

**FORM 10-Q**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

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: 000-24523

**CNB Corporation**

(Exact name of registrant as specified in its charter)

South Carolina

(State or other jurisdiction of incorporation or organization)

57-0792402

(I.R.S. Employer Identification No.)

P.O. Box 320, Conway, South Carolina

(Address of principal executive offices)

29528

(Zip Code)

(Registrant's telephone number, including area code): (843) 248-5721

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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No.

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practical date: 785,129 shares of common stock, par value \$10 per share, November 1, 2006.

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## **Forward-Looking Statements**

Statements included in this report which are not historical in nature are intended to be, and are hereby identified as "forward-looking statements" for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts. Such forward-looking statements may be identified, without limitation, by the use of the words "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," and similar expressions. The Company's expectations, beliefs, estimates and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties, but there can be no assurance that management's expectations, beliefs, estimates or projections will result or be achieved or accomplished.

The Company cautions readers that forward-looking statements, including without limitation, those relating to the Company's recent and continuing expansion, its future business prospects, revenues, working capital, liquidity, capital needs, interest costs, income, and adequacy of the allowance for loan losses, are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Company's reports filed with the Securities and Exchange Commission.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## PART I.

### Item 1. Financial Statements

**CNB Corporation and Subsidiary**  
**Consolidated Balance Sheets**  
 (All Dollar Amounts, Except Per Share Data, in Thousands)

| ASSETS:   | September 30,<br>2006<br><u>(Unaudited)</u> | December 31,<br>2005<br><u>                    </u> | September 30,<br>2005<br><u>(Unaudited)</u> |
|---|---|---|---|
| Cash and due from banks   | \$ 32,456                                   | \$ 33,461   | \$ 34,823                                   |
| Investment Securities<br>(Fair values of \$4,395 at September 30, 2006, \$4,218 at December 31, 2005, and \$4,260 at September 30, 2005)                  | 4,315                                       | 4,120   | 4,120                                       |
| Securities Available for Sale<br>(Amortized cost of \$172,476 at September 30, 2006, \$179,380 at December 31, 2005, and \$186,519 at September 30, 2005) | 169,816                                     | 176,363   | 184,880                                     |
| Federal Funds sold and securities purchased under agreement to resell   | 44,000                                      | 46,000  | 35,000                                      |
| Other Investments   | 2,376                                       | 1,459   | 1,459                                       |
| Loans:  |   |   |   |
| Total loans   | 567,088                                     | 503,926   | 479,225                                     |
| Less allowance for possible loan losses   | <u>(6,491)</u>                              | <u>(5,918)</u>                                      | <u>(5,790)</u>                              |
| Net loans   | 560,597                                     | 498,008   | 473,435                                     |
| Bank premises and equipment   | 21,329                                      | 20,574  | 18,892                                      |
| Other assets  | <u>13,582</u>                               | <u>13,364</u>                                       | <u>11,962</u>                               |
| <b>Total assets</b>   | <b><u>\$848,471</u></b>                     | <b><u>\$793,349</u></b>                             | <b><u>\$764,571</u></b>                     |
| <br><b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>  |   |   |   |
| Deposits:   |   |   |   |
| Non-interest bearing  | \$ 144,491                                  | \$ 135,082  | \$ 143,381                                  |
| Interest-bearing  | <u>535,891</u>                              | <u>532,023</u>                                      | <u>505,523</u>                              |
| Total deposits  | <u>680,382</u>                              | <u>667,105</u>                                      | <u>648,904</u>                              |
| Federal funds purchased and securities sold under agreement to repurchase   | 65,547                                      | 43,296  | 33,914                                      |
| Other short-term borrowings   | 18,436                                      | 2,197   | 3,248                                       |
| Other liabilities   | <u>6,284</u>                                | <u>10,192</u>                                       | <u>5,234</u>                                |
| <b>Total liabilities</b>  | <b><u>770,649</u></b>                       | <b><u>722,790</u></b>                               | <b><u>691,300</u></b>                       |
| Stockholders' equity:   |   |   |   |
| Common stock, par value \$10 per share:<br>Authorized 1,500,000 in 2006 and 2005; issued 789,774 in 2006 and 2005   | 7,898                                       | 7,898   | 7,898                                       |
| Surplus   | 43,547                                      | 43,547  | 43,543                                      |
| Undivided Profits   | 28,669                                      | 21,094  | 22,993                                      |
| Net Unrealized Holding (Losses)<br>On Available-For-Sale Securities   | (1,596)                                     | (1,810)   | (983)                                       |
| Less: Treasury stock  | <u>(696)</u>                                | <u>(170)</u>  | <u>(180)</u>                                |
| Total stockholders' equity  | <u>77,822</u>                               | <u>70,559</u>                                       | <u>73,271</u>                               |
| <b>Total liabilities and stockholders' equity</b>   | <b><u>\$848,471</u></b>                     | <b><u>\$793,349</u></b>                             | <b><u>\$764,571</u></b>                     |

**CNB Corporation and Subsidiary**  
**Consolidated Statement of Income**  
(All Dollar Amounts, Except Per Share Data, in Thousands)  
(Unaudited)

|  | <u>Three Months Ended</u> |                 | <u>Nine Months Ended</u> |                 |
|--|---------------------------|-----------------|--------------------------|-----------------|
|  | September 30,             |                 | September 30,            |                 |
|  | <u>2006</u>               | <u>2005</u>     | <u>2006</u>              | <u>2005</u>     |
| <b>Interest Income:</b>  |                           |                 |                          |                 |
| Interest and fees on loans   | \$ 10,758                 | \$ 8,127        | \$30,160                 | \$22,279        |
| <b>Interest on investment securities:</b>  |                           |                 |                          |                 |
| Taxable investment securities  | 1,488                     | 1,619           | 4,438                    | 4,951           |
| Tax-exempt investment securities   | 206                       | 220             | 609                      | 676             |
| <b>Interest on federal funds sold and securities purchased under agreement to resell</b>     | <u>286</u>                | <u>276</u>      | <u>789</u>               | <u>523</u>      |
| <b>Total interest income</b>   | <u>12,738</u>             | <u>10,242</u>   | <u>35,996</u>            | <u>28,429</u>   |
| <b>Interest Expense:</b>   |                           |                 |                          |                 |
| Interest on deposits   | 4,239                     | 2,713           | 11,613                   | 6,801           |
| <b>Interest on federal funds purchased and securities sold under agreement to repurchase</b> | 314                       | 166             | 835                      | 445             |
| <b>Interest on other short-term borrowings</b>   | <u>373</u>                | <u>9</u>        | <u>468</u>               | <u>20</u>       |
| <b>Total interest expense</b>  | <u>4,926</u>              | <u>2,888</u>    | <u>12,916</u>            | <u>7,266</u>    |
| <b>Net interest income</b>   | <u>7,812</u>              | <u>7,354</u>    | <u>23,080</u>            | <u>21,163</u>   |
| <b>Provision for loan losses</b>   | <u>238</u>                | <u>265</u>      | <u>888</u>               | <u>800</u>      |
| <b>Net interest income after provision for loan losses</b>                                   | <u>7,574</u>              | <u>7,089</u>    | <u>22,192</u>            | <u>20,363</u>   |
| <b>Other income:</b>   |                           |                 |                          |                 |
| Service charges on deposit accounts  | 813                       | 838             | 2,466                    | 2,538           |
| Gains/(Losses) on sale of securities available-for-sale                                      | 0                         | 0               | (6)                      | 2               |
| <b>Other operating income</b>  | <u>1,222</u>              | <u>960</u>      | <u>2,748</u>             | <u>2,385</u>    |
| <b>Total other income</b>  | <u>2,035</u>              | <u>1,798</u>    | <u>5,208</u>             | <u>4,925</u>    |
| <b>Other expenses:</b>   |                           |                 |                          |                 |
| Salaries and employee benefits   | 3,244                     | 3,050           | 10,032                   | 9,079           |
| Occupancy expense  | 817                       | 668             | 2,428                    | 2,004           |
| <b>Other operating expenses</b>  | <u>1,192</u>              | <u>1,134</u>    | <u>3,705</u>             | <u>3,171</u>    |
| <b>Total operating expenses</b>  | <u>5,253</u>              | <u>4,852</u>    | <u>16,165</u>            | <u>14,254</u>   |
| <b>Income before income taxes</b>  | <u>4,356</u>              | <u>4,035</u>    | <u>11,235</u>            | <u>11,034</u>   |
| <b>Income tax provision</b>  | <u>1,319</u>              | <u>1,305</u>    | <u>3,660</u>             | <u>3,599</u>    |
| <b>Net income</b>  | <u>3,037</u>              | <u>2,730</u>    | <u>7,575</u>             | <u>7,435</u>    |
| <br>   |                           |                 |                          |                 |
| <b>Net income per weighted average shares outstanding</b>                                    | <u>\$ 3.86</u>            | <u>\$ 3.46</u>  | <u>\$ 9.62</u>           | <u>\$ 9.43</u>  |
| <br>   |                           |                 |                          |                 |
| <b>Cash dividend paid per share</b>  | <u>\$ 0</u>               | <u>\$ 0</u>     | <u>\$ 0</u>              | <u>\$ 0</u>     |
| <br>   |                           |                 |                          |                 |
| <b>Book value per actual number of shares outstanding</b>                                    | <u>\$ 99.11</u>           | <u>\$ 92.94</u> | <u>\$ 99.11</u>          | <u>\$ 92.94</u> |
| <br>   |                           |                 |                          |                 |
| <b>Weighted average number of shares outstanding</b>   | <u>787,507</u>            | <u>788,497</u>  | <u>787,507</u>           | <u>788,497</u>  |
| <br>   |                           |                 |                          |                 |
| <b>Actual number of shares outstanding</b>   | <u>785,169</u>            | <u>788,411</u>  | <u>785,169</u>           | <u>788,411</u>  |

**CNB Corporation and Subsidiary**  
**Consolidated Statements of Comprehensive Income**  
**(All Dollar Amounts, Except Per Share Data, in Thousands)**  
**(Unaudited)**

|  | <b>Three Months Ended<br/>September 30,</b> |                 | <b>Nine Months Ended<br/>September 30,</b> |                 |
|--|---|-----------------|--|-----------------|
|  | <b>2006</b>                                 | <b>2005</b>     | <b>2006</b>                                | <b>2005</b>     |
| <b>Net Income</b>                                      | \$ 3,037                                    | \$ 2,730        | \$ 7,575                                   | \$ 7,435        |
| <b>Other comprehensive income, net of tax</b>          |   |                 |  |                 |
| <b>Unrealized gains/(losses) on securities:</b>        |   |                 |  |                 |
| <b>Unrealized holding gains/(losses) during period</b> | 686   | (305)           | 214  | (1,717)         |
| <b>Net Comprehensive Income/(Loss)</b>                 | <b>\$ 3,723</b>                             | <b>\$ 2,425</b> | <b>\$ 7,789</b>                            | <b>\$ 5,718</b> |

**CNB Corporation and Subsidiary**  
**Consolidated Statement of Changes in Stockholders' Equity**  
**(All Dollar Amounts in Thousands)**  
**(Unaudited)**

|   | <b>Nine Months Ended</b>    |                        |
|---|-----------------------------|------------------------|
|   | <b><u>September 30,</u></b> |                        |
|   | <b><u>2006</u></b>          | <b><u>2005</u></b>     |
| <b>Common Stock:</b>                            |                             |                        |
| (\$10 par value; 1,500,000 shares authorized)   |                             |                        |
| Balance, January 1                              | \$ 7,898                    | \$ 7,898               |
| Issuance of Common Stock                        | None                        | None                   |
| Stock Dividend                                  | <u>None</u>                 | <u>None</u>            |
| Balance at end of period                        | <u>7,898</u>                | <u>7,898</u>           |
| <b>Surplus:</b>                                 |                             |                        |
| Balance, January 1                              | 43,547                      | 43,543                 |
| Issuance of Common Stock                        | None                        | None                   |
| Stock Dividend                                  | None                        | None                   |
| Gain on sale of Treasury stock                  | <u>None</u>                 | <u>None</u>            |
| Balance at end of period                        | <u>43,547</u>               | <u>43,543</u>          |
| <b>Undivided profits:</b>                       |                             |                        |
| Balance, January 1                              | 21,093                      | 15,559                 |
| Net Income                                      | 7,575                       | 7,435                  |
| Stock Dividend                                  | None                        | None                   |
| Cash dividends declared                         | <u>None</u>                 | <u>None</u>            |
| Balance at end of period                        | <u>28,669</u>               | <u>22,993</u>          |
| <b>Net unrealized holding gains/(losses) on</b> |                             |                        |
| <b>Available-for-sale securities:</b>           |                             |                        |
| Balance, January 1                              | (1,810)                     | 734                    |
| Change in net unrealized gains/(losses)         | <u>214</u>                  | <u>(1,717)</u>         |
| Balance at end of period                        | <u>(1,596)</u>              | <u>(983)</u>           |
| <b>Treasury stock:</b>                          |                             |                        |
| Balance, January 1                              | (170)                       | (148)                  |
| (1,240 shares in 2006; 1,129 shares in 2005)    |                             |                        |
| Purchase of treasury stock                      | (526)                       | (32)                   |
| Reissue of treasury stock                       | <u>None</u>                 | <u>None</u>            |
| Balance at end of period                        | <u>(696)</u>                | <u>(180)</u>           |
| (4,605 shares in 2006; 1,363 shares in 2005)    |                             |                        |
| <b>Total stockholders' equity</b>               | <b><u>\$77,822</u></b>      | <b><u>\$73,271</u></b> |

**Note:** Columns may not add due to rounding.

**CNB CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(All Dollar Amounts in Thousands)  
(Unaudited)

|  | <u>For the Nine months ended</u><br><u>September 30,</u> |                 |
|--|--|-----------------|
|  | <u>2006</u>  | <u>2005</u>     |
| <b>OPERATING ACTIVITIES</b>  |  |                 |
| Net Income   | \$ 7,575   | \$ 7,435        |
| Adjustments to reconcile net income to net cash provided by operating activities |  |                 |
| Depreciation and amortization  | 907  | 747             |
| Provision for loan losses  | 888  | 800             |
| Provision for deferred income taxes  | 14   | (1,747)         |
| (Gain)/Loss on sale of investment securities                                     | 6  | (2)             |
| (Increase) in accrued interest receivable  | (802)  | (347)           |
| (Increase)/decrease in other assets  | (318)  | 429             |
| Increase/(decrease) in other liabilities   | <u>(956)</u>   | <u>2,810</u>    |
| Net cash provided by operating activities  | <u>7,314</u>   | <u>10,125</u>   |
| <b>INVESTING ACTIVITIES</b>  |  |                 |
| Proceeds from sale of investment securities available for sale                   | 0  | 4,002           |
| Proceeds from pay downs of mortgage-backed securities available for sale         | 299  | 0               |
| Proceeds from maturities/calls of investment securities held to maturity         | 935  | 399             |
| Proceeds from maturities/calls of investment securities available for sale       | 23,310   | 19,252          |
| Purchase of investment securities available for sale                             | (16,745)   | (1,000)         |
| Purchase of investment securities held to maturity                               | (1,128)  | 0               |
| Net (increase)/decrease in federal funds sold                                    | 2,000  | (35,000)        |
| Net (increase) in loans  | (63,152)   | (72,242)        |
| Premises and equipment expenditures  | <u>(1,662)</u>   | <u>(2,011)</u>  |
| Net cash used for investing activities   | <u>(56,143)</u>  | <u>(86,600)</u> |
| <b>FINANCING ACTIVITIES</b>  |  |                 |
| Dividends paid   | (3,943)  | (3,352)         |
| Net increase in deposits   | 13,277   | 88,540          |
| Net increase/(decrease) in securities sold under repurchase agreement            | 22,251   | (36)            |
| Net increase in other short-term borrowings                                      | <u>16,239</u>  | <u>353</u>      |
| Net cash provided by financing activities  | <u>47,824</u>  | <u>85,505</u>   |
| Net increase/(decrease) in cash and due from banks                               | (1,005)  | 9,030           |
| <b>CASH AND DUE FROM BANKS, BEGINNING OF YEAR</b>                                | <u>33,461</u>  | <u>25,793</u>   |
| <b>CASH AND DUE FROM BANKS, September 30, 2006 AND 2005</b>                      | <u>\$32,456</u>  | <u>\$34,823</u> |
| <b>CASH PAID FOR:</b>  |  |                 |
| Interest   | <u>\$12,168</u>  | <u>\$ 6,695</u> |
| Income taxes   | <u>\$ 3,773</u>  | <u>\$ 3,026</u> |

**CNB CORPORATION AND SUBSIDIARY (The "Company")**

**CNB CORPORATION (The "Parent")**

**THE CONWAY NATIONAL BANK (The "Bank")**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(All Dollar Amounts in Thousands)**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Net income per share - Net income per share is computed on the basis of the weighted average number of common shares outstanding, which was 787,507 shares for the nine-month period ended September 30, 2006 and 788,497 shares for the nine-month period ended September 30, 2005.

Recently Issued Accounting Pronouncements - The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." This Statement amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not believe that the adoption of SFAS No. 155 will have a material impact on its financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140." This Statement amends FASB No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose its subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. An entity should adopt SFAS No. 156 as of the beginning of its first fiscal year that begins after September 15, 2006. The Company does not believe the adoption of SFAS No. 156 will have a material impact on its financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the effects of FIN 48.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” (“SFAS 158”), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date — the date at which the benefit obligation and plan assets are measured — is required to be the company’s fiscal year end. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company is currently analyzing the anticipated effects of SFAS 158 but does not expect its implementation will have a significant impact on the Company’s financial conditions or results of operations.

In September, 2006, The FASB ratified the consensus reached by the FASB’s Emerging Issues Task Force (EITF) relating to EITF 06-4 “Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements”. EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with FASB Statement of Financial Accounting Standards (SFAS) No. 106, “*Employers’ Accounting for Postretirement Benefits Other Than Pensions*”, or Accounting Principles Board (APB) Opinion No. 12, “*Omnibus Opinion—1967*”. EITF 06-4 is effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial position, results of operations and cash flows.

On September 13, 2006, the SEC issued Staff Accounting Bulletin No. 108 (“SAB 108”). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies could evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company’s balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that upon adoption it will have no impact on the reported results of operations or financial conditions.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company’s financial position, results of operations and cash flows.

## **NOTE 2 - RESTRICTIONS ON CASH AND DUE FROM BANKS**

The Bank is required to maintain average reserve balances either at the Bank or on deposit with the Federal Reserve Bank. The average amounts of these reserve balances for the nine-month period ended September 30, 2006 and for the year ended December 31, 2005 were approximately \$19,324 and \$17,493, respectively.

**NOTE 3 - INVESTMENT SECURITIES**

Investment securities with a par value of approximately \$137,103 at September 30, 2006 and \$122,980 at December 31, 2005 were pledged to secure public deposits and for other purposes required by law.

The following summaries reflect the book value, unrealized gains and losses, approximate market value, and tax-equivalent yields of investment securities at September 30, 2006 and at December 31, 2005.

|                                     | <b>September 30, 2006</b>     |                                |                              |                          |                        |
|-------------------------------------|-------------------------------|--------------------------------|------------------------------|--------------------------|------------------------|
|                                     | <b>(Dollars in Thousands)</b> |                                |                              |                          |                        |
|                                     | <b><u>Book Value</u></b>      | <b><u>Unrealized Gains</u></b> | <b><u>Holding Losses</u></b> | <b><u>Fair Value</u></b> | <b><u>Yield(1)</u></b> |
| <b>AVAILABLE FOR SALE</b>           |                               |                                |                              |                          |                        |
| Federal agencies                    |                               |                                |                              |                          |                        |
| Within one year                     | \$ 55,009                     | \$ 2                           | \$ 589                       | \$ 54,422                | 3.464%                 |
| One to five years                   | <u>101,998</u>                | <u>2</u>                       | <u>2,283</u>                 | <u>99,717</u>            | 3.732                  |
|                                     | <u>157,007</u>                | <u>4</u>                       | <u>2,872</u>                 | <u>154,139</u>           | 3.638                  |
| Mortgage Backed Securities          |                               |                                |                              |                          |                        |
| Six to ten years                    | 469                           | 8                              | 0                            | 477                      | 5.908                  |
| Over ten years                      | <u>396</u>                    | <u>0</u>                       | <u>31</u>                    | <u>365</u>               | 3.625                  |
|                                     | <u>865</u>                    | <u>8</u>                       | <u>31</u>                    | <u>842</u>               | 4.864                  |
| State, county and municipal         |                               |                                |                              |                          |                        |
| Within one year                     | 4,912                         | 4                              | 3                            | 4,913                    | 5.440                  |
| One to five years                   | 7,933                         | 197                            | 2                            | 8,128                    | 6.966                  |
| Six to ten years                    | <u>1,411</u>                  | <u>35</u>                      | <u>0</u>                     | <u>1,446</u>             | 6.182                  |
|                                     | <u>14,256</u>                 | <u>236</u>                     | <u>5</u>                     | <u>14,487</u>            | 6.363                  |
| Other-CRA Qualified Investment Fund | <u>348</u>                    | <u>-</u>                       | <u>-</u>                     | <u>348</u>               | -                      |
| Total available for sale            | <u>\$172,476</u>              | <u>\$ 248</u>                  | <u>\$2,908</u>               | <u>\$169,816</u>         | 3.870                  |
| <b>HELD TO MATURITY</b>             |                               |                                |                              |                          |                        |
| State, county and municipal         |                               |                                |                              |                          |                        |
| Within one year                     | \$ 1,345                      | \$ 11                          | \$ 0                         | \$ 1,356                 | 7.384                  |
| One to five years                   | 1,841                         | 44                             | 0                            | 1,885                    | 7.063                  |
| Over ten years                      | <u>1,129</u>                  | <u>25</u>                      | <u>0</u>                     | <u>1,154</u>             | 5.977                  |
|                                     | <u>4,315</u>                  | <u>80</u>                      | <u>0</u>                     | <u>4,395</u>             | 6.879                  |
| Total held to maturity              | <u>\$ 4,315</u>               | <u>\$ 80</u>                   | <u>\$ 0</u>                  | <u>\$ 4,395</u>          | 6.879%                 |

(1) Tax equivalent adjustment based on a 34% tax rate

As of September 30, 2006, the Bank did not hold any securities of an issuer that exceeded 10% of stockholders' equity. The net unrealized holding gains/(losses) on available-for-sale securities component of capital was \$(1,596) as of September 30, 2006.

**NOTE 3 - INVESTMENT SECURITIES (Continued)**

|                                     | <b>December 31, 2005</b>      |                                  |                      |                     |                        |
|-------------------------------------|-------------------------------|----------------------------------|----------------------|---------------------|------------------------|
|                                     | <b>(Dollars in Thousands)</b> |                                  |                      |                     |                        |
|                                     | <b><u>Book</u></b>            | <b><u>Unrealized Holding</u></b> |                      | <b><u>Fair</u></b>  | <b><u>Yield(1)</u></b> |
|                                     | <b><u>Value</u></b>           | <b><u>Gains</u></b>              | <b><u>Losses</u></b> | <b><u>Value</u></b> |                        |
| <b>AVAILABLE FOR SALE</b>           |                               |                                  |                      |                     |                        |
| Federal agencies                    |                               |                                  |                      |                     |                        |
| Within one year                     | \$ 29,047                     | \$ 53                            | \$ 153               | \$ 28,947           | 4.08%                  |
| One to five years                   | <u>132,739</u>                | <u>10</u>                        | <u>3,209</u>         | <u>129,540</u>      | 3.41                   |
|                                     | <u>161,786</u>                | <u>63</u>                        | <u>3,362</u>         | <u>158,487</u>      | 3.53                   |
| Mortgage Backed Securities          |                               |                                  |                      |                     |                        |
| Over ten years                      | <u>684</u>                    | <u>-</u>                         | <u>45</u>            | <u>639</u>          | 3.62                   |
| State, county and municipal         |                               |                                  |                      |                     |                        |
| Within one year                     | 2,689                         | 7                                | 1                    | 2,695               | 5.72                   |
| One to five years                   | 10,454                        | 192                              | -                    | 10,646              | 6.10                   |
| Six to ten years                    | <u>3,438</u>                  | <u>131</u>                       | <u>2</u>             | <u>3,567</u>        | 6.86                   |
|                                     | <u>16,581</u>                 | <u>330</u>                       | <u>3</u>             | <u>16,908</u>       | 6.20                   |
| Other-CRA Qualified Investment Fund | <u>329</u>                    | <u>-</u>                         | <u>-</u>             | <u>329</u>          | -                      |
| Total available for sale            | <u>\$179,380</u>              | <u>\$ 393</u>                    | <u>\$ 3,410</u>      | <u>\$176,363</u>    | 3.78%                  |
| <b>HELD TO MATURITY</b>             |                               |                                  |                      |                     |                        |
| State, county and municipal         |                               |                                  |                      |                     |                        |
| Within one year                     | \$ 935                        | \$ 5                             | \$ -                 | \$ 940              | 7.55%                  |
| One to five years                   | <u>3,185</u>                  | <u>93</u>                        | <u>-</u>             | <u>3,278</u>        | 7.20                   |
|                                     | <u>4,120</u>                  | <u>98</u>                        | <u>-</u>             | <u>4,218</u>        | 7.28                   |
| Total held to maturity              | <u>\$ 4,120</u>               | <u>\$ 98</u>                     | <u>\$ -</u>          | <u>\$ 4,218</u>     | 7.28%                  |

(1) Tax equivalent adjustment based on a 34% tax rate

As of December 31, 2005, the Bank did not hold any securities of an issuer that exceeded 10% of stockholders' equity. The net unrealized holding gains/(losses) on available-for-sale securities component of capital was \$(1,810) as of December 31, 2005.

**NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES**

The following is a summary of loans at September 30, 2006 and December 31, 2005 by major classification:

|   | <b>September 30,</b><br><b><u>2006</u></b> | <b>December 31,</b><br><b><u>2005</u></b> |
|---|--|---|
| <b>Real estate loans - mortgage</b>   | \$ 361,122                                 | \$ 324,475                                |
| <b>- construction</b>   | 73,764                                     | 50,210                                    |
| <b>Commercial and industrial loans</b>  | 84,795                                     | 84,474                                    |
| <b>Loans to individuals for household,<br/>family and other consumer expenditures</b> | 44,215                                     | 41,400                                    |
| <b>Agricultural</b>   | 2,764                                      | 1,912                                     |
| <b>All other loans, including overdrafts</b>  | <u>428</u>                                 | <u>1,455</u>                              |
| <b>Gross loans</b>  | <u>\$ 567,088</u>                          | <u>503,926</u>                            |
| <b>Less allowance for loan losses</b>   | <u>(6,491)</u>                             | <u>(5,918)</u>                            |
| <b>Net loans</b>  | <u>\$ 560,597</u>                          | <u>\$ 498,008</u>                         |

**NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES, continued**

Changes in the allowance for loan losses for the quarters ended and nine-month periods ended September 30, 2006 and 2005, and the year ended December 31, 2005 are summarized as follows:

|  | <b>Quarter Ended</b> |                 | <b>Nine-Months Ended</b> |                 |                     |
|--|----------------------|-----------------|--------------------------|-----------------|---------------------|
|  | <b>September 30,</b> |                 | <b>September 30,</b>     |                 | <b>December 31,</b> |
|  | <b>2006</b>          | <b>2005</b>     | <b>2006</b>              | <b>2005</b>     | <b>2005</b>         |
| <b>Balance, beginning of period</b>  | \$ 6,394             | \$ 5,602        | \$ 5,918                 | \$ 5,104        | \$ 5,104            |
| <b>Charge-offs:</b>  |                      |                 |                          |                 |                     |
| Commercial, financial, and agricultural  | 68                   | 25              | 153                      | 112             | 324                 |
| Real Estate - construction and mortgage  | 38                   | 0               | 44                       | 3               | 52                  |
| Loans to individuals   | <u>162</u>           | <u>111</u>      | <u>493</u>               | <u>277</u>      | <u>445</u>          |
| Total charge-offs  | <u>\$ 268</u>        | <u>\$ 136</u>   | <u>\$ 690</u>            | <u>\$ 392</u>   | <u>\$ 821</u>       |
| <b>Recoveries:</b>   |                      |                 |                          |                 |                     |
| Commercial, financial, and agricultural  | \$ 20                | \$ 32           | \$ 175                   | \$ 71           | \$ 76               |
| Real Estate - construction and mortgage  | 0                    | 0               | 3                        | 83              | 85                  |
| Loans to individuals   | <u>107</u>           | <u>27</u>       | <u>197</u>               | <u>124</u>      | <u>199</u>          |
| Total recoveries   | <u>\$ 127</u>        | <u>\$ 59</u>    | <u>\$ 375</u>            | <u>\$ 278</u>   | <u>\$ 360</u>       |
| <b>Net charge-offs</b>   | <u>\$ 141</u>        | <u>\$ 77</u>    | <u>\$ 315</u>            | <u>\$ 114</u>   | <u>\$ 461</u>       |
| <b>Additions charged to operations</b>   | <u>\$ 238</u>        | <u>\$ 265</u>   | <u>\$ 888</u>            | <u>\$ 800</u>   | <u>\$ 1,275</u>     |
| <b>Balance, end of period</b>  | <u>\$ 6,491</u>      | <u>\$ 5,790</u> | <u>\$ 6,491</u>          | <u>\$ 5,790</u> | <u>\$ 5,918</u>     |
| Ratio of net charge-offs during the period<br>to average loans outstanding during the period | <u>.03%</u>          | <u>.02%</u>     | <u>.06%</u>              | <u>.03%</u>     | <u>.10%</u>         |

The entire balance of the allowance for loan losses is available to absorb future loan losses.

At September 30, 2006 and September 30 and December 31, 2005 loans on which no interest was being accrued totaled approximately \$763, \$339, and \$405, respectively. The Company had \$29 of foreclosed real estate at September 30, 2006, \$14 of foreclosed real estate at September 30, 2005, and no foreclosed real estate at December 31, 2005. Loans 90 days past due and still accruing interest totaled \$154, \$402, and \$277 at September 30, 2006 and September 30 and December 31, 2005, respectively.

At September 30, 2006 classified assets, the majority consisting of classified loans, were \$13,766, \$9,325 and \$8,567 at September 30, 2005 and December 31, 2005, respectively. At September 30, 2006, classified assets represented 16.93% of total capital (the sum of Tier 1 Capital and the Allowance for Loan Losses), 12.44% and 11.79% at September 30 and December 31, 2005, respectively.

## **NOTE 5 - PREMISES AND EQUIPMENT**

Property at September 30, 2006 and December 31, 2005 is summarized as follows:

|   | <b><u>September 30,</u></b><br><b><u>2006</u></b> | <b><u>December 31,</u></b><br><b><u>2005</u></b> |
|---|---|--|
| <b>Land and buildings</b>                             | \$ 22,455   | \$ 22,512  |
| <b>Furniture, fixtures and equipment</b>              | 7,057   | 6,642  |
| <b>Construction in progress</b>                       | <u>1,535</u>                                      | <u>234</u>                                       |
|   | \$ 31,046   | \$ 29,388  |
| <br>  |   |  |
| <b>Less accumulated depreciation and amortization</b> | <u>9,717</u>                                      | <u>8,814</u>                                     |
|   | <u>\$ 21,329</u>                                  | <u>\$ 20,574</u>                                 |

Depreciation and amortization of bank premises and equipment charged to operating expense was \$907 for the nine-month period ended September 30, 2006, and \$983 for the year ended December 31, 2005. The construction in process is primarily related to ongoing renovations to the Company's Main Office in Conway, South Carolina. Land, construction and equipment costs are estimated at \$1,000.

## **NOTE 6 - CERTIFICATES OF DEPOSIT IN EXCESS OF \$100,000**

At September 30, 2006 and December 31, 2005, certificates of deposit of \$100,000 or more included in time deposits totaled approximately \$152,618 and \$149,634, respectively. Interest expense on these deposits was approximately \$4,828 for the nine-month period ended September 30, 2006 and \$3,649 for the year ended December 31, 2005.

## **NOTE 7 - SECURITIES SOLD UNDER REPURCHASE AGREEMENTS**

At September 30, 2006 and December 31, 2005, securities sold under repurchase agreements totaled \$65,547 and \$43,296, respectively. Securities with a book value of \$82,680 (\$80,831 market value) and \$44,055 (\$43,383 market value), respectively, were used as collateral for the agreements. The weighted-average interest rate of these agreements was 3.26 percent and 1.96 percent at September 30, 2006 and December 31, 2005, respectively.

## **NOTE 8 - LINES OF CREDIT**

At September 30, 2006, the Bank had unused short-term lines of credit to purchase Federal Funds from unrelated banks totaling \$37,000. These lines of credit are available on a one to seven day basis for general corporate purposes of the Bank. All of the lenders have reserved the right to withdraw these lines at their option.

The Bank has a demand note through the U.S. Treasury, Tax and Loan system with the Federal Reserve Bank of Richmond. The Bank may borrow up to \$7,000 under the arrangement at a variable interest rate. The note is secured by bonds with a market value of \$3,949 at September 30, 2006. The amount outstanding under the note totaled \$3,436 and \$2,197 at September 30, 2006 and December 31, 2005, respectively.

The Bank also has a line of credit from the Federal Home Loan Bank of Atlanta for \$116,125 secured by a lien on the Bank's 1-4 family mortgages. Allowable terms range from overnight to twenty years at varying rates set daily by the FHLB. There was \$15,000 outstanding under the agreement at September 30, 2006 and no amount outstanding as of December 31, 2005.

## **NOTE 9 - INCOME TAXES**

Income tax expense for the quarters ended September 30, 2006 and September 30, 2005 on pretax income of \$4,356 and \$4,035 totaled \$1,319 and \$1,305, respectively. The provision for federal income taxes is calculated by applying the 34% statutory federal income tax rate and increasing or reducing this amount due to any tax-exempt interest, state bank tax (net of federal benefit), business credits, surtax exemption, tax preferences, alternative minimum tax calculations, or other factors. A summary of income tax components and a reconciliation of income taxes to the federal statutory rate are included in fiscal year-end reports.

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes".

## **NOTE 10 - COMMITMENTS AND CONTINGENT LIABILITIES**

From time to time the bank subsidiary is a party to various litigation matters, both as plaintiff and as defendant, arising from its normal operations. Certain of the Company's directors and former directors are involved in litigation arising from actions taken by them in their capacity as such. If they are wholly successful on the merits, the Company may be required to indemnify their legal fees and expenses. The Interim President and CEO of the Company, who is also a director of the Company, is a plaintiff in the suit filed against these directors. No material losses are anticipated in connection with any of these matters at September 30, 2006.

In the normal course of business, the bank subsidiary is a party to financial instruments with off-balance-sheet risk including commitments to extend credit and standby letters of credit. Such instruments have elements of credit risk in excess of the amount recognized in the balance sheet. The exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. Generally, the same credit policies used for on-balance-sheet instruments, such as loans, are used in extending loan commitments and standby letters of credit.

Following are the off-balance-sheet financial instruments whose contract amounts represent credit risk:

|                                  | <b><u>September 30, 2006</u></b> |
|----------------------------------|----------------------------------|
| <b>Loan Commitments</b>          | \$ 63,503                        |
| <b>Standby letters of credit</b> | 7,784                            |

Loan commitments involve agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and some involve payment of a fee. Many of the commitments are expected to expire without being fully drawn. Therefore, the total amount of loan commitments does not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if any, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include commercial and residential real properties, accounts receivable, inventory and equipment.

Standby letters of credit are conditional commitments to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is the same as that involved in making loan commitments to customers. Many letters of credit will expire without being drawn upon and do not necessarily represent future cash requirements.

Management believes that its various sources of liquidity provide the resources necessary for the bank subsidiary to fund the loan commitments and to perform under standby letters of credit, if the need arises. Neither the Company nor the Bank are involved in other off-balance sheet contractual relationships or transactions that could result in liquidity needs, or other commitments, or that could significantly impact earnings.

## **NOTE 11 - EMPLOYEE BENEFIT PLAN**

The Bank has a defined contribution pension plan covering all employees who have attained age twenty-one and have a minimum of one year of service. Upon ongoing approval of the Board of Directors, the Bank matches one-hundred percent of employee contributions up to three percent of employee salary deferred and fifty percent of employee contributions in excess of three percent and up to five percent of salary deferred. The Board of Directors may also make discretionary contributions to the Plan. For the nine-month period ended September 30, 2006 and the year ended December 31, 2005, \$426 and \$634, respectively, was charged to operations under the plan.

## **NOTE 12 - REGULATORY MATTERS**

The Bank and the Company are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the financial statements. The regulations require the Bank and the Company to meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

**NOTE 12 - REGULATORY MATTERS - Continued**

Quantitative measures established by regulation to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the tables below) of Tier 1 capital to adjusted total assets (Leverage Capital ratio) and minimum ratios of Tier 1 and total capital to risk-weighted assets. To be considered adequately capitalized under the regulatory framework for prompt corrective action, the Company and the Bank must maintain minimum Tier 1 leverage, Tier 1 risk-based and total risk-based ratios as set forth in the tables below. The Company's and the Bank's actual capital ratios are also presented in the tables below as of September 30, 2006:

**Bank**

|  | <u>Actual</u>                           |              | <u>For Capital adequacy Purposes Minimum</u> |              | <u>To be well capitalized under prompt corrective action provisions Minimum</u> |              |
|--|---|--------------|--|--------------|---|--------------|
|  | <u>Amount</u>                           | <u>Ratio</u> | <u>Amount</u>                                | <u>Ratio</u> | <u>Amount</u>   | <u>Ratio</u> |
|  | Total Capital (to risk weighted assets) | \$82,884     | 14.44%                                       | 45,910       | 8.0%  | \$57,388     |
| Tier 1 Capital (to risk weighted assets) | 76,393                                  | 13.31        | 22,955                                       | 4.0          | 34,433  | 6.0          |
| Tier 1 Capital (to average assets)       | 76,393                                  | 9.26         | 31,550                                       | 4.0          | 39,437  | 5.0          |

**Company**

|  | <u>Actual</u>                           |              | <u>For Capital adequacy Purposes Minimum</u> |              | <u>To be well capitalized under prompt corrective action provisions Minimum</u> |              |
|--|---|--------------|--|--------------|---|--------------|
|  | <u>Amount</u>                           | <u>Ratio</u> | <u>Amount</u>                                | <u>Ratio</u> | <u>Amount</u>   | <u>Ratio</u> |
|  | Total Capital (to risk weighted assets) | \$85,909     | 14.94%                                       | 46,002       | 8.0%  | \$57,502     |
| Tier 1 Capital (to risk weighted assets) | 79,418                                  | 13.81        | 23,001                                       | 4.0          | 34,501  | 6.0          |
| Tier 1 Capital (to average assets)       | 79,418                                  | 9.63         | 32,992                                       | 4.0          | 41,240  | 5.0          |

**NOTE 13 - CONDENSED FINANCIAL INFORMATION**

Following is condensed financial information of CNB Corporation (parent company only):

| <b>CONDENSED BALANCE SHEET</b>                  |  | <b>September 30,</b> |                  |
|---|--|----------------------|------------------|
| <b>(Unaudited)</b>                              |  | <b>2006</b>          | <b>2005</b>      |
| <b>ASSETS</b>                                   |  |                      |                  |
| Cash  |  | \$ 1,880             | \$ 4,041         |
| Investment in subsidiary                        |  | 74,797               | 69,194           |
| Fixed Assets                                    |  | 1,109                | -                |
| Other assets                                    |  | <u>36</u>            | <u>36</u>        |
|   |  | <u>\$ 77,822</u>     | <u>\$ 73,271</u> |
| <br><b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |  |                      |                  |
| Other liability                                 |  | \$ 0                 | \$ 0             |
| Stockholders' equity                            |  | <u>77,822</u>        | <u>73,271</u>    |
|   |  | <u>\$ 77,822</u>     | <u>\$ 73,271</u> |

| <b>CONDENSED STATEMENT OF INCOME</b>      |  | <b>For the nine-month period ended</b> |                 |
|---|--|--|-----------------|
| <b>(Unaudited)</b>                        |  | <b>September 30,</b>                   | <b>2005</b>     |
|   |  | <b>2006</b>                            | <b>2005</b>     |
| <b>EQUITY IN NET INCOME OF SUBSIDIARY</b> |  | \$ 7,849                               | \$ 7,495        |
| <b>OTHER INCOME</b>                       |  | 1                                      | 1               |
| <b>OTHER EXPENSES</b>                     |  | <u>(275)</u>                           | <u>(61)</u>     |
| Net Income                                |  | <u>\$ 7,575</u>                        | <u>\$ 7,435</u> |

**Item 2.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(All dollar amounts in thousands, except per share data.)

Management's Discussion and Analysis is provided to afford a clearer understanding of the major elements of the Company's results of operations, financial condition, liquidity, and capital resources. The following discussion should be read in conjunction with the Company's financial statements and notes thereto and other detailed information appearing elsewhere in this report. In addition, the results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. The accompanying consolidated financial statements include all accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying unaudited consolidated financial statements at September 30, 2006 and for the three-month and nine-month periods ending September 30, 2006 and 2005 have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q for the Securities and Exchange Commission. Accordingly, they do not include all information and footnotes required by GAAP for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

## **DISTRIBUTION OF ASSETS AND LIABILITIES**

The Company has historically maintained a conservative approach in determining the distribution of assets and liabilities. However, loans increased 18.3% from \$479,225 at September 30, 2005 to \$567,088 at September 30, 2006, and increased 12.5% from \$503,926 at December 31, 2005 to \$567,088 at September 30, 2006. Loans increased as a percentage of total assets from 62.7% to 66.8% and from 63.5% to 66.8% over the same periods, respectively. The material change in loans represents a strategic move by the Board of Directors which, during the second half of 2005, increased the loan to asset target ratio to a 60% to 70% range. Loan demand in our market area has remained solid in 2005 and 2006 due, in part, to a strong real estate market. However, the demand for real estate loans has begun to level in the second half of 2006. Securities and federal funds sold have decreased as a percentage of total assets from 29.3% at September 30, 2005 to 25.7% at September 30, 2006, and from 28.5% at December 2005 to 25.7% at September 30, 2006. The decline in investments is a consequence of the increases in loans. The remaining level of investments and federal funds sold provides for a more than adequate supply of secondary liquidity. There have been no other material changes in financial position.

Management has sought to build the deposit base with stable, relatively non-interest-sensitive deposits by offering the small to medium deposit account holders a wide array of deposit instruments at competitive rates. Non-interest-bearing demand deposits decreased as a percentage of total assets from 18.8% at September 30, 2005 to 17.0% at September 30, 2006, but remained flat at 17.0% from December 31, 2005 to September 30, 2006. As more customers, both business and personal, are attracted to interest-bearing deposit accounts, we expect the percentage of non-interest bearing demand deposits to continue to decline over the long-term. Interest-bearing deposits also decreased from 66.1% of total assets at September 30, 2005 to 63.2% at September 30, 2006, and decreased from 67.1% at December 31, 2005 to 63.2% at September 30, 2006. The decline in interest bearing deposits from September 30, 2005 to September 30, 2006 and from December 31, 2005 to September 30, 2006 was due, in part, to the movement of certain recurring funds from interest bearing deposits to securities sold under agreement to repurchase. Securities sold under agreement to repurchase increased from 4.4% at September 30, 2005 to 7.7% at September 30, 2006, and from 5.5% at December 31, 2005 to 7.7% at September 30, 2006. Other short-term borrowings increased as a percentage of total assets from .4% at September 30, 2005 to 2.2% at September 30, 2006 and from .3% at December 31, 2005 to 2.2% at September 30, 2006, as the Company utilized \$15,000 in Federal Home Loan Bank advances to fund short-term real estate loans.

The following table sets forth the percentage relationship to total assets of significant components of the Company's balance sheets as of September 30, 2006 and September 30 and December 31, 2005:

|   | <b><u>September 30,</u></b> | <b><u>2005</u></b> | <b><u>December 31</u></b> |
|---|-----------------------------|--------------------|---------------------------|
|   | <b><u>2006</u></b>          | <b><u>2005</u></b> | <b><u>2005</u></b>        |
| <b>Assets:</b>  |                             |                    |                           |
| Earning assets:   |                             |                    |                           |
| Loans   | 66.8%                       | 62.7%              | 63.5%                     |
| Investment securities   | .5                          | .5                 | .5                        |
| Securities Available for Sale   | 20.0                        | 24.2               | 22.2                      |
| Federal funds sold and securities purchased under agreement to resell     | <u>5.2</u>                  | <u>4.6</u>         | <u>5.8</u>                |
| Total earning assets  | <u>92.5</u>                 | <u>92.0</u>        | <u>92.0</u>               |
| Other assets  | <u>7.5</u>                  | <u>8.0</u>         | <u>8.0</u>                |
| Total assets  | <u>100.0%</u>               | <u>100.0%</u>      | <u>100.0%</u>             |
| <b>Liabilities and stockholder's equity:</b>                              |                             |                    |                           |
| Interest-bearing liabilities:   |                             |                    |                           |
| Interest-bearing deposits   | 63.2%                       | 66.1%              | 67.1%                     |
| Federal funds purchased and securities sold under agreement to repurchase | 7.7                         | 4.4                | 5.5                       |
| Other short-term borrowings   | <u>2.2</u>                  | <u>.4</u>          | <u>.3</u>                 |
| Total interest-bearing liabilities  | <u>73.1</u>                 | <u>70.9</u>        | <u>72.9</u>               |
| Noninterest-bearing deposits  | 17.0                        | 18.8               | 17.0                      |
| Other liabilities   | .7                          | .7                 | 1.2                       |
| Stockholders' equity  | <u>9.2</u>                  | <u>9.6</u>         | <u>8.9</u>                |
| Total liabilities and stockholders' equity                                | <u>100.0%</u>               | <u>100.0%</u>      | <u>100.0%</u>             |

## **RESULTS OF OPERATIONS**

CNB Corporation had earnings for the three-month periods ended September 30, 2006 and 2005 of \$3,037 and \$2,730, respectively, resulting in a return on average assets of 1.47% and 1.46% and a return on average stockholders' equity of 16.36% and 15.14%, also respectively.

CNB Corporation had earnings for the nine-month periods ended September 30, 2006 and 2005 of \$7,575 and \$7,435, respectively, resulting in a return on average assets of 1.26% and 1.38% and a return on average stockholders equity of 13.69% and 14.16%, also respectively.

The earnings were primarily attributable to net interest income in each period (see Net Income-Net Interest Income). Other factors include management's ongoing effort to maintain other income at adequate levels (see Net Income - Other Income) and to control other expenses (see Net Income - Other Expenses). This level of earnings, coupled with a moderate dividend policy, has supplied the necessary capital funds to support the growth in total assets. Total assets increased \$83,900 or 11.0% from \$764,571 at September 30, 2005 to \$848,471 at September 30, 2006. The following table sets forth the financial highlights for the three-month and nine-month periods ending September 30, 2006 and September 30, 2005:

**CNB Corporation and Subsidiary  
FINANCIAL HIGHLIGHTS  
(All Dollar Amounts, Except Per Share Data, in Thousands)**

|  | Three-Month Period Ended Sept. 30, |             |                                   | Nine-Month Period Ended Sept. 30, |             |                                   |
|--|------------------------------------|-------------|-----------------------------------|-----------------------------------|-------------|-----------------------------------|
|  | <u>2006</u>                        | <u>2005</u> | Percent<br>Increase<br>(Decrease) | <u>2006</u>                       | <u>2005</u> | Percent<br>Increase<br>(Decrease) |
| <b>Net interest income after provision for<br/>loan losses</b> | 7,574                              | 7,089       | 6.8%                              | 22,192                            | 20,363      | 9.0                               |
| <b>Income before income taxes</b>                              | 4,356                              | 4,035       | 8.0                               | 11,235                            | 11,034      | 1.8                               |
| <b>Net Income</b>  | 3,037                              | 2,730       | 10.1                              | 7,575                             | 7,435       | 1.9                               |
| <b>Per Share</b>   | 3.86                               | 3.46        | 11.6                              | 9.62                              | 9.43        | 2.0                               |
| <b>Cash dividends declared</b>                                 | 0                                  | 0           | -                                 | 0                                 | 0           | -                                 |
| <b>Per Share</b>   | 0                                  | 0           | -                                 | 0                                 | 0           | -                                 |
| <b>Total assets</b>  | 848,471                            | 764,571     | 11.0%                             | 848,471                           | 764,571     | 11.0%                             |
| <b>Total deposits</b>  | 680,382                            | 648,904     | 4.9                               | 680,382                           | 648,904     | 4.9                               |
| <b>Loans</b>   | 567,088                            | 479,225     | 18.3                              | 567,088                           | 479,225     | 18.3                              |
| <b>Investment securities and securities available for sale</b> | 176,506                            | 189,000     | (6.6)                             | 176,506                           | 189,000     | (6.6)                             |
| <b>Stockholders' equity</b>                                    | 77,822                             | 73,271      | 6.2                               | 77,822                            | 73,271      | 6.2                               |
| <b>Book value per share</b>                                    | 99.11                              | 92.94       | 6.6                               | 99.11                             | 92.94       | 6.6                               |
| <b>Ratios (1):</b>   |                                    |             |                                   |                                   |             |                                   |
| <b>Annualized return on average total assets</b>               | 1.47%                              | 1.46%       | .7%                               | 1.26%                             | 1.38%       | (8.7)%                            |
| <b>Annualized return on average stockholders' equity</b>       | 16.36%                             | 15.14%      | 8.1%                              | 13.69%                            | 14.16%      | (3.3)%                            |

- (1) For the three-month periods ended September 30, 2006 and September 30, 2005, average total assets amounted to \$824,801 and \$749,074 with average stockholders' equity totaling \$74,257 and \$72,148 for the same periods, respectively. For the nine-month periods ended September 30, 2006 and September 30, 2005, average total assets amounted to \$801,897 and \$717,882 with average stockholders' equity totaling \$73,791 and \$69,986 for the same periods, respectively.

## NET INCOME

Net Interest Income - Earnings are dependent to a large degree on net interest income, defined as the difference between gross interest and fees earned on earning assets, primarily loans and securities, and interest paid on deposits and borrowed funds. Net interest income is affected by the interest rates earned or paid and by volume changes in loans, securities, deposits, and borrowed funds.

Interest rates paid on deposits and borrowed funds and earned on loans and investments have generally followed the fluctuations in market interest rates in 2006 and 2005. However, fluctuations in market interest rates do not necessarily have a significant impact on net interest income, depending on the bank's rate sensitivity position. A rate sensitive asset (RSA) is any loan or investment that can be repriced either up or down in interest rate within a certain time interval. A rate sensitive liability (RSL) is an interest paying deposit or other liability that can be repriced either up or down in interest rate within a certain time interval. When a proper balance between RSA and RSL exists, market interest rate fluctuations should not have a significant impact on earnings. The larger the imbalance, the greater the interest rate risk assumed by the Bank and the greater the positive or negative impact of interest rate fluctuations on earnings. The Bank seeks to manage its assets and liabilities in a manner that will limit interest rate risk and thus stabilize long-term earning power. Management believes that a 200 basis point rise or fall in interest rates will have less than a 10 percent effect on before-tax net interest income over a one-year period, which is within Bank guidelines.

The Bank has maintained net interest margins for the three-month and nine-month periods ended September 30, 2006, of 4.16% and 4.21%, respectively, and 4.33% and 4.32%, respectively, for the same periods in 2005, as compared to management's long-term target of 4.35%. Net interest margins have been compressed at the Bank and industry-wide as we have recently experienced a flat to slightly inverted treasury yield curve where short-term rates differ little from longer-term rates or are slightly higher than longer-term rates. A return to a more historically upward-sloping yield curve would enhance the Bank's net interest margin.

Fully-tax-equivalent net interest income showed a 5.7% increase from \$7,486 for the three-month period ended September 30, 2005 to \$7,916 for the three-month period ended September 30, 2006. During the same period, total fully-tax-equivalent interest income increased by 23.8% from \$10,374 to \$12,842 and total interest expense increased by 41.4% from \$2,888 to \$4,926. Fully-tax-equivalent net interest income as a percentage of total average earning assets decreased .17% from 4.33% for the three-month period ended September 30, 2005 to 4.16% for the three-month period ended September 30, 2006.

Fully-tax-equivalent net interest income showed a 8.6% increase from \$21,530 for the nine-month period ended September 30, 2005 to \$23,392 for the nine-month period ended September 30, 2006. During the same period, total fully-tax-equivalent interest income increased 26.1% from \$28,796 to \$36,308 and total interest expense increased by 77.8% from \$7,266 to \$12,916. Fully-tax-equivalent net interest income as a percentage of total average earning assets decreased .11% from 4.32% for the nine-month period ended September 30, 2005 to 4.21% for the nine-month period ended September 30, 2006.

The tables on the following pages present selected financial data and an analysis of average balances, yields and rates for the interest sensitive segments of the Company's balance sheets for the three-month and nine-month periods ended September 30, 2006 and 2005, and a summary of changes in net interest income resulting from changes in volume and changes in rate between the three-month and nine-month periods ended September 30, 2006 and 2005.

**CNB Corporation and Subsidiary**  
**Average Balances, Yields, and Rates**  
**(Dollars in Thousands)**

|  | Three Months Ended 9/30/06 |                                   |                               | Three Months Ended 9/30/05 |                                   |                               |
|--|----------------------------|-----------------------------------|-------------------------------|----------------------------|-----------------------------------|-------------------------------|
|  | Avg.<br>Balance            | Interest<br>Income/<br>Expense(1) | Avg. Ann.<br>Yield or<br>Rate | Avg.<br>Balance            | Interest<br>Income/<br>Expense(1) | Avg. Ann.<br>Yield or<br>Rate |
| <b>Assets:</b>   |                            |                                   |                               |                            |                                   |                               |
| Earning assets:  |                            |                                   |                               |                            |                                   |                               |
| Loans, net of unearned income (2)  | \$562,280                  | \$ 10,758                         | 7.65%                         | \$463,140                  | \$ 8,146                          | 7.04%                         |
| Securities:  |                            |                                   |                               |                            |                                   |                               |
| Taxable  | 157,518                    | 1,488                             | 3.78                          | 174,340                    | 1,619                             | 3.71                          |
| Tax-exempt   | 18,241                     | 310                               | 6.80                          | 21,264                     | 333                               | 6.26                          |
| Federal funds sold and securities purchased under<br>agreement to resell     | <u>22,924</u>              | <u>286</u>                        | 4.99                          | <u>33,088</u>              | <u>276</u>                        | 3.34                          |
| Total earning assets   | <u>760,963</u>             | <u>12,842</u>                     | 6.75                          | <u>691,832</u>             | <u>10,374</u>                     | 6.00                          |
| Other assets   | <u>63,838</u>              |                                   |                               | <u>57,242</u>              |                                   |                               |
| Total assets   | <u>\$824,801</u>           |                                   |                               | <u>\$749,074</u>           |                                   |                               |
| <b>Liabilities and stockholder equity</b>                                    |                            |                                   |                               |                            |                                   |                               |
| Interest-bearing liabilities:  |                            |                                   |                               |                            |                                   |                               |
| Interest-bearing deposits  | \$522,942                  | 4,239                             | 3.24                          | \$501,538                  | 2,713                             | 2.16                          |
| Federal funds purchased and securities sold under<br>agreement to repurchase | 38,126                     | 314                               | 3.29                          | 30,925                     | 166                               | 2.15                          |
| Other short-term borrowings  | <u>25,768</u>              | <u>373</u>                        | 5.79                          | <u>1,254</u>               | <u>9</u>                          | 2.87                          |
| Total interest-bearing liabilities   | <u>\$586,836</u>           | <u>\$ 4,926</u>                   | 3.36                          | <u>\$533,717</u>           | <u>\$ 2,888</u>                   | 2.16                          |
| Noninterest-bearing deposits   | 155,298                    |                                   |                               | 138,128                    |                                   |                               |
| Other liabilities  | 6,580                      |                                   |                               | 5,081                      |                                   |                               |
| Stockholders' equity   | <u>76,087</u>              |                                   |                               | <u>72,148</u>              |                                   |                               |
| Total liabilities and stockholders' equity                                   | <u>\$824,801</u>           |                                   |                               | <u>\$749,074</u>           |                                   |                               |
| Net interest income as a percent of total<br>earning assets                  | <u>\$760,963</u>           | <u>\$ 7,916</u>                   | 4.16                          | <u>\$691,832</u>           | <u>\$ 7,486</u>                   | 4.33                          |
| <b>Ratios:</b>   |                            |                                   |                               |                            |                                   |                               |
| Annualized return on average total assets                                    |                            |                                   | 1.47                          |                            |                                   | 1.46                          |
| Annualized return on average stockholders' equity                            |                            |                                   | 15.97                         |                            |                                   | 15.14                         |
| Cash dividends declared as a percent of net income                           |                            |                                   | 0                             |                            |                                   | 0                             |
| Average stockholders' equity as a percent of:                                |                            |                                   |                               |                            |                                   |                               |
| Average total assets   |                            |                                   | 9.22                          |                            |                                   | 9.63                          |
| Average total deposits   |                            |                                   | 11.22                         |                            |                                   | 11.28                         |
| Average loans  |                            |                                   | 13.53                         |                            |                                   | 15.58                         |
| Average earning assets as a percent of<br>average total assets               |                            |                                   | 92.26                         |                            |                                   | 92.36                         |

(1) Tax-equivalent adjustment based on a 34%  
tax rate

\$ 198

\$ 132

(2) Includes non-accruing loans. Includes an immaterial amount of loan fees in 2006 and 2005.

**CNB Corporation and Subsidiary**  
**Average Balances, Yields, and Rates**  
**(Dollars in Thousands)**

|   | Nine Months Ended 9/30/06 |                                   |                               | Nine Months Ended 9/30/05 |                                   |                               |
|---|---------------------------|-----------------------------------|-------------------------------|---------------------------|-----------------------------------|-------------------------------|
|   | Avg.<br>Balance           | Interest<br>Income/<br>Expense(1) | Avg. Ann.<br>Yield or<br>Rate | Avg.<br>Balance           | Interest<br>Income/<br>Expense(1) | Avg. Ann.<br>Yield or<br>Rate |
| <b>Assets:</b>  |                           |                                   |                               |                           |                                   |                               |
| Earning assets:   |                           |                                   |                               |                           |                                   |                               |
| Loans, net of unearned income (2)   | \$537,750                 | \$ 30,160                         | 7.48%                         | \$441,374                 | \$ 22,298                         | 6.74%                         |
| Securities:   |                           |                                   |                               |                           |                                   |                               |
| Taxable   | 161,275                   | 4,438                             | 3.67                          | 177,924                   | 4,951                             | 3.71                          |
| Tax-exempt  | 18,980                    | 921                               | 6.47                          | 21,586                    | 1,024                             | 6.33                          |
| Federal funds sold and securities purchased under agreement to resell     | <u>22,334</u>             | <u>789</u>                        | 4.71                          | <u>23,204</u>             | <u>523</u>                        | 3.01                          |
| Total earning assets  | <u>740,339</u>            | <u>36,308</u>                     | 6.54                          | <u>664,088</u>            | <u>28,796</u>                     | 5.78                          |
| Other assets  | <u>61,558</u>             |                                   |                               | <u>53,794</u>             |                                   |                               |
| Total assets  | <u>\$801,897</u>          |                                   |                               | <u>\$717,882</u>          |                                   |                               |
| <b>Liabilities and stockholder equity</b>                                 |                           |                                   |                               |                           |                                   |                               |
| Interest-bearing liabilities:   |                           |                                   |                               |                           |                                   |                               |
| Interest-bearing deposits   | \$531,220                 | 11,613                            | 2.91                          | \$479,782                 | 6,801                             | 1.89                          |
| Federal funds purchased and securities sold under agreement to repurchase | 38,996                    | 835                               | 2.85                          | 32,645                    | 445                               | 1.82                          |
| Other short-term borrowings   | <u>11,153</u>             | <u>468</u>                        | 5.59                          | <u>1,044</u>              | <u>20</u>                         | 2.55                          |
| Total interest-bearing liabilities  | <u>\$581,369</u>          | <u>\$ 12,916</u>                  | 2.96                          | <u>\$513,471</u>          | <u>\$ 7,266</u>                   | 1.89                          |
| Noninterest-bearing deposits  | 141,880                   |                                   |                               | 129,932                   |                                   |                               |
| Other liabilities   | 4,857                     |                                   |                               | 4,493                     |                                   |                               |
| Stockholders' equity  | <u>73,791</u>             |                                   |                               | <u>69,986</u>             |                                   |                               |
| Total liabilities and stockholders' equity                                | <u>\$801,897</u>          |                                   |                               | <u>\$717,882</u>          |                                   |                               |
| Net interest income as a percent of total earning assets                  | <u>\$740,339</u>          | <u>\$ 23,392</u>                  | 4.21                          | <u>\$664,088</u>          | <u>\$ 21,530</u>                  | 4.32                          |
| <b>Ratios:</b>  |                           |                                   |                               |                           |                                   |                               |
| Annualized return on average total assets                                 |                           |                                   | 1.26                          |                           |                                   | 1.38                          |
| Annualized return on average stockholders' equity                         |                           |                                   | 13.69                         |                           |                                   | 14.16                         |
| Cash dividends declared as a percent of net income                        |                           |                                   | 0                             |                           |                                   | 0                             |
| Average stockholders' equity as a percent of:                             |                           |                                   |                               |                           |                                   |                               |
| Average total assets  |                           |                                   | 9.20                          |                           |                                   | 9.75                          |
| Average total deposits  |                           |                                   | 10.96                         |                           |                                   | 11.48                         |
| Average loans   |                           |                                   | 13.72                         |                           |                                   | 15.86                         |
| Average earning assets as a percent of average total assets               |                           |                                   | 92.32                         |                           |                                   | 92.51                         |

(1) Tax-equivalent adjustment based on a 34% tax rate

\$ 605

\$ 367

(2) Includes non-accruing loans. Includes an immaterial amount of loan fees in 2006 and 2005.

The tables "Rate/Volume Variance Analysis" on the following pages provide a summary of changes in net interest income resulting from changes in rate and changes in volume. The changes due to rate are the difference between the current and prior period rates multiplied by the current period volume. The changes due to volume are the difference between the current and prior period volume multiplied by rates earned or paid.

**CNB Corporation and Subsidiary**  
**Rate/Volume Variance Analysis**  
**For the Three Months Ended September 30, 2006 and 2005**  
**(Dollars in Thousands)**

|  | <b>Average<br/>Volume<br/><u>2006</u></b> | <b>Average<br/>Volume<br/><u>2005</u></b> | <b>Yield/Rate<br/><u>2006 (1)</u></b> | <b>Yield/Rate<br/><u>2005 (1)</u></b> | <b>Interest<br/>Earned/Paid<br/><u>2006 (1)</u></b> | <b>Interest<br/>Earned/Paid<br/><u>2005 (1)</u></b> | <b>Variance</b>     | <b>Change<br/>Due to<br/>Rate</b> | <b>Change<br/>Due to<br/>Volume</b> |
|--|---|---|---------------------------------------|---------------------------------------|---|---|---------------------|-----------------------------------|-------------------------------------|
| <b>Earning Assets:</b>   |   |   |                                       |                                       |   |   |                     |                                   |                                     |
| Loans , Net of unearned Income (2)   | 562,280                                   | 463,140                                   | 7.65%                                 | 7.04%                                 | 10,758  | 8,146   | 2,612               | 862                               | 1,750                               |
| <b>Investment securities:</b>  |   |   |                                       |                                       |   |   |                     |                                   |                                     |
| Taxable  | 157,518                                   | 174,340                                   | 3.78%                                 | 3.71%                                 | 1,488   | 1,619   | (131)               | 26                                | (157)                               |
| Tax-exempt   | 18,241                                    | 21,264                                    | 6.80%                                 | 6.26%                                 | 310   | 333   | (23)                | 25                                | (48)                                |
| Federal funds sold and securities<br>purchased under agreement to resell       | <u>22,924</u>                             | <u>33,088</u>                             | 4.99%                                 | 3.34%                                 | <u>286</u>  | <u>276</u>  | <u>10</u>           | <u>95</u>                         | <u>(85)</u>                         |
| <b>Total Earning Assets</b>  | <b><u>760,963</u></b>                     | <b><u>691,832</u></b>                     | 6.75%                                 | 6.00%                                 | <b><u>12,842</u></b>                                | <b><u>10,374</u></b>                                | <b><u>2,468</u></b> | <b><u>1,008</u></b>               | <b><u>1,460</u></b>                 |
| <b>Interest-bearing Liabilities:</b>   |   |   |                                       |                                       |   |   |                     |                                   |                                     |
| Interest-bearing deposits  | 522,942                                   | 501,538                                   | 3.24%                                 | 2.16%                                 | 4,239   | 2,713   | 1,526               | 1,411                             | 115                                 |
| Federal funds purchased and securities<br>sold under agreement to repurchase   | 38,126                                    | 30,925                                    | 3.29%                                 | 2.15%                                 | 314   | 166   | 148                 | 109                               | 39                                  |
| Other short-term borrowings  | <u>25,768</u>                             | <u>1,254</u>                              | 5.79%                                 | 2.87%                                 | <u>373</u>  | <u>9</u>  | <u>364</u>          | <u>188</u>                        | <u>176</u>                          |
| <b>Total Interest-bearing Liabilities</b>                                      | <b><u>586,836</u></b>                     | <b><u>533,717</u></b>                     | 3.36%                                 | 2.16%                                 | <b><u>4,926</u></b>                                 | <b><u>2,888</u></b>                                 | <b><u>2,038</u></b> | <b><u>1,708</u></b>               | <b><u>330</u></b>                   |
| <b>Interest-free Funds Supporting<br/>Earning Assets</b>                       | <b><u>174,127</u></b>                     | <b><u>158,115</u></b>                     |                                       |                                       |   |   |                     |                                   |                                     |
| <b>Total Funds Supporting Earning Assets</b>                                   | <b><u>760,963</u></b>                     | <b><u>691,832</u></b>                     | 2.59%                                 | 1.67%                                 | <b><u>4,926</u></b>                                 | <b><u>2,888</u></b>                                 | <b><u>2,038</u></b> | <b><u>1,708</u></b>               | <b><u>330</u></b>                   |
| <b>Interest Rate Spread</b>  |   |   | 3.39%                                 | 3.84%                                 |   |   |                     |                                   |                                     |
| <b>Impact of Non-interest-bearing Funds<br/>on Net Yield on Earning Assets</b> |   |   | <u>.77%</u>                           | <u>.49%</u>                           |   |   |                     |                                   |                                     |
| <b>Net Yield on Earning Assets</b>   |   |   | <b><u>4.16%</u></b>                   | <b><u>4.33%</u></b>                   | <b><u>7,916</u></b>                                 | <b><u>7,486</u></b>                                 |                     |                                   |                                     |

(1) Tax-equivalent adjustment based on a 34% tax rate. Yields and rates have been annualized.

(2) Includes non-accruing loans which does not have a material effect on the Net Yield on Earning Assets. Includes an immaterial amount of loan fees for 2006 and 2005.

**CNB Corporation and Subsidiary**  
**Rate/Volume Variance Analysis**  
**For the Nine Months Ended September 30, 2006 and 2005**  
**(Dollars in Thousands)**

|  | Average<br>Volume<br><u>2006</u> | Average<br>Volume<br><u>2005</u> | Yield/Rate<br><u>2006 (1)</u> | Yield/Rate<br><u>2005 (1)</u> | Interest<br>Earned/Paid<br><u>2006 (1)</u> | Interest<br>Earned/Paid<br><u>2005 (1)</u> | <u>Variance</u> | <u>Change<br/>Due to<br/>Rate</u> | <u>Change<br/>Due to<br/>Volume</u> |
|--|----------------------------------|----------------------------------|-------------------------------|-------------------------------|--|--|-----------------|-----------------------------------|-------------------------------------|
| <b>Earning Assets:</b>   |                                  |                                  |                               |                               |  |  |                 |                                   |                                     |
| Loans , Net of unearned Income (2)   | 537,750                          | 441,374                          | 7.48%                         | 6.74%                         | 30,160                                     | 22,298                                     | 7,862           | 2,987                             | 4,875                               |
| <b>Investment securities:</b>  |                                  |                                  |                               |                               |  |  |                 |                                   |                                     |
| Taxable  | 161,275                          | 177,924                          | 3.67%                         | 3.71%                         | 4,438                                      | 4,951                                      | (513)           | (49)                              | (464)                               |
| Tax-exempt   | 18,980                           | 21,586                           | 6.47%                         | 6.33%                         | 921  | 1,024                                      | (103)           | 20                                | (123)                               |
| Federal funds sold and securities<br>purchased under agreement to resell       | <u>22,334</u>                    | <u>23,204</u>                    | 4.71%                         | 3.01%                         | <u>789</u>                                 | <u>523</u>                                 | <u>266</u>      | <u>285</u>                        | <u>(19)</u>                         |
| <b>Total Earning Assets</b>  | <u>740,339</u>                   | <u>664,088</u>                   | 6.54%                         | 5.78%                         | <u>36,308</u>                              | <u>28,796</u>                              | <u>7,512</u>    | <u>3,243</u>                      | <u>4,269</u>                        |
| <b>Interest-bearing Liabilities:</b>   |                                  |                                  |                               |                               |  |  |                 |                                   |                                     |
| Interest-bearing deposits  | 531,220                          | 479,782                          | 2.91%                         | 1.89%                         | 11,613                                     | 6,801                                      | 4,812           | 4,073                             | 739                                 |
| Federal funds purchased and securities<br>sold under agreement to repurchase   | 38,996                           | 32,645                           | 2.85%                         | 1.82%                         | 835  | 445  | 390             | 302                               | 88                                  |
| Other short-term borrowings  | <u>11,153</u>                    | <u>1,044</u>                     | 5.59%                         | 2.55%                         | <u>468</u>                                 | <u>20</u>                                  | <u>448</u>      | <u>254</u>                        | <u>194</u>                          |
| <b>Total Interest-bearing Liabilities</b>                                      | <u>581,369</u>                   | <u>513,471</u>                   | 2.96%                         | 1.89%                         | <u>12,916</u>                              | <u>7,266</u>                               | <u>5,650</u>    | <u>4,629</u>                      | <u>1,021</u>                        |
| Interest-free Funds Supporting<br>Earning Assets                               | <u>158,970</u>                   | <u>150,617</u>                   |                               |                               |  |  |                 |                                   |                                     |
| <b>Total Funds Supporting Earning Assets</b>                                   | <u>740,339</u>                   | <u>664,088</u>                   | 2.33%                         | 1.46%                         | <u>12,916</u>                              | <u>7,266</u>                               | <u>5,650</u>    | <u>4,629</u>                      | <u>1,021</u>                        |
| <b>Interest Rate Spread</b>  |                                  |                                  | 3.58%                         | 3.89%                         |  |  |                 |                                   |                                     |
| <b>Impact of Non-interest-bearing Funds<br/>on Net Yield on Earning Assets</b> |                                  |                                  | <u>.63%</u>                   | <u>.43%</u>                   |  |  |                 |                                   |                                     |
| <b>Net Yield on Earning Assets</b>   |                                  |                                  | <u>4.21%</u>                  | <u>4.32%</u>                  | <u>23,392</u>                              | <u>21,530</u>                              |                 |                                   |                                     |

(1) Tax-equivalent adjustment based on a 34% tax rate. Yields and rates have been annualized.

(2) Includes non-accruing loans which does not have a material effect on the Net Yield on Earning Assets. Includes an immaterial amount of loan fees for 2006 and 2005.

## **NET INCOME (continued)**

Provision for Loan Losses – The Bank utilizes various methodologies and analyses to assess the risk of loan losses existing in the loan portfolios as well as to determine the adequacy of the Bank's allowance for loan losses. The primary tools utilized to assess the Bank's adequacy of the allowance for loan losses are the graded loans method and migration method.

The provision for loan losses was \$238 for the three-month period ended September 30, 2006 and \$265 for the three-month period ended September 30, 2005. Net loan charge-offs/(recoveries) totaled \$141 for the three-month period ended September 30, 2006 and \$77 for the same period in 2005.

The provision for loan losses was \$888 for the nine-month period ended September 30, 2006 and \$800 for the nine-month period ended September 30, 2005. Net loan charge-offs/(recoveries) totaled \$315 for the nine-month period ended September 30, 2006 and \$114 for the same period in 2005.

The allowance for loan losses as a percentage of net loans was 1.16% at September 30, 2006 and was 1.22% at September 30, 2005. The level of provisions during the three-month and nine-month periods ended September 30, 2006 and September 30, 2005 reflect the substantial growth in the loan portfolio during the periods.

Securities Transactions - At September 30, 2006, December 31, 2005, and September 30, 2005 market value appreciation/(depreciation) in the investment portfolio totaled \$(2,580), \$(2,919), and \$(1,499) respectively. As indicated, market values have decreased due to higher market interest rates in 2005 and 2006.

Other Income - Other income, net of any gains/losses on security transactions, increased by 13.2% from \$1,798 for the three-month period ended September 30, 2005 to \$2,035 for the three-month period ended September 30, 2006.

Other income, net of any gains/losses on security transactions, increased 5.9% from \$4,923 for the nine-month period ended September 30, 2005 to \$5,214 for the nine-month period ended September 30, 2006.

The increase in other income for the three-month period ended September 30, 2006, was due to higher loan processing and letter of credit fees, up 10.4%, significantly higher fees from secondary mortgage market department operations, up 34.7%, and an increase in miscellaneous other income, up 28.1%. The increases were partially offset by lower service charge income on deposit accounts, down 3.0%.

The increase in other income for the nine-month period ended September 30, 2006 was due to higher loan processing and letter of credit fees, up 20.6%, significantly higher fees from secondary mortgage market department operations, up 72.2% and an increase in miscellaneous other income, up 14.8%. The increases were partially offset by lower service charge income on deposit accounts, down 2.9%.

Other Expenses - Other expenses increased by 8.3% from \$4,852 for the three-month period ended September 30, 2005 to \$5,253 for the three-month period ended September 30, 2006. The major components of other expenses are salaries and employee benefits which increased 6.4% from \$3,050 to \$3,244; occupancy expense which increased 22.3% from \$668 to \$817; and other operating expenses which increased by 5.1% from \$1,134 to \$1,192.

Other expenses increased by 13.4% from \$14,254 for the nine-month period ended September 30, 2005 to \$16,165 for the nine-month period ended September 30, 2006. The major components of other expenses are salaries and employee benefits which increased 10.5% from \$9,079 to \$10,032; occupancy expense which increased 21.2% from \$2,004 to \$2,428; and other operating expenses which increased by 16.8% from \$3,171 to \$3,705.

The increase in the three-month and nine-month periods ended September 30, 2006 salaries and employee benefits was due to staff additions, pay increases, and the increased costs of providing employee benefits, particularly health insurance coverage. Occupancy expense continues to grow due to the addition of new banking facilities and staff. The construction and equipping of a new banking office on Highway 701 North in Conway, South Carolina, which opened on July 17, 2006, and continued renovations to the Company's Main Office on Third Avenue in Conway, South Carolina, will add to future occupancy expenses.

Income Taxes - Provisions for income taxes increased 1.1% from \$1,305 for the three-month period ended September 30, 2005 to \$1,319 for the three-month period ended September 30, 2006. Income before income taxes less interest on tax-exempt investment securities increased 8.8% from \$3,815 for the three-month period ended September 30, 2005 to \$4,150 for the same period in 2006.

## **NET INCOME (continued)**

Provisions for income taxes increased 1.7% from \$3,599 for the nine-month period ended September 30, 2005 to \$3,660 for the nine-month period ended September 30, 2006. Income before income taxes less interest on tax-exempt investment securities increased by 2.6% from \$10,358 for the nine-month period ended September 30, 2005 to \$10,626 for the same period in 2006.

Off-balance sheet arrangements – See Note 10 – “Commitments and Contingent Liabilities” to the financial statements for a discussion of financial instruments with off-balance sheet risk.

## **LIQUIDITY**

The bank's liquidity position is primarily dependent on short-term demands for funds caused by customer credit needs and deposit withdrawals and upon the liquidity of bank assets to meet these needs. The bank's liquidity sources include cash and due from banks, federal funds sold, and short-term investments. In addition, the bank has established federal funds lines of credit from correspondent banks and has the ability to borrow funds from the Federal Reserve System and the Federal Home Loan Bank of Atlanta. Management believes that short-term and long-term liquidity sources are more than adequate to meet funding needs, including the funding of off-balance sheet loan commitments and standby letters of credit, if the need arises. Neither the Company nor the Bank is involved in other off-balance sheet contractual relationships or transactions that could result in liquidity needs, or other commitments, or that could significantly impact earnings.

## **CAPITAL RESOURCES**

Total stockholders' equity was \$77,822 and \$70,559 at September 30, 2006 and December 31, 2005 representing 9.17% and 8.89% of total assets, respectively. At September 30, 2006, the Company and the Bank exceed quantitative measures established by regulation to ensure capital adequacy (see NOTE 12 to the consolidated unaudited financial statements - REGULATORY MATTERS). Capital is considered sufficient by management to meet current and prospective capital requirements and to support anticipated growth in bank operations.

## **CRITICAL ACCOUNTING POLICIES**

We have adopted various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation of our financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements at December 31, 2005 as filed in our annual report on Form 10-K. Certain accounting policies involve significant judgments and assumptions by us which have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on the historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a major impact on our carrying values of assets and liabilities and our results of operations.

We believe the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of our consolidated financial statements. Refer to the portions of our 2005 Annual Report on Form 10-K and this Form 10-Q that address our allowance for loan losses for description of our processes and methodology for determining our allowance for loan losses.

## **RISKS AND UNCERTAINTIES**

In the normal course of its business the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrower's inability or unwillingness to make contractually required payments. Market risk, as it relates to lending and real estate held for operating locations, reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

### **Item 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk, as it relates to marketable securities held by the Company, is the risk of loss from adverse changes in market prices and rates. Management actively monitors and manages its interest rate risk exposure. In addition to other risks which the Company manages in the normal course of business, such as credit quality and liquidity risk, management considers interest rate risk to be a significant market risk that could potentially have a material effect on the Company's financial condition and results of operations (See MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - Net Income – Net Interest Income). Other types of market risks, such as foreign currency risk and commodity price risk, do not arise in the normal course of the Company's business activities.

### **Item 4. CONTROLS AND PROCEDURES**

Based on the evaluation required by 17 C.F.R. Section 240.13a-15(b) or 240.15d-15(b) of the Company's disclosure controls and procedures (as defined in 17 C.F.R. Sections 240.13a-15(e) and 240.15d-15(e)), the Company's interim chief executive officer and interim chief financial officer concluded that such controls and procedures, as of the end of the period covered by this quarterly report, were effective.

There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II

### Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

#### ISSUER PURCHASES OF EQUITY SECURITIES

| <b>Period</b>                    | <b>(a) Total Number<br/>of Shares<br/>Purchased (1)</b> | <b>(b) Average Price<br/>Paid per Share</b> | <b>(c) Total Number<br/>of Shares<br/>Purchased as<br/>Part of Publicly<br/>Announced<br/>Program</b> | <b>(d) Maximum<br/>Number of<br/>Shares that May<br/>Yet Be Purchased<br/>Under the<br/>Program</b> |
|----------------------------------|---|---|---|---|
| July 1 - July 31, 2006           | 2,820   | 156.50                                      | -   | -   |
| August 1 - August 31, 2006       | 217   | 156.50                                      | -   | -   |
| September 1 - September 30, 2006 | <u>10</u>   | <u>156.50</u>                               | -   | -   |
| Total                            | 3,047   | \$156.50                                    | -   | -   |

(1) During the period covered by this report the Company purchased 3,047 shares of stock from shareholders, at the request of the shareholders, which are held by the Company as Treasury Stock. These shares were purchased on a case-by-case basis and not pursuant to any formal program.

## **Item 6. EXHIBITS**

All exhibits, the filing of which are required with this Form, are listed below

- 31.1 Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

## **SIGNATURE**

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.

**CNB Corporation**  
(Registrant)

/s/L. Ford Sanders, II  
L. Ford Sanders, II  
Interim Executive Vice President,  
Treasurer and Chief Financial Officer

Date: November 6, 2006

## **EXHIBIT INDEX**

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