



To our shareholders:

Highlands State Bank ended the third quarter of 2007 with total assets of \$39.6 million, increasing \$4.3 million or 12% compared to June 30, 2007 total assets of \$35.3 million. Assets increased \$11.0 million or 38% compared to September 30, 2006 when assets were \$28.6 million. The Bank's loan portfolio continued to increase with net loans outstanding as of September 30, 2007 of \$25.3 million, compared with \$20.8 million outstanding at the end of the second quarter of 2007 and \$4.6 million on September 30, 2006. Deposit increases continue to be strong. Total deposits as of September 30, 2007 were \$31.3 million compared to \$27.2 million on June 30 this year and \$19.8 million one year ago. A comparative balance sheet is printed on the back of this letter.

Shareholders began exercising their warrants during the quarter. By the expiration date of the warrants on October 11th, 95,159 new shares were purchased, bringing Highlands State Bank \$951,590 in new capital. I am gratified by the response. The Bank's Board of Directors decided at its regular June 2007 meeting to issue new warrants ("2007 stock warrants") to those shareholders who fully exercise their stock warrants by October 11, 2007. The new 2007 warrants will be distributed proportionally to the shareholders based on the number of original warrants that they exercised. A 2007 warrant letter will be sent out shortly.

Highlands State Bank has instituted a residential mortgage department. We believe that this is an opportune time to take this additional step toward rounding out our community banking product mix. Rest assured, the Bank will make only quality mortgages and has not, and will not, deal in sub-prime or other types of alternative mortgage products. Christina Barger, a mortgage professional, has joined our team to direct this effort.

The Bank is always looking for additional quality team members to help achieve our goals, especially commercial and small business lenders. If you know of someone from your own banking experience that would enjoy and benefit from working with Highlands State Bank, please let me know.

Once again, I would be remiss if I didn't ask for your banking business. Our products and rates for both loans and deposits are very competitive. Best of all, by banking with Highlands State Bank you will also be helping to increase the value of your investment.

Sincerely,

George E. Irwin,
President & CEO

HIGHLANDS STATE BANK BALANCE SHEET

(in dollars)

	September 30 2007 (unaudited)	December 31 2006 (audited)	September 30 2006 (unaudited)
ASSETS			
Cash and due from banks	\$664,765	\$568,607	\$519,200
Interest bearing deposits in other banks	189,000	199,000	199,000
Time deposits in other banks	2,880,000	2,676,000	2,875,000
Securities available for sale	8,107,891	9,324,030	5,864,993
Federal funds sold	1,593,000	9,944,000	13,886,000
Loans	\$25,504,435	\$7,847,281	\$4,643,384
less: Allowance for loan loss	(253,037)	(78,513)	(55,381)
Net loans	\$25,251,398	\$7,768,768	\$4,588,003
Bank premises and equipment, net	483,124	466,721	473,691
Other assets	390,259	228,700	194,901
Total Assets	\$39,559,437	\$31,175,826	\$28,600,788
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES			
Non-interest bearing	\$9,347,381	\$7,217,122	\$6,823,692
Interest-bearing	21,969,343	15,335,554	12,931,593
Total Deposits	\$31,316,724	\$22,552,676	\$19,755,285
Other Liabilities	172,717	129,844	104,703
Total Liabilities	\$31,489,441	\$22,682,520	\$19,859,988
STOCKHOLDERS EQUITY			
Common stock, \$5 par value authorized 5,000,000 shares; issued and outstanding 1,023,894 shares	\$5,119,470	\$5,000,000	\$5,000,000
Surplus	5,348,612	5,153,695	5,078,062
Accumulated deficit	(2,388,621)	(1,660,939)	(1,331,908)
Accumulated other comprehensive loss	(9,465)	550	(5,354)
Total Stockholders' Equity	\$8,069,996	\$8,493,306	\$8,740,800
Total Liabilities and Stockholders' Equity	\$39,559,437	\$31,175,826	\$28,600,788