



Highlands State Bank[®]

To our shareholders:

Highlands State Bank experienced strong growth in 2007. Assets grew 38% to \$42.9 million on December 31, 2007 compared to \$31.2 million on last day of 2006. Net loans outstanding grew even more significantly. Current year-end net loans totaled \$31 million increasing \$23.2 million or 297% compared to December 31, 2006. Deposits increased by \$10.6 million during the year from \$22.6 million at year-end 2006 to \$33.2 million at the end of 2007. Non-interest bearing deposits continue to constitute a large part of the Bank's deposits equaling 20% of the total as of the current year-end. A copy of the comparative balance sheets of your Bank as of December 31, 2006 and 2007 is printed on the reverse side of this letter.

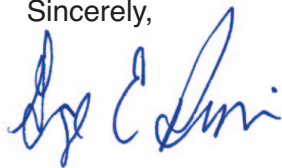
2007 was a challenging year in many ways. The economy faced and continues to deal with a multitude of difficult issues not the least of which is the sub-prime mortgage situation. **Your bank is fortunate to not hold any sub-prime mortgages nor do we hold any securities that are backed or secured by sub-prime loans.** We are entering 2008 with high expectations despite a tough economic environment. Interest rates are dropping but the quantity and quality of potential loans is falling as well. We will continue to seek high quality and profitable loans for your bank.

A benefit of the lower interest rates is that it offers borrowers an opportunity to refinance existing mortgage debt. If you are looking to refinance, please remember that we want your business. Our mortgage officer, Christina Barger will be happy to discuss your financing options with you. You can reach her at (973) 764-3200 (X 118), on her cell phone at (973) 600-8079, or via email at cbarger@highlandsstatebank.com. Highlands State Bank is a member of the Federal Deposit Insurance Corporation and is an Equal Housing Lender.

Finally, there is a company by the name of Howe Barnes Hoefler & Arnett that makes a market in the common stock of your bank. While the stock is infrequently traded, if you are interested in purchasing, selling or have questions about Highlands State Bank common stock you can reach this company at 1-888-239-4463 and ask for Kevin Mirise. The symbol assigned to our common stock on the over-the-counter bulletin board (OTCBB) is "HSBK".

A notice of the annual meeting, the annual report for 2007 and a proxy statement will be mailed to you in March. The annual meeting is scheduled for April 17, 2008. We want to hear from you if you have any questions about your investment in Highlands State Bank or if we can assist you in any way.

Sincerely,



George E. Irwin
President & CEO

HIGHLANDS STATE BANK BALANCE SHEET

(in dollars)

	December 31 2007 (unaudited)	December 31 2006 (audited)
ASSETS		
Cash and due from banks	\$1,161,075	\$568,607
Interest bearing deposits in other banks	0	199,000
Time deposits in other banks	2,481,000	2,676,000
Securities available for sale	7,364,599	9,324,030
Federal funds sold	0	9,944,000
Loans	\$31,327,766	\$7,847,281
less: Allowance for loan loss	(304,144)	(78,513)
Net loans	\$31,023,622	\$7,768,768
Bank premises and equipment, net	468,443	466,721
Other assets	375,379	228,700
Total Assets	\$42,874,118	\$31,175,826
 LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	\$6,697,367	\$7,217,122
Interest-bearing	26,518,749	15,335,554
Total Deposits	\$33,216,116	\$22,552,676
Federal funds purchased	\$759,000	0
Other liabilities	197,426	129,844
Total Liabilities	\$34,172,542	\$22,682,520
 STOCKHOLDERS' EQUITY		
Common stock, \$5 par value authorized 5,000,000 shares; issued and outstanding 1,095,159 shares	\$5,475,795	\$5,000,000
Surplus	5,730,086	5,153,695
Accumulated deficit	(2,566,089)	(1,660,939)
Accumulated other comprehensive gain	61,784	550
Total Stockholders' Equity	\$8,701,576	\$8,493,306
Total Liabilities and Stockholders' Equity	\$42,874,118	\$31,175,826