KENTUCKY BANCSHARES INC /KY/
Form 10-Q
August 13, 2009

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, 2009
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 has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No X _

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 July 31, 2009: 2,742,661.

KENTUCKY BANCSHARES, INC.

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Item 1 - Financial Statements

KENTUCKY BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS (unaudited)

(thousands)	6/30/2009	12/31/2008
Assets		
Cash and due from banks	$ 13,675	$ 16,411
Federal funds sold	25	20,695
Cash and cash equivalents	13,700	37,106
Securities available for sale	172,075	172,834
Loans	417,556	424,276
Allowance for loan losses	(6,373)	(5,465)
Net loans	411,183	418,811
Federal Home Loan Bank stock	6,731	6,731

Bank premises and equipment, net	17,720	17,875
Interest receivable	4,420	5,156
Goodwill	13,117	13,117
Other intangible assets	1,392	1,523
Mortgage servicing rights	728	465
Other assets	7,661	5,157
Total assets	$ 648,727	$ 678,775
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	$ 95,084	$ 90,480
Time deposits, $100,000 and over	104,852	108,465
Other interest bearing	294,159	321,863
Total deposits	494,095	520,808
Repurchase agreements and other borrowings	12,548	10,717
Federal Funds Purchased	2,639	-
Federal Home Loan Bank advances	63,848	77,301
Subordinated debentures	7,217	7,217
Interest payable	4,188	2,874
Other liabilities	5,382	2,817
Total liabilities	589,917	621,734
Stockholders' equity		
Common stock	12,337	12,053
Retained earnings	45,640	44,974
Accumulated other comprehensive income (loss)	833	14
Total stockholders' equity	58,810	57,041
Total liabilities & stockholders' equity	$ 648,727	$ 678,775

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)

(thousands, except per share amounts)	Six Months Ending	
	6/30/2009	6/30/2008
INTEREST INCOME:		
Loans, including fees	$ 12,303	$ 14,083
Securities available for sale	3,787	3,589
Other	14	256
Total interest income	16,104	17,928
INTEREST EXPENSE:		
Deposits	4,896	6,202
Other	1,783	1,793
Total interest expense	6,679	7,995
Net interest income	9,425	9,933
Loan loss provision	900	900
Net interest income after provision	8,525	9,033
NON-INTEREST INCOME:		
Service charges	2,522	2,560
Loan service fee income	50	45

Trust department income	235	270
Securities available for sale gains (losses), net	203	15
Gain on sale of mortgage loans	811	278
Other	799	867
Total other income	4,620	4,035
NON-INTEREST EXPENSE:		
Salaries and employee benefits	5,986	5,230
Occupancy expenses	1,301	1,378
Amortization	131	133
Advertising and marketing	253	253
Taxes other than payroll, property and income	366	358
Other	2,867	2,264
Total other expenses	10,904	9,616
Income before taxes	2,241	3,452
Income taxes	170	773
Net income	$ 2,071	$ 2,679
Other Comprehensive Income, net of tax:		
Change in Unrealized Gains on Securities	819	(851)
Comprehensive Income	$ 2,890	$ 1,828
Earnings per share		
Basic	$ 0.76	$ 0.95
Diluted	0.76	0.95

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (unaudited)

(thousands, except per share amounts)	Three Months Ending	
	6/30/2009	6/30/2008
INTEREST INCOME:		
Loans, including fees	$ 6,224	$ 6,775
Securities available for sale	1,679	1,855
Other	4	45
Total interest income	7,907	8,675
INTEREST EXPENSE:		
Deposits	2,363	2,696
Other	871	942
Total interest expense	3,234	3,638
Net interest income	4,673	5,037
Loan loss provision	450	500
Net interest income after provision	4,223	4,537
NON-INTEREST INCOME:		
Service charges	1,376	1,371
Loan service fee income	23	21
Trust department income	126	150
Securities available for sale gains (losses), net	199	8
Gain on sale of mortgage loans	433	117
Other	458	393
Total other income	2,615	2,060

NON-INTEREST EXPENSE:		
Salaries and employee benefits	3,437	2,581
Occupancy expenses	640	644
Amortization	65	66
Advertising and marketing	129	113
Taxes other than payroll, property and income	178	179
Other	1,567	1,071
Total other expenses	6,016	4,654
Income before taxes	822	1,943
Income taxes	(82)	457
Net income	$ 904	$ 1,486
Other Comprehensive Income, net of tax:		
Change in Unrealized Gains on Securities	(217)	(1,342)
Comprehensive Income	$ 687	$ 144
Earnings per share		
Basic	$ 0.33	$ 0.53
Diluted	0.33	0.53

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

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

	----Common Stock----			Accumulated	S
	Shares	Amount (1)	Retained Earnings	Other Comprehensive Income	
Balances, December 31, 2008	2,745,729	$ 12,344	$ 44,683	$ 14	
Common stock issued, including tax benefit, net (including stock grants of 3,714 shares)	3,732	-	-	-	
Stock based compensation expense	-	57	-	-	
Common stock purchased and retired	(4,700)	(64)	(15)	-	
Net change in unrealized gain (loss) on securities available for sale, net of tax	-	-	-	819	
Net income	-	-	2,071	-	
Dividends declared - $0.40 per share	-	-	(1,099)	-	

Balances, June 30, 2009	2,744,761	$ 12,337	$ 45,640	$ 833

(1) Common Stock has no par value; amount includes Additional Paid-in Capital

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(thousands)	Six Months Ending	
	6/30/2009	6/30/2008
Cash Flows From Operating Activities		
Net Income	$ 2,071	$ 2,679
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & Amortization	691	797
Securities amortization (accretion), net	811	(165)
Noncash compensation expense	57	68
Provision for loan losses	900	900
Securities (gains) losses, net	(203)	(15)
Originations of loans held for sale	(36,455)	(13,503)
Proceeds from sale of loans	37,266	13,701
Federal Home Loan Bank stock dividends	-	(173)
Losses (gains) on sale of bank premises and equipment	-	(5)
Gain on sale of mortgage loans	(811)	(278)
Changes in:		
Interest receivable	736	374
Other assets	(2,872)	(1,449)
Interest payable	1,314	(1,819)
Other liabilities	2,143	(57)
Net cash from operating activities	5,648	1,055
Cash Flows From Investing Activities		
Purchases of securities available for sale	(53,208)	(63,690)
Proceeds from sales of securities available for sale	17,515	-
Proceeds from principal payments, maturities and calls of securities available for sale	37,085	49,369
Net change in loans	6,728	(1,817)
Purchases of bank premises and equipment	(336)	(1,402)
Proceeds from the sale of bank premises and equipment	-	5
Net cash from investing activities	7,784	(17,535)
Cash Flows From Financing Activities:		
Net change in deposits	(26,713)	(30,806)
Net change in securities sold under agreements to repurchase, federal funds purchased and other borrowings	4,670	15,478
Advances from Federal Home Loan Bank	-	35,000
Payments on Federal Home Loan Bank advances	(13,417)	(11,964)
Proceeds from note payable	-	5,000
Payment on note payable	(200)	(2,300)
Proceeds from issuance of common stock	-	15
Purchase of common stock	(79)	(2,842)
Dividends paid	(1,099)	(1,584)
Net cash from financing activities	(36,838)	5,997
Net change in cash and cash equivalents	(23,406)	(10,483)
Cash and cash equivalents at beginning of period	37,106	25,807
Cash and cash equivalents at end of period	13,700	15,324

Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest expense	$ 6,679	$ 7,995
Income taxes	200	700
Supplemental schedules of non-cash investing activities		
Real estate acquired through foreclosure	$ 3,941	$ 950

See Accompanying Notes

KENTUCKY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements for Kentucky Bancshares, Inc. (the "Company") 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, 2008.

Recently Issued But Not Yet Effective Accounting Standards

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards "(SFAS") No. 166, "Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140". This statement is a revision to SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" and requires more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures.

SFAS No. 166 enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and an entity's continuing involvement in transferred financial assets. This statement is effective at the beginning of a reporting entity's first fiscal year beginning after November 15, 2009, or January 1, 2010, for the Company. Early application is not permitted. The Company does not expect this statement to have a material impact on its consolidated results of operations or financial position upon adoption.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)". SFAS No. 167 is a revision to FIN 46 (Revised December 2003), Consolidation of Variable Interest Entities, and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance.

SFAS No. 167 requires a number of new disclosures. SFAS No. 167 requires a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity's financial statements. SFAS No. 167 is effective at the beginning of a reporting entity's first fiscal year beginning after November 15, 2009, or January 1, 2010, for the Company. Early application is not permitted. The Company does not expect this statement to have a material impact on its consolidated results of operations or financial position upon adoption.

In June 2009, the FASB issued SFAS No. 168, "FASB Accounting Standards CodificationTM" and the Hierarchy of Generally Accepted Accounting Principles." SFAS No. 168 establishes the FASB Accounting Standards CodificationTM ("Codification") as the single source of authoritative U.S. generally accepted accounting principles ("GAAP") recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS No. 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009.

When effective, the Codification will supersede all existing non-SEC accounting and reporting standards. All other non-SEC accounting and other nongrandfathered literature not included in the Codification will become nonauthoritative. Subsequent to SFAS No. 168, the FASB will not issue new standards in the form of SFAS's, FSP's, or Emerging Issues Task Force Abstracts. Instead, the FASB will issue Accounting Standards Updates ("ASU"), which will serve only to: (a) update the Codification; (b) provide background information about the guidance; and (c) provide the bases for conclusions on changes in the Codification. The Company does not expect this statement to have a material impact on its consolidated results of operations or financial position upon adoption.

Adoption of New Accounting Standards

Effective January 1, 2009 the Company adopted SFAS No. 141(R), "Business Combinations", SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements", SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities", and SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts".

During the second quarter of 2009, the Company adopted FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly", FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments", FSP FAS 107-1 and APB 28-1, "Interim Disclosure about Fair Value of Financial Instruments" , SFAS No. 165, "Subsequent Events", and FASB Staff Position ("FSP") FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies" .

SFAS No. 141(R) establishes principals and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree. The statement also provides guidance for recognizing and measuring goodwill or gain from a bargain purchase in a business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The provisions of this statement will only impact the Company if it enters into a business combination on or after January 1, 2009.

FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies" was issued in April 2009 and amends the guidance in SFAS No. 141(R) as follows:

? Requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, "Accounting for Contingencies", and FASB Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss". Further, the FASB decided to remove the subsequent accounting guidance for assets and liabilities arising from contingencies from Statement 141(R), and carry forward without significant revision the guidance in SFAS No. 141.

? Eliminates the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, the FASB decided to require that entities include only the disclosures required by Statement 5 and that those disclosures be included in the business combination footnote.

? Requires that contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination be treated as contingent consideration of the acquirer and should be initially and subsequently measured at fair value in accordance with SFAS No. 141(R).

This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The impact of adopting this FSP will depend on the timing of future acquisitions, if any, and the nature of any contingencies associated with such acquisitions.

SFAS No. 160 amends Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements" to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement also amends certain of ARB No. 51's consolidation procedures for consistency with the requirements of

SFAS No. 141(R). The adoption of this statement did not have an impact on the Company's consolidated financial position or results of operations.

SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" to provide enhanced disclosures about 1) how and why an entity uses derivative instruments; 2) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and related interpretations; and 3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The adoption of this statement did not have an impact on the Company's consolidated financial position or results of operations.

SFAS No. 163 clarifies how SFAS No. 60, "Accounting and Reporting by Insurance Enterprises", applies to financial guarantee insurance contracts issued by insurance enterprises, including the recognition and measurement of premium revenue and claim liabilities. It also requires expanded disclosures about financial guarantee insurance contracts. The adoption of this statement did not have an impact on the Company's consolidated financial position or results of operations.

FSP FAS 157-4, adopted in the second quarter of 2009:

? Affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction.

? Clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active.

? Eliminates the proposed presumption that all transactions are distressed (not orderly) unless proven otherwise. The FSP instead requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence.

? Includes an example that provides additional explanation on estimating fair value when the market activity for an asset has declined significantly.

? Requires an entity to disclose a change in valuation technique (and the related inputs) resulting from the application of the FSP and to quantify its effects, if practicable.

? Applies to all fair value measurements when appropriate.

The adoption of FSP FAS 157-4 did not have a material impact on the Company's consolidated financial position or results of operations.

FSP FAS 115-2 and FAS 124-2, adopted in the second quarter of 2009:

? Changes existing guidance for determining whether an impairment is other than temporary to debt securities;

? Replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis;

? Incorporates examples of factors from existing literature that should be considered in determining whether a debt security is other-than-temporarily impaired;

? Requires that an entity recognize noncredit losses on held-to-maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security in a prospective manner by offsetting the recorded value of the asset unless the security is subsequently sold or there are additional credit losses;

? Requires an entity to present the total other-than-temporary impairment in the statement of earnings with an offset for the amount recognized in other comprehensive income; and

? When adopting FSP FAS 115-2 and FAS 124-2, an entity is required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-temporary impairment from retained earnings to accumulated other comprehensive income if the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery.

The adoption of FSP FAS 115-2 and FAS 124-2 did not have a material impact on the Company's consolidated financial position or results of operations. Reference is made to Note 7 for additional disclosures required by FSP FAS 115-2 and FAS 124-2.

The Company adopted FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" during the second quarter of 2009. This FSP amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments", to require an entity to provide disclosures about fair value of financial instruments in interim financial information. This FSP also amends APB Opinion No. 28, "Interim Financial Reporting", to require those disclosures in summarized financial information at interim reporting periods. Under this FSP, a publicly traded company shall include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. In addition, an entity shall disclose in the body or in the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for annual reporting periods the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position, as required by SFAS No. 107.

The adoption of this FSP did not have a material impact on the Company's consolidated financial position or results of operations. Please refer to Note 6 for additional information related to the impact of adopting this FSP.

The Company adopted SFAS No. 165, "Subsequent Events" during the second quarter of 2009. This statement establishes general standards of accounting for and disclosures of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. Specifically, SFAS No. 165 provides:

? The period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;

? The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

? The disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

The adoption of SFAS No. 165 did not have a material impact on the Company's consolidated financial position or results of operations. The Company evaluated subsequent events through August 13, 2009, the date its financial statements were issued, and believes that no events have occurred requiring further disclosure or adjustment to the consolidated financial statements.

2. INVESTMENT SECURITIES

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for Sale				
June 30, 2009				
U.S. government agencies	$ 23,514	$ 45	$ (55)	$ 23,504
States and political subdivisions	74,026	1,078	(1,460)	73,644
Mortgage-backed	73,003	1,686	(54)	74,635
Equity securities	270	22	-	292
Total	170,813	2,831	(1,569)	172,075
December 31, 2008				
U.S. government agencies	$ 19,138	$ 212	$ -	$ 19,350
States and political subdivisions	65,091	1,061	(2,181)	63,971
Mortgage-backed	88,314	1,142	(233)	89,223
Equity securities	270	20	-	290
Total	172,813	2,435	(2,414)	172,834

Securities with unrealized losses at June 30, 2009 and December 31, 2008 not recognized in income are as follows:

June 30, 2009
(in thousands)

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government securities	$ 8,971	$ (55)	$ -	$ -	$ 8,971	$ (55)
States and municipals	13,800	(397)	30,002	(1,063)	43,802	(1,460)
Mortgage-backed	4,277	(54)	-	-	4,277	(54)
Total temporarily impaired	$27,048	$ (506)	$30,002	$(1,063)	$57,050	$(1,569)

December 31, 2008
(in thousands)

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government securities	$ -	$ -	$ -	$ -	$ -	$ -
States and municipals	$13,055	$ (587)	$23,023	$(1,594)	$36,078	$(2,181)
Mortgage-backed	30,903	(165)	1,565	(68)	32,468	(233)
Total temporarily impaired	$43,958	$ (752)	$24,588	$(1,662)	$68,546	$(2,414)

Other-than-temporary impairment ("OTTI")

All unrealized losses are reviewed on at least a quarterly basis to determine whether the losses are other than temporary and are reviewed more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and our intent and ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for anticipated credit losses.

3. LOANS

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

	6/30/2009	12/31/2008
Commercial	$ 22,490	$ 21,505
Real estate construction	17,937	16,818
Real estate mortgage	276,299	286,846
Agricultural	82,468	80,779
Consumer	18,362	18,328
Total	417,556	424,276

Activity in the allowance for loan losses for the six month period ended was as follows:

	2009	2008
Beginning balance	$ 5,464,864	$ 4,878,732
Charge-offs	(458,414)	(457,199)
Recoveries	466,479	72,227
Provision for loan losses	900,000	900,000
Ending balance	$ 6,372,929	$ 5,393,760

Impaired loans totaled $7,790,000 at June 30, 2009 and $5,131,000 at December 31, 2008.

Nonperforming loans were as follows:

	6/30/09	12/31/08
Loans past due over 90 days still on accrual	$ 375,000	$ 779,000
Nonaccrual loans	8,227,000	6,562,000

Nonperforming loans include impaired loans and smaller balance homogeneous loans, such as residential mortgage and consumer loans, that are collectively evaluated for impairment.

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:

	Six Months Ended June 30	
	2009	2008
(in thousands, except per share information)		

Basic Earnings Per Share		
Net Income	$2,071	$2,679
Weighted average common shares outstanding	2,737	2,819
Basic earnings per share	$ 0.76	$ 0.95
Diluted Earnings Per Share		
Net Income	$2,071	$2,679
Weighted average common shares outstanding	2,737	2,819
Add dilutive effects of assumed exercise of stock options	1	4
Weighted average common and dilutive potential common shares outstanding	2,738	2,823
Diluted earnings per share	$ 0.76	$ 0.95

	Three Months Ended June 30	
(in thousands, except per share information)	2009	2008
Basic Earnings Per Share		
Net Income	$ 904	$1,486
Weighted average common shares outstanding	2,738	2,797
Basic earnings per share	$ 0.33	$ 0.53
Diluted Earnings Per Share		
Net Income	$ 904	$1,486
Weighted average common shares outstanding	2,738	2,797
Add dilutive effects of assumed exercise of stock options	1	3
Weighted average common and dilutive potential common shares outstanding	2,739	2,800
Diluted earnings per share	$ 0.33	$ 0.53

Stock options for 37,844 shares of common stock for the six and three months ended June 30, 2009, and for 31,900 shares of common stock for the three months ended June 30, 2008 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

Under its 1999 Employee Stock Option Plan, the Company has granted 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 100,000 options. Under the expired 1993 Non-Employee Directors Stock Ownership Incentive Plan, the Company has also granted certain directors stock option awards which vest and become fully exercisable immediately and provided 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. No options have been granted in 2009.

	2008
Weighted-average fair value of options granted during the year	$2.38
Risk-free interest rate	2.96%
Expected option life	8 years
Expected stock price volatility	11.05%
Expected dividend yield	3.61%

Summary of activity in the stock option plan for the six months ended June 30, 2009 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	50,169	$28.57		
Forfeited or expired	(12,325)	25.86		
Outstanding, end of period	37,844	29.45	54.6 months	$ -
Vested and expected to vest	37,844	29.45	54.6 months	-
Options exercisable at period end	35,374	29.38	53.8 months	-

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 $57 thousand in stock compensation expense during the six months ended June 30, 2009 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 Per Share Fair Value
Nonvested at December 31, 2008	10,006	$ 30.58
Granted	4,150	17.15
Vested	(2,804)	30.16
Forfeited	(334)	25.40
Nonvested at June 30, 2009	11,018	$ 25.79

6. DIVIDENDS

Dividends per share paid for the quarter ended June 30, 2009 were $0.20 compared to $0.28 for June 30, 2008. 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

Pension Benefits	Six months ended June 30 (in thousands)	
	2009	2008
Service cost	$ -	$ 254
Interest cost	-	231
Expected return on plan assets	-	(241)
(Gain) loss amortization	-	14
Net Periodic Benefit Cost	$ -	$ 258

Pension Benefits	Three months ended June 30 (in thousands)	
	2009	2008
Service cost	$ -	$ 132
Interest cost	-	119
Expected return on plan assets	-	(120)
(Gain) loss amortization	-	10
Net Periodic Benefit Cost	$ -	$ 141

Employer Contributions

The defined benefit plan offered to employees by the Company was terminated effective December 31, 2008. Therefore, the company had no contributions to the plan during the first quarter of this year and will also have no contributions going forward.

As of December 31, 2008, the date of termination, the projected benefit obligation was $6,749,694 and the fair value of the plan assets was $5,206,908. The difference of $1,542,786 is recognized in other liabilities on the consolidated balance sheet. During the third quarter of 2009, distributions from the defined benefit plan will be made to those employees in which the Company had an obligation to as of the December 31, 2008, the plan's termination date. Once all funds have been distributed, the Company will no longer have any liabilities associated with the plan. During the second quarter of 2009, the Company recognized $860 thousand for the final expenses related to terminating the plan.

8. Fair Value Measurements

Statement 157 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 (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Assets and Liabilities Measured on a Recurring Basis

For this disclosure, the Company only has available for sale investment securities that meet the requirement.

Available for sale investment securities are the Company's only balance sheet item that meet the disclosure requirements for instruments measured at fair value on a recurring basis. Disclosures are as follows in the table below.

(In thousands)	Fair Value Measurements at June 30, 2009 Using			
Description	Fair Value 6/30/09	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for Sale Securities	$172,075	$ 292	$ 171,783	$ -

(In thousands)	Fair Value Measurements at December 31, 2008 Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

Description	12/31/08	(Level 1)	(Level 2)	(Level 3)
Available for Sale Securities	$172,834	$ 290	$172,544	$ -

Assets and Liabilities Measured on a Non-Recurring Basis

Servicing rights are carried at lower of cost or fair value. The current value of $728 thousand includes a valuation allowance of $213 thousand, which was recorded during the fourth quarter of 2008.

Impaired loans totaled $7,790,000 at June 30, 2009 and $5,131,000 at December 31, 2008. The total allowance for loan losses related to these loans was $600,000 and $320,000 at June 30, 2009 and December 31, 2008. Impaired loans are measured at fair value based on the underlying collateral and are considered level 3 inputs.

Fair Value of Financial Instruments

In accordance with FSP SFAS 107-1, the carrying amounts and estimated fair values of financial instruments, at June 30, 2009 and December 31, 2008 are as follows:

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets				
Cash and cash equivalents	$ 13,700	$ 13,700	$ 37,106	$ 37,106
Securities	172,075	172,075	172,834	172,834
Loans, net	411,183	411,678	418,811	418,635
FHLB stock	6,731	6,731	6,731	6,731
Interest receivable	4,420	4,420	5,156	5,156
Financial liabilities				
Deposits	$ 494,095	$ 501,500	$ 520,808	$ 528,949
Securities sold under agreements to repurchase and other borrowings	12,548	12,814	10,717	10,983
FHLB advances	63,848	65,735	77,301	79,665
Subordinated debentures	7,217	4,472	7,217	4,253
Interest payable	4,188	4,188	2,874	2,874

The methods and assumptions used to estimate fair value are described as follows: Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, Federal Home Loan Bank stock, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. The fair value of commitments to extend credit and standby letters of credit is not considered material.

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 $2.1 million, or $0.76 basic and diluted earnings per share for the first six months ending June 30, 2009 compared to $2.7 million, or $0.95 basic and diluted earnings per share for the six month period ending June 30, 2008. The first six months earnings reflects a decrease of 23% compared to the same time period in 2008, due primarily to a decrease in net interest income of $508 thousand, an increase in salaries and benefits of $756 thousand and an increase in other expenses of $603 thousand. The increase in salaries and benefits was primarily due to final costs of $860 thousand related to the terminating the pension plan. The increase in other expenses was mainly due to an increase of $684 thousand in FDIC insurance expense. These reductions to income were partially offset by an increase on the gain on securities of $188 thousand, the gain on sold loans of $533 thousand and a reduction in income tax expense of $603 thousand. The earnings for the three months ended June 30, 2009 were $0.9 million, or $.33 basic and diluted earnings per share for the three month period ending June 30, 2009 compared to $1.5 million, or $.53 basic and diluted earnings per share for the three month period ending June 30, 2008. This three month period earnings reflects a 39% decrease compared to the same time period in 2008.

Return on average assets was 0.61% for the six months ended June 30, 2009 and 0.85% for the six month period ended June 30, 2008. Return on average assets was 0.54% for the three months ended June 30, 2009 and 0.94% for the three month period ended June 30, 2008. Return on average equity was 7.1% for the six month period ended June 30, 2009 compared to 9.1% for the six month period ended June 30, 2008. Return on average equity was 6.1% for the three months ended June 30, 2009 and 10.1% for the same time period in 2008.

Loans decreased $6.7 million from $424.3 million on December 31, 2008 to $417.6 million on June 30, 2009. Decreases in real estate mortgage loans were offset by an increase in real estate construction, agricultural, commercial & consumer loans.

Total deposits decreased from $520.8 million on December 31, 2008 to $494.1 million on June 30, 2009, a decrease of $26.7 million. This decrease is primarily the result of a decrease in interest bearing deposit accounts, excluding time deposits. Management attributes the decrease mainly due to large dollar public fund accounts that have rolled off during 2009 and increased competition for deposits.

Net Interest Income

Net interest income was $9.4 million for the six months ended June 30, 2009 compared to $9.9 million for the six months ended June 30, 2008, a decrease of 5.1%. The interest spread was 2.94% for the first six months of 2009 comparable to 3.32% for the same period in 2008, a decrease of 38 basis points. Net interest income was $4.7 million for the three month period ending June 30, 2009 compared to $5.0 million for the three month period ending June 30, 2008, a decrease of 7.2%. The interest spread was 2.93% for the three month period ending June 30, 2009 compared to 3.38% for the three month period in 2008, a decrease of 45 basis points. For the first three months in 2009, the prime interest rate was 200 basis points less than the first 3 months in 2008. During the second quarter of 2009, the prime interest rate was 175 basis points less than the same period a year ago. These declines in rates have significantly impacted the Company's interest spread. In addition to lower rates and tightening interest margins, the net interest spread for 2009 is also lower than 2008 due to an increase in "lost" loan interest during 2009 that can be attributed to an increase in non-performing loans in our loan portfolio.

For the first six months, the yield on assets decreased from 6.15% in 2008 to 5.13% in 2009. The cost of liabilities decreased from 2.83% in 2008 to 2.19% in 2009. Year to date average loans increased $5.8 million, or 1.4% from June 30, 2008 to June 30, 2009. Loan interest income has decreased $1.8 million for the first six months of 2009 compared to the first six months of 2008. Year to date average deposits increased from June 30, 2008 to June 30, 2008, up $44.6 million or 9.3%. The increase is primarily the result of an increase in interest bearing public funds. Deposit interest expense has decreased $1.3 million for the first six months of 2009 compared to the same period in 2008.

Non-Interest Income

Non-interest income increased $585 thousand for the six months ended June 30, 2009 compared to the same period in 2008 to $4.6 million, due primarily to an increase of $533 thousand on the gain of the sale of mortgage loans and an increase of $188 thousand on gains recognized from the sale of securities. These increases were partially offset by a decrease in service charges of $38 thousand, trust department income of $35 thousand and other income of $68 thousand. The decrease in service charges was primarily the result of a decrease in overdraft income of $65 thousand for the first six months of 2009. The decrease in other non-interest income was primarily due to a decrease in brokerage income of $139 thousand partially offset by an increase in building rents of $43 thousand and an increase of $34 thousand in debit card interchange income. The $555 thousand increase in non-interest income for the three months ended June 30, 2009 compared to same time period in 2008 is primarily due to an increase of $316 thousand on the gain of the sale of mortgage loans and an increase of $191 thousand on gains recognized from the sale of securities. These gains were partially offset by a decrease in trust fees of $24 thousand for the three months ending June 30, 2009 compared to the same period a year ago.

Gain on sale of mortgage loans increased from $278 thousand in the first six months of 2008 to $811 thousand during the first six months of 2009. For the three months ended June 30, 2009 compared to the same time period in 2008, the gain on sale of mortgage loans increased $316 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 $1.3 million for the six month period ended June 30, 2009 compared to the same period in 2008. For the three month period ended June 30, 2009, total non-interest expense increased $1.4 million.

For the comparable six month periods, salaries and benefits increased $756 thousand, an increase of 14%. The increase in salaries & benefits is primarily attributed to the Company terminating the defined benefit plan offered to employees of the Company as of December 31, 2008. During the second quarter of 2009, the Company recognized $860 thousand for the final expenses related to terminating the plan. In addition, the Company has offered a voluntary separation option to various employees effective as early as August 31, 2009 and as late as October 31, 2009. The payouts for those electing this option are expected to occur in 2009, with future salary and benefit savings from those electing this option to be realized in the latter part of this year and in future periods. Salaries & benefits increased $856 thousand for the three month period ending June 30, 2009 compared to the same time period in 2008.

Occupancy expenses decreased $77 thousand to $1,301 thousand for the first six months of 2009 compared to the same time period in 2008. Occupancy expenses decreased $4 thousand for the three month period ended June 30, 2009 compared to the same time period in 2008. The decrease in year to date occupancy expense during 2009 is mainly due to a reduction in depreciation expense. For the first six months ending June 30, 2009, depreciation expense decreased $88 thousand compared to the first six months 2008. The decrease in depreciation expense is due to assets with a high cost basis becoming fully depreciated at the end of 2008. In April of 2009, construction on the new Nicholasville location was completed and is expected to cause a slight increase in occupancy expense going forward.

In addition to the relocation of the Nicholasville branch, during the second quarter of this year, the downtown Cynthiana location was consolidated with the Company's newer location in Cynthiana. On July 31, 2009, the North Middletown branch was closed. Management believes that consolidating these locations will reduce costs and improve net income.

Other expenses increased $603 thousand for the first six months ended June 30, 2009 compared to the same time period in 2008. For the three month period ended June 30, 2009 other expenses increased $496 thousand compared to the three month period ended June 30, 2008. Increases in other expenses for both year to date and the three months ending June 30 are related to an increase in FDIC insurance expense. FDIC insurance expense increased $684 thousand for the first six months in 2009 compared to the same period a year ago and increased $466 thousand for the three months ending June 30, 2009 compared to the three months ending June 30, 2008. The increase in FDIC insurance is primarily the result of two things. The first being an increase in FDIC insurance premiums(see below for more details). The other being a special assessment that the FDIC assessed on all FDIC insured banks. This additional expense was not made formal until May of this year and cost the Company approximately $300 thousand which was expensed during the three months ending June 30, 2009.

Deposit Insurance: In February 2009, the FDIC adopted a long-term deposit insurance fund ("DIF") restoration plan as well as an additional emergency assessment for 2009. The restoration plan increases base assessment rates for banks in all risk categories with the goal of raising the DIF reserve ratio from its current 0.40% to 1.15% within seven years. Banks in the best risk category, which include the Company's subsidiary bank, will pay initial base rates ranging from 12 to 16 basis points of assessable deposits beginning April 1, 2009, up from the initial base rate range of 12 to 14 basis points. Additionally, the FDIC approved an interim rule imposing a special emergency assessment to all financial institutions of 20 basis points of insured deposits as of June 30, 2009. The interim rule was subject to a 30-day comment period and in early March 2009 a proposal was introduced in Congress to lower the special emergency assessment to 10 basis points from the initial 20 basis points. The special emergency assessment is estimated to be $1.1 million for the Company as currently adopted under the 20 basis point rule and will be collected on September 30, 2009. The amount of the special emergency assessment would decrease to $530 thousand if the 10 basis point scenario is adopted. The FDIC is also permitted to impose an emergency special assessment after June 30, 2009 of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance. The increase in assessments by the FDIC could have a material adverse effect on the Company's earnings.

Temporary Liquidity Guarantee Program ("TLGP"): The TLGP consists of two separate programs implemented by the FDIC in October 2008. This includes the Debt Guarantee Program ("DGP") and the Transaction Account Guarantee Program ("TAGP"). These programs were initially provided at no cost to participants during the first 30 days. Eligible institutions that do not "opt out" of either of these programs become participants by default and will incur the fees assessed for taking part.

Under the DGP, the FDIC will guarantee senior unsecured debt issued on or after October 14, 2008 through June 30, 2009 up to certain limits by participating entities. The FDIC will provide guarantee coverage for debt issued between those dates until the earlier of the maturity date of the debt or June 30, 2012. The Company chose to opt out of the DGP.

Under the TAGP, the FDIC guarantees 100% of certain noninterest bearing transaction accounts up to any amount to participating FDIC insured institutions. The unlimited coverage is applicable until December 31, 2009. The Company opted to participate in the TAGP; as such, it will incur an additional quarterly-assessed 10 basis point fee on balances in noninterest bearing transaction accounts exceeding the recently increased $250 thousand deposit limit that became effective on November 13, 2008. The previous deposit insurance limit amount was $100 thousand.

Emergency Economic Stabilization Act of 2008 ("EESA"): EESA was signed into law by the President on October 3, 2008 as a measure to stabilize and provide liquidity to the U.S. financial markets. Under EESA, the Troubled Asset Relief Program ("TARP") was created. TARP granted the Treasury authority to, among other things, invest in financial institutions and purchase troubled assets in an aggregate amount up to $700 billion.

In connection with TARP, the Capital Purchase Program ("CPP") was launched on October 14, 2008. Under the CPP, the Treasury announced a plan to use up to $250 billion of TARP funds to purchase equity stakes in certain eligible financial institutions, including the Company. The Company was preliminarily approved for $13 million of equity capital in December 2008, and subsequently withdrew its application.

Income Taxes

The effective tax rate for the six months ended June 30, 2009 was 7.6% compared to 22.4% in 2008. The effective tax rate for the three months ended June 30, 2009 was (10.0%) compared to 23.5% for the three month period ended June 30, 2008. These rates are less than the statutory rate as a result of the tax-free securities and loans held by the Company. In addition, beginning in June of 2009, the Company began recognizing tax benefits the Company will receive from historic and low income housing credits. The rates for 2009 are lower due to the lower level of income for 2009. Nontaxable interest income increased $152 thousand for the first six months of 2009 compared to the same time period in 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. 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, 2009, 262,701 shares have been purchased under the program. The most recent share repurchase occurred on June 1, 2009. 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 $13.7 million as of June 30, 2009 compared to $37.1 million at December 31, 2008. 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 a decrease in borrowings from the Federal Home Loan Bank. In addition to cash and cash equivalents, the securities portfolio provides an important source of liquidity. Securities available for sale totaled $172.1 million at June 30, 2009. 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 a public fund account which brought $20 million in deposits to the Company. The full $20 million was expected to roll off by June 30, 2009. As of June 30, 2009, $4 million remains with the Company. In addition, in early January 2009, the Company received deposits in the amount of $18 million as a result of being the successful bidder on a public fund account. As of June 30 2009, $9.2 million has rolled off with the remaining $6.8 million to roll off during the remainder of 2009 and another $2 million is expected to roll of during the first quarter of 2010. In July 2009, the Company was again successful with bidding on a public fund account and was rewarded with additional public fund deposits totaling $16 million. As of June 30, 2009, we have sufficient collateral to borrow an additional $41 million from the FHLB. In addition, as of June 30, 2009, over $30 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, 2009, the Company's non-performing loans totaled $13.4 million or 2.06% of loans compared to $9.2 million or 1.73% of loans at December 31, 2008. (See table below) The Company experienced an increase of $1.7 million in non-accrual loans from December 31, 2008 to June 30, 2009. As of June 30, 2009, non-accrual loans include $2.9 million in loans secured by 1-4 family residential real estate, $2.1 million in real estate construction and $2.0 million in loans secured by non-farm non-residential properties. Real estate loans composed 93% of the non-performing loans as of June 30, 2009 and 96% as of December 31, 2008. Forgone interest income on the non-accrual loans was $367 thousand for the first six months of 2009 compared to $312 thousand for the same time period in 2008.

Nonperforming Assets

	6/30/09	12/31/08
	(in thousands)	
Non-accrual Loans	$ 8,227	$ 6,562
Accruing Loans which are Contractually past due 90 days or more	375	779
Total Nonperforming and Restructured	8,602	7,341
Other Real Estate	4,838	1,840
Total Nonperforming and Restructured Loans and Other Real Estate	$ 13,440	$ 9,181
Nonperforming and Restructured Loans as a Percentage of Loans	2.06%	1.73%
Nonperforming and Restructured Loans and Other Real Estate as a Percentage of Total Assets	2.07%	1.35%
Allowance as a Percentage of Period-end Loans	1.53%	1.29%
Allowance as a Percentage of Non-performing and Restructured Loans	74%	60%

Provision for Loan Losses

The loan loss provision for the first six months ending June 30 was $900 thousand for both 2009 and 2008 The loan loss provision for the three months ended June 30, 2009 was $450 thousand and $500 thousand for the same period in

2008. The current level of nonperforming loans has caused management to keep the 2009 year to date the same as in 2008 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 recoveries for the six month period ended June 30, 2009 were $8 thousand compared to net charge-offs of $385 thousand for the same period in 2008. Net charge-offs for the three month period ended June 30, 2009 were $76 thousand compared to $197 thousand during the same time period in 2008. 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, 2009 (in thousands)	
	2009	2008
Balance at Beginning of Period	$ 5,465	$ 4,879
Amounts Charged-off:		
Commercial	67	5
Real Estate Construction	39	217
Real Estate Mortgage	82	55
Agricultural	6	12
Consumer	624	612
Total Charged-off Loans	818	901
Recoveries on Amounts Previously Charged-off:		
Commercial	2	5
Real Estate Construction	35	2
Real Estate Mortgage	387	12
Agricultural	-	30
Consumer	402	467
Total Recoveries	826	516
Net Charge-offs	(8)	385
Provision for Loan Losses	900	900
Balance at End of Period	6,373	5,394
Loans		
Average	418,375	412,549
At June 30	417,556	418,820
As a Percentage of Average Loans:		
Net Charge-offs	0.00%	0.09%
Provision for Loan Losses	0.22%	0.22%
Allowance as a Multiple of Net Charge-offs	(398.3)	7.0

Loan Losses

	Quarter Ended June 30 (in thousands)	
	2009	2008
Balance at Beginning of Period	$ 5,999	$ 5,091
Amounts Charged-off:		
Commercial	67	5
Real Estate Construction	36	92
Real Estate Mortgage	34	31
Consumer	353	254
Total Charged-off Loans	490	382
Recoveries on Amounts Previously Charged-off:		

Commercial	2	1
Real Estate Construction	35	-
Real Estate Mortgage	152	5
Agricultural	-	1
Consumer	225	178
Total Recoveries	414	185
Net Charge-offs	76	197
Provision for Loan Losses	450	500
Balance at End of Period	6,373	5,394
Loans		
Average	418,038	413,840
At June 30	417,556	418,820
As a Percentage of Average Loans:		
Net Charge-offs	0.02%	0.05%
Provision for Loan Losses	0.11%	0.12%
Allowance as a Multiple of Net Charge-offs	21.0	6.6

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, 2009 the projected percentage changes are within the Board approved limits with the only exception being rates falling 100 basis points. 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, 2009 is as follows:

PROJECTED NET INTEREST INCOME
(dollars in thousands)

Change in basis points:	- 300	- 100	Level Rates	+ 100	+ 300
Year One (7/09 - 6/10)					
Net interest income	20,407	21,487	22,415	22,957	23,420
Net interest income dollar change	(2,008)	(928)	N/A	542	1,005
Net interest income percentage change	-9.0%	-4.1%	N/A	2.4%	4.5%
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, 2008 is as follows:

PROJECTED NET INTEREST INCOME
(dollars in thousands)

Change in basis points:	- 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%

Projections from June 30, 2009, year one reflected a decline in net interest income of 4.1% with a 100 basis point decline compared to the 3.7% decline in 2008. The 100 basis point increase in rates reflected a 2.4% increase in net interest income in 2009 compared to 1.7% in 2008.

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, 2009 balance sheet, a 300 basis point increase in rates results in a 11% decline in EVE. A 300 basis point decrease in rates results in a 1.5% 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, 2008 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
4/1/09 - 4/30/09	-	-	-	41,999 shares
5/1/09 - 5/31/09	2,000	17.60	2,000	39,999 shares
6/1/09 - 6/30/09	2,700	16.34	2,700	37,299 shares
Total	4,700		4,700	37,299 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, 2009 262,701 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 2009 Annual Meeting of Shareholders was held May 13, 2009. 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
Betty J. Long	1,951,643	11,634
Ted McClain	1,936,253	27,024
Edwin S. Saunier	1,959,017	4,260
Buckner Woodford, IV	1,919,719	43,558

The following directors have a term of office that will continue following the Annual Meeting: Louis Prichard, B. Proctor Caudill, William Arvin, Henry Hinkle, Theodore Kuster, Robert Thompson and Woodford Van Meter.

A proposal to approve the 2009 Stock Award Plan (attached hereto as Exhibit 10.1 and incorporated herein by reference) was approved by a majority of the outstanding shares of the registrant's common stock. A total of 1,383,809 shares were voted in favor of the proposal; 79,118 shares were voted against; 29,407 shares abstained; and 508,141 shares were broker non-votes.

The total number of Common Shares outstanding as of May 13, 2009, the record date for the Annual Meeting of Shareholders, was 2,749,443.

Item 5. Other Information

None

Item 6. Exhibits

10.1 2009 Stock Award 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 ______7/13/09________ __/s/Louis Prichard_______________
Louis Prichard, President and C.E.O.

Date ______7/13/09________ __/s/Gregory J. Dawson____________
Gregory J. Dawson, Chief Financial Officer

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