



To Our Shareholders:

The year of 2008 is providing numerous challenges for the financial services industry. However, Highlands State Bank continues to grow. Total assets as of June 30, 2008 were \$59.2 million, increasing 68% when compared to \$35.3 million at June 30, 2007 and increasing 38% when compared to total assets at December 31, 2007 of \$42.9 million. The loan portfolio on a net basis grew to \$43.3 million, increasing 108% over the previous year and 40% over the balance at December 31, 2007. Deposits have grown to support the lending activity of Highlands. On June 30, 2008 total deposits were \$46.8 million, reflecting an increase of \$19.6 million or 72% over the same period last year and \$13.6 million or 41% over the balance at December 31, 2007. Comparative balance sheets for the periods reported are shown on the back of this letter.

We are all aware of what is taking place in the financial industry, particularly as it relates to residential lending. Several banks have failed. Fannie Mae and Freddie Mac, the major purchasers and guarantor of mortgages, together with the federal government have been dealing with the ensuing financial problems.

I am happy to report that the loan portfolio at Highlands State Bank is performing well. We believe that the conservative underwriting standards practiced by our management and overseen by our board of directors has served our shareholders well. While there are signs that the economy may be starting to turn around, many believe that the credit crisis and the economy will continue in its present slump until sometime in 2009. In the meantime, your management and board will continue to grow the bank, while maintaining the highest of credit standards.

If you have any questions about Highlands State Bank and your investment in it, I would welcome the opportunity to talk with you. You can call me at 973-764-3200 ext. 101 or by email at girwin@highlandsstatebank.com.

Sincerely,

George E. Irwin,
President & CEO

HIGHLANDS STATE BANK BALANCE SHEET

(in dollars)

	June 30 2008 (unaudited)	December 31 2007 (audited)	June 30 2007 (unaudited)
ASSETS			
Cash and due from banks	\$1,038,390	\$1,161,515	\$667,273
Interest bearing deposits in other banks	547,389	-	-
Time deposits in other banks	893,000	2,481,000	3,965,000
Securities available for sale	10,644,706	7,364,599	8,917,471
Restricted investment in bank stock	292,100	50,000	50,000
Federal funds sold	1,681,000	-	103,000
Loans	\$43,766,338	\$31,327,016	\$20,979,292
less: Allowance for loan loss	(442,112)	(304,144)	(205,400)
Net loans	\$43,324,226	\$31,022,872	\$20,773,892
Bank premises and equipment, net	459,318	468,443	498,681
Other assets	352,333	329,195	291,998
Total Assets	<u>\$59,232,462</u>	<u>\$42,877,624</u>	<u>\$35,267,315</u>
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	\$11,624,013	\$6,693,759	\$5,928,401
Interest-bearing	35,225,422	26,518,735	21,279,727
Total Deposits	\$46,849,435	\$33,212,494	\$27,208,128
Borrowings	4,000,000	759,000	-
Other liabilities	217,126	204,554	158,477
Total Liabilities	\$51,066,561	\$34,176,048	\$27,366,605
STOCKHOLDERS EQUITY			
Common stock, \$5 par value; authorized 5,000,000 shares; issued and outstanding 1,095,159 shares 6/30/2008 and 12/31/2007; 6/30/2007 1,000,625 shares	\$5,475,795	\$5,475,795	\$5,003,125
Surplus	5,751,878	5,730,086	5,207,118
Accumulated deficit	(2,927,027)	(2,566,089)	(2,213,901)
Accumulated other comprehensive loss	(134,745)	61,784	(95,632)
Total Stockholders' Equity	\$8,165,901	\$8,701,576	\$7,900,710
Total Liabilities and Stockholders' Equity	<u>\$59,232,462</u>	<u>\$42,877,624</u>	<u>\$35,267,315</u>