the six and three months ended June 30, 2008, and for 10,035 shares of common stock for the three months ended June 30, 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 six months ended June 30, 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	60.7 months	$64,532
Vested and expected to vest	50,849	28.58	60.7 months	64,532
Options exercisable at period end	42,159	28.06	57.5 months	64,532

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 $68 thousand in stock compensation expense during the six months ended June 30, 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	(1,744)	(52,691)
Forfeited	-	-
Nonvested at June 30, 2008	10,318	$ 315,558

6. DIVIDENDS

Dividends per share paid for the quarter ended June 30, 2008 were $0.28 compared to $0.27 for June 30, 2007. This is the same rate of dividend paid for the first quarter of the respective years.

7. RETIREMENT PLAN

Components of Net Periodic Benefit Cost

	Six months ended June 30 (in thousands)	
Pension Benefits	2008	2007
Service cost	$ 254	$ 227
Interest cost	231	202
Expected return on plan assets	(241)	(217)
(Gain) loss amortization	14	17
Net Periodic Benefit Cost	$ 258	$ 229

	Three months ended June 30 (in thousands)	
Pension Benefits	2008	2007
Service cost	$ 132	$ 113
Interest cost	119	101
Expected return on plan assets	(120)	(108)
(Gain) loss amortization	10	9
Net Periodic Benefit Cost	$ 141	$ 115

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 June 30, 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 $2.7 million, or $.95 basic earnings and diluted earnings per share for the first six months ending June 30, 2008 compared to $3.5 million, or $1.22 basic earnings per share and $1.21 diluted earnings per share for the six month period ending June 30, 2007. The first six months earnings reflects a decrease of 23.0% compared to the same time period in 2007, due primarily to an increase in the loan loss provision of $580 thousand and an increase in other expenses of $668 thousand. These increases in expenses were somewhat offset by a reduction in income tax expense of $535 thousand. The earnings for the three months ended June 30, 2008 were $1.5 million, or $.53 basic and diluted earnings per share for the three month period ending June 30, 2008 compared to $1.9 million, or $.67 basic and diluted earnings per share for the three month period ending June 30, 2007. This three months period earnings reflects a decrease of 22.5% compared to the same time period in 2007.

Return on average assets was 0.85% for the six months ended June 30, 2008 and 1.08% for the six month period ended June 30, 2007. Return on average assets was .94% for the three months ended June 30, 2008 and 1.20% for the three month period ended June 30, 2007. Return on average equity was 9.1% for the six month period ended June 30, 2008 and 12.3% for the same period in 2007. Return on average equity was 10.1% for the three months ended June 30, 2008 and 13.6% for the same time period in 2007.

Loans increased $1.4 million from $417.4 million on December 31, 2007 to $418.8 million on June 30, 2008. Decreases in commercial & real estate construction loans were offset by an increase in real estate mortgage, agricultural & consumer loans.

Total deposits decreased from $486.0 million on December 31, 2007 to $455.2 million on June 30, 2008, a decrease of $30.8 million. This decrease is primarily the result of a decrease in interest bearing deposit accounts less than $100 thousand. Management attributes the decrease mainly to increased competition for deposits. As a result of this, management has utilized other lower costing funding sources, such as Federal Home Loan Bank advances.

Net Interest Income

Net interest income was $9.9 million for the six months ended June 30, 2008 compared to $10.1 million for the six months ended June 30, 2007, a decrease of 1.8%. The interest spread was 3.32% for the first six months of 2008 comparable to 3.31% for the same period in 2007, an increase of 1 basis point.

Net interest income was $5.0 million for the three month period ending June 30, 2008 compared to $5.1 million for the three month period ending June 30, 2007, a decrease of 2.1%. The interest spread was 3.38% for the three month period ending June 30, 2008 compared to 3.36% for the three month period in 2007, an increase of 2 basis points. Net interest margins have thus far remained steady in 2008. The net interest spread during the second quarter of 2008 was lowered, primarily due to interest income that was placed into non-accrual status.

For the first six months, the yield on assets decreased from 6.68% in 2007 to 6.15% in 2008. The cost of liabilities decreased from 3.37% in 2007 to 2.83% in 2008. Year to date average loans are down $27.0 million, or 6.1% from June 30, 2007 to June 30, 2008. Loan interest income has decreased $2.0 million for the first six months of 2008 compared to the first six months of 2007. Year to date average deposits decreased from June 30, 2007 to June 30, 2008, down $6.5 million or 1.3%. The slight decrease is primarily the result of a decline in interest bearing deposits less than $100 thousand during the second quarter. The decline in interest bearing deposit accounts was offset slightly with an increase in non-interest bearing deposits. Deposit interest expense has decreased $1.5 million for the first six months of 2008 compared to the same period in 2007.

Non-Interest Income

Non-interest income increased $98 thousand for the six months ended June 30, 2008 compared to the same period in 2007 to $4.0 million, due primarily to a decrease in service charges of $213 thousand offset by an increase in other non-interest income of $222 thousand. The decrease in service charges was primarily from a decrease in overdraft income of $251 thousand for the first six months of 2008. The other non-interest income increase was primarily due to an increase in brokerage income of $141 thousand and an increase of $75 thousand in debit card interchange income. The $32 thousand decrease in non-interest income for the three months ended June 30, 2008 compared to same time period in 2007 is primarily due to a decrease in service charges of $99 thousand.

Gain on sale of mortgage loans increased from $210 thousand in the first six months of 2007 to $278 thousand during the first six months of 2008. For the three months ended June 30, 2008 compared to the same time period in 2007, the gain on sale of mortgage loans decreased $27 thousand. 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 $668 thousand for the six month period ended June 30, 2008 compared to the same period in 2007. For the three month period ended June 30, 2008, total non-interest expense increased $253 thousand.

For the comparable six month periods, salaries and benefits decreased $152 thousand, a decrease of 2.8%. Incentives decreased $309 thousand, due to the lower level of net income reported by the Company. Salaries & benefits decreased $25 thousand for the three month period ending June 30, 2008 compared to the same time period in 2007.

Occupancy expenses increased $135 thousand to $1,378 thousand for the first six months of 2008 compared to the same time period in 2007. Occupancy expenses increased $34 thousand for the three month period ended June 30, 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 $689 thousand for the first six months ended June 30, 2008 compared to the same time period in 2007. For the three month period ended June 30, 2008 other expenses increased $260 thousand compared to the three month period ended June 30, 2007. The year to date increase is mainly a result of an increase of data processing fees of $351 thousand, an increase in ATM & debit card processing of $99 thousand, and an increase in legal and professional fees of $76 thousand. In August 2007, the Company started outsourcing its account processing to Fiserv, Inc. causing the data processing to be more in 2008 compared to 2007. The increase in ATM and debit card processing is a result of more customer usage. Higher legal and professional fees are mainly a result of outsourcing loan review, loan collection costs and other corporate matters.

Income Taxes

The effective tax rate for the six months ended June 30, 2008 was 22.4% compared to 27.3% in 2007. The effective tax rate for the three months ended June 30, 2008 was 23.5% compared to 28.1% for the three month period ended June 30, 2007. These rates are less than the statutory rate as a result of the tax-free securities and loans held by the Company. The rates for 2008 are lower due to the lower level of income for 2008. Nontaxable interest income increased $244 thousand for the first six months of 2008 compared to the same time period in 2007.

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. On May 20, 2008, the Board of Directors approved and authorized the Company to repurchase 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 June 30, 2008 245,921 shares have been purchased under the program. The most recent share repurchase occurred on July 29, 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 $15.3 million as of June 30, 2008 compared to $25.8 million at December 31, 2007. The decrease in cash and cash equivalents is mainly attributable to a decrease in federal funds sold resulting primarily from a decrease in deposits and also an increase in the Company's security portfolio. In addition to cash and cash equivalents, the securities portfolio provides an important source of liquidity. Securities available for sale totaled $161.0 million at June 30, 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. In early July 2008, the Company received deposits from being the successful bidder on $20 million in public deposits. These deposits will roll off over the next 12 months. As of June 30, 2008, we have sufficient collateral to borrow an additional $7 million from the FHLB. In addition, as of June 30, 2008, over $37 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 June 30, 2008, the Company's non-performing loans totaled $10.1 million or 2.40% of loans compared to $6.5 million or 1.57% of loans at December 31, 2007. (See table below) The Company experienced an increase of $2.5 million in non-accrual loans from December 31, 2007 to June 30, 2008, mainly due to some large dollar commercial loans being reclassified as non-accrual during the second quarter. As of June 30, 2008, non-accrual loans include $2.0 million in loans secured by 1-4 family residential real estate, $2.3 million in real estate construction and $4.0 million in loans secured by non-farm non-residential properties. Real estate loans composed 99% of the non-performing loans as of June 30, 2008 and 98% as of December 31, 2007. Forgone interest income on the non-accrual loans was $312 thousand for the first six months of 2008 compared to $156 thousand for the same time period in 2007.

Nonperforming Assets

	6/30/08	12/31/07
	(in thousands)	
Non-accrual Loans	$ 8,862	$ 6,358
Accruing Loans which are Contractually past due 90 days or more	1,190	195
Total Nonperforming and Restructured Loans	10,052	6,553
Other Real Estate	1,514	768
Total Nonperforming and Restructured Loans and Other Real Estate	$ 11,566	$ 7,321
Nonperforming and Restructured Loans as a Percentage of Loans	2.40%	1.57%
Nonperforming and Restructured Loans and Other Real Estate as a Percentage of Total Assets	1.82%	1.16%
Allowance as a Percentage of Period-end Loans	1.29%	1.17%

Allowance as a Percentage of Non-performing and Restructured Loans	54%	74%

Provision for Loan Losses

The loan loss provision for the first six months was $900 thousand for 2008 and $320 thousand for the same period in 2007. The loan loss provision for the three months ended June 30, 2008 was $500 thousand and $170 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 six month period ended June 30, 2008 were $385 thousand compared to $355 thousand for the same period in 2007. Net charge-offs for the three month period ended June 30, 2008 were $197 thousand compared to $257 thousand during the same time 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

	Six Months Ended June 30, 2008 (in thousands)	
	2008	2007
Balance at Beginning of Period	$ 4,879	$ 4,991
Amounts Charged-off:		
Commercial	5	127
Real Estate Construction	217	-
Real Estate Mortgage	55	91
Agricultural	12	-
Consumer	612	482
Total Charged-off Loans	901	700
Recoveries on Amounts Previously Charged-off:		
Commercial	5	1
Real Estate Construction	2	10
Real Estate Mortgage	12	2
Agricultural	30	29
Consumer	467	303
Total Recoveries	516	345
Net Charge-offs	385	355
Provision for Loan Losses	900	320
Balance at End of Period	5,394	4,956
Loans		
Average	412,549	439,559
At June 30	418,820	430,538
As a Percentage of Average Loans:		
Net Charge-offs	0.09%	0.08%
Provision for Loan Losses	0.22%	0.07%
Allowance as a Multiple of Net Charge-offs	7.0	7.0

Loan Losses

	Quarter Ended June 30 (in thousands)	
	2008	2007

Balance at Beginning of Period	$ 5,091	$ 5,043
Amounts Charged-off:		
Commercial	5	127
Real Estate Construction	92	-
Real Estate Mortgage	31	35
Consumer	254	261
Total Charged-off Loans	382	423
Recoveries on Amounts Previously Charged-off:		
Commercial	1	-
Real Estate Construction	-	5
Real Estate Mortgage	5	-
Agricultural	1	14
Consumer	178	147
Total Recoveries	185	166
Net Charge-offs	197	257
Provision for Loan Losses	500	170
Balance at End of Period	5,394	4,956
Loans		
Average	413,840	436,937
At June 30	418,820	430,538
As a Percentage of Average Loans:		
Net Charge-offs	0.05%	0.06%
Provision for Loan Losses	0.12%	0.04%
Allowance as a Multiple of Net Charge-offs	6.6	4.8

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 Company 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 June 30, 2008 the projected percentage changes are within the Board approved limits. This period's volatility is higher in each rate shock in a falling rate environment when compared to the same period a year ago. In a rising rate environment, there is little change in the projected net interest income volatility between the two periods. The projected net interest income report summarizing the Company's interest rate sensitivity as of June 30, 2008 is as follows:

(dollars in thousands)

PROJECTED NET INTEREST INCOME

Rate Change:	- 300	- 100	Level Rates	+ 100	+ 300
Year One (7/08 - 6/09)					
Net interest income	23,304	24,135	25,061	25,481	25,816
Net interest income dollar change	(1,757)	(926)	N/A	420	755
Net interest income percentage change	-7.0%	-3.7%	N/A	1.7%	3.0%
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 June 30, 2007 is as follows:

PROJECTED NET INTEREST INCOME
(dollars in thousands)

Change in basis points:	- 300	- 100	Level Rates	+ 100	+ 300
Year One (7/07 - 6/08)					
Net interest income	22,916	23,368	23,831	24,181	24,563
Net interest income dollar change	(915)	(463)	N/A	350	732
Net interest income percentage change	-3.8%	-1.9%	N/A	1.5%	3.1%
Limitation on % Change	>-10.0%	>-4.0%	N/A	>-4.0%	>-10.0%

Projections from June 30, 2008, year one reflected a decline in net interest income of 3.7% with a 100 basis point decline compared to the 1.9% decline in 2007. The 100 basis point increase in rates reflected a 1.7% increase in net interest income in 2008 compared to 1.5% 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 June 30, 2008 balance sheet, a 300 basis point increase in rates results in a 21% decline in EVE. A 300 basis point decrease in rates results in a 19% 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
4/1/08 - 4/30/08	43,500	$30.76	43,500	839 shares
5/1/08 - 5/31/08	2,800	27.60	2,800	98,039 shares
6/1/08 - 6/30/08	43,960	27.33	43,960	54,079 shares
Total	90,260		90,260	54,079 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. On May 20, 2008, the Board of Directors approved and authorized 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 June 30, 2008 245,921 shares have been purchased.

Item 3. Defaults upon Senior Securities

None

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

The registrant's 2008 Annual Meeting of Shareholders was held May 14, 2008. Proxies were solicited by the registrant's Board of Directors. There was no solicitation in opposition to the Board's nominees as listed in the proxy statement, and all of the nominees were elected by vote of the shareholders. Voting results for each nominee were as follows:

	Votes For	Votes Withheld
Henry Hinkle	2,199,806	98,934
Theodore Kuster	2,218,434	80,306
Robert G. Thompson	2,229,434	69,306

The following directors have a term of office that will continue following the Annual Meeting: William Arvin, B. Proctor Caudill, Betty J. Long, Ted McClain, Louis Prichard, Edwin S. Saunier, Woodford Van Meter and Buck Woodford.

The total number of Common Shares outstanding as of March 20, 2008, the record date for the Annual Meeting of Shareholders, was 2,852,367.

Item 5. Other Information

None

Item 6. Exhibits

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

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

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

SIGNATURES

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

KENTUCKY BANCSHARES, INC.

Date ______7/14/08________ __/s/Louis Prichard_______________
Louis Prichard, President and C.E.O.

Date ______7/14/08________ __/s/Gregory J. Dawson____________
Gregory J. Dawson, Chief Financial Officer

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