

ISABELLA BANK CORP  
Form 10-Q  
August 08, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended June 30, 2011**

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: 0-18415**

**Isabella Bank Corporation**

(Exact name of registrant as specified in its charter)

Michigan

38-2830092

(State or other jurisdiction of  
incorporation or organization)

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

401 N. Main St, Mt. Pleasant, MI

48858

(Address of principal executive offices)

(Zip code)

(989) 772-9471

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock no par value, 7,580,042 as of July 22, 2011

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**ISABELLA BANK CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)****INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

(Dollars in thousands)

|   | June 30<br>2011     | December 31<br>2010 |
|---|---------------------|---------------------|
| <b>ASSETS</b>   |                     |                     |
| Cash and cash equivalents   |                     |                     |
| Cash and demand deposits due from banks   | \$ 20,707           | \$ 16,978           |
| Interest bearing balances due from banks  | 1,085               | 1,131               |
| <b>Total cash and cash equivalents</b>  | <b>21,792</b>       | <b>18,109</b>       |
| Certificates of deposit held in other financial institutions                              | 10,874              | 15,808              |
| Trading securities  | 4,910               | 5,837               |
| Available-for-sale securities (amortized cost of \$373,607 in 2011 and \$329,435 in 2010) | 380,225             | 330,724             |
| Mortgage loans available-for-sale   | 764                 | 1,182               |
| Loans   |                     |                     |
| Agricultural  | 72,126              | 71,446              |
| Commercial  | 358,943             | 348,852             |
| Installment   | 31,035              | 30,977              |
| Residential real estate mortgage  | 284,190             | 284,029             |
| <b>Total loans</b>  | <b>746,294</b>      | <b>735,304</b>      |
| Less allowance for loan losses  | 12,378              | 12,373              |
| <b>Net loans</b>  | <b>733,916</b>      | <b>722,931</b>      |
| Premises and equipment  | 24,229              | 24,627              |
| Corporate owned life insurance  | 17,753              | 17,466              |
| Accrued interest receivable   | 5,579               | 5,456               |
| Equity securities without readily determinable fair values                                | 17,061              | 17,564              |
| Goodwill and other intangible assets  | 46,939              | 47,091              |
| Other assets  | 17,228              | 19,015              |
| <b>TOTAL ASSETS</b>   | <b>\$ 1,281,270</b> | <b>\$ 1,225,810</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                     |                     |
| Deposits  |                     |                     |
| Noninterest bearing   | \$ 113,635          | \$ 104,902          |
| NOW accounts  | 148,176             | 142,259             |
| Certificates of deposit under \$100 and other savings                                     | 443,909             | 425,981             |
| Certificates of deposit over \$100  | 218,479             | 204,197             |
| <b>Total deposits</b>   | <b>924,199</b>      | <b>877,339</b>      |
| Borrowed funds (\$10,306 in 2011 and \$10,423 in 2010 at fair value)                      | 196,480             | 194,917             |
| Accrued interest payable and other liabilities  | 9,077               | 8,393               |

|  |                     |                     |
|--|---------------------|---------------------|
| <b>Total liabilities</b>   | <b>1,129,756</b>    | <b>1,080,649</b>    |
| Shareholders' equity   |                     |                     |
| Common stock - no par value 15,000,000 shares authorized; issued and outstanding 7,576,676 (including 30,312 shares to be issued) in 2011 and 7,550,074 (including 32,686 shares to be issued) in 2010 | 134,063             | 133,592             |
| Shares to be issued for deferred compensation obligations  | 4,735               | 4,682               |
| Retained earnings  | 10,703              | 8,596               |
| Accumulated other comprehensive income (loss)  | 2,013               | (1,709)             |
| <b>Total shareholders' equity</b>  | <b>151,514</b>      | <b>145,161</b>      |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>  | <b>\$ 1,281,270</b> | <b>\$ 1,225,810</b> |

See notes to interim condensed consolidated financial statements.

**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY  
(UNAUDITED)**

(Dollars in thousands except per share data)

|   | Common<br>Stock<br>Shares | Common<br>Stock   | Shares to<br>be<br>Issued for<br>Deferred<br>Compensation<br>Obligations | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Totals            |
|---|---------------------------|-------------------|--|----------------------|---|-------------------|
| <b>Balance, January 1, 2010</b>   | <b>7,535,193</b>          | <b>\$ 133,443</b> | <b>\$ 4,507</b>  | <b>\$ 4,972</b>      | <b>\$ (2,119)</b>   | <b>\$ 140,803</b> |
| Comprehensive income  |                           |                   |  | 4,174                | 3,744   | 7,918             |
| Issuance of common stock  | 59,197                    | 1,529             |  |                      |   | 1,529             |
| Common stock issued for<br>deferred compensation<br>obligations               | 26,898                    | 537               | (448)  |                      |   | 89                |
| Share based payment awards<br>under equity compensation<br>plan               |                           |                   | 332  |                      |   | 332               |
| Common stock purchased for<br>deferred compensation<br>obligations            |                           | (254)             |  |                      |   | (254)             |
| Common stock repurchased<br>pursuant to publicly announced<br>repurchase plan | (76,097)                  | (1,426)           |  |                      |   | (1,426)           |
| Cash dividends (\$0.36 per<br>share)  |                           |                   |  | (2,712)              |   | (2,712)           |
| <b>Balance, June 30, 2010</b>   | <b>7,545,191</b>          | <b>\$ 133,829</b> | <b>\$ 4,391</b>  | <b>\$ 6,434</b>      | <b>\$ 1,625</b>   | <b>\$ 146,279</b> |
| <b>Balance, January 1, 2011</b>   | <b>7,550,074</b>          | <b>\$ 133,592</b> | <b>\$ 4,682</b>  | <b>\$ 8,596</b>      | <b>\$ (1,709)</b>   | <b>\$ 145,161</b> |
| Comprehensive income  |                           |                   |  | 4,988                | 3,722   | 8,710             |
| Issuance of common stock  | 61,218                    | 1,346             |  |                      |   | 1,346             |
| Common stock issued for<br>deferred compensation<br>obligations               | 14,842                    | 266               | (254)  |                      |   | 12                |
| Share based payment awards<br>under equity compensation<br>plan               |                           |                   | 307  |                      |   | 307               |
| Common stock purchased for<br>deferred compensation<br>obligations            |                           | (227)             |  |                      |   | (227)             |
| Common stock repurchased<br>pursuant to publicly announced<br>repurchase plan | (50,458)                  | (914)             |  |                      |   | (914)             |

|                                   |  |  |  |  |         |  |         |
|-----------------------------------|--|--|--|--|---------|--|---------|
| Cash dividends (\$0.38 per share) |  |  |  |  | (2,881) |  | (2,881) |
|-----------------------------------|--|--|--|--|---------|--|---------|

|                               |                  |                   |           |              |                  |           |              |                   |
|-------------------------------|------------------|-------------------|-----------|--------------|------------------|-----------|--------------|-------------------|
| <b>Balance, June 30, 2011</b> | <b>7,575,676</b> | <b>\$ 134,063</b> | <b>\$</b> | <b>4,735</b> | <b>\$ 10,703</b> | <b>\$</b> | <b>2,013</b> | <b>\$ 151,514</b> |
|-------------------------------|------------------|-------------------|-----------|--------------|------------------|-----------|--------------|-------------------|

See notes to interim condensed consolidated financial statements.

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**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED)**

(Dollars in thousands except per share data)

|  | Three Months Ended<br>June 30 |               | Six Months Ended<br>June 30 |               |
|--|-------------------------------|---------------|-----------------------------|---------------|
|  | 2011                          | 2010          | 2011                        | 2010          |
| <b>Interest income</b>                                     |                               |               |                             |               |
| Loans, including fees                                      | \$ 11,464                     | \$ 11,651     | \$ 22,825                   | \$ 23,168     |
| Investment securities                                      |                               |               |                             |               |
| Taxable  | 1,836                         | 1,346         | 3,349                       | 2,625         |
| Nontaxable   | 1,189                         | 1,079         | 2,368                       | 2,173         |
| Trading account securities                                 | 47                            | 86            | 98                          | 191           |
| Federal funds sold and other                               | 133                           | 110           | 267                         | 214           |
| <b>Total interest income</b>                               | <b>14,669</b>                 | <b>14,272</b> | <b>28,907</b>               | <b>28,371</b> |
| <b>Interest expense</b>                                    |                               |               |                             |               |
| Deposits   | 2,776                         | 2,874         | 5,561                       | 5,757         |
| Borrowings   | 1,325                         | 1,417         | 2,593                       | 2,934         |
| <b>Total interest expense</b>                              | <b>4,101</b>                  | <b>4,291</b>  | <b>8,154</b>                | <b>8,691</b>  |
| <b>Net interest income</b>                                 | <b>10,568</b>                 | <b>9,981</b>  | <b>20,753</b>               | <b>19,680</b> |
| Provision for loan losses                                  | 603                           | 1,056         | 1,420                       | 2,263         |
| <b>Net interest income after provision for loan losses</b> | <b>9,965</b>                  | <b>8,925</b>  | <b>19,333</b>               | <b>17,417</b> |
| <b>Noninterest income</b>                                  |                               |               |                             |               |
| Service charges and fees                                   | 1,617                         | 1,494         | 3,093                       | 3,122         |
| Gain on sale of mortgage loans                             | 53                            | 74            | 182                         | 167           |
| Net loss on trading securities                             | (8)                           | (37)          | (27)                        | (38)          |
| Net gain (loss) on borrowings measured at fair value       | 37                            | (3)           | 117                         | 53            |
| Gain on sale of available-for-sale investment securities   |                               |               |                             | 56            |
| Other  | 279                           | 342           | 561                         | 677           |
| <b>Total noninterest income</b>                            | <b>1,978</b>                  | <b>1,870</b>  | <b>3,926</b>                | <b>4,037</b>  |
| <b>Noninterest expenses</b>                                |                               |               |                             |               |
| Compensation and benefits                                  | 4,746                         | 4,565         | 9,751                       | 9,160         |
| Occupancy  | 613                           | 557           | 1,259                       | 1,119         |
| Furniture and equipment                                    | 1,127                         | 1,082         | 2,233                       | 2,113         |
| FDIC insurance premiums                                    | 331                           | 313           | 665                         | 619           |
| Other  | 1,962                         | 1,758         | 3,458                       | 3,618         |
| <b>Total noninterest expenses</b>                          | <b>8,779</b>                  | <b>8,275</b>  | <b>17,366</b>               | <b>16,629</b> |

|   |                 |                 |                 |                 |
|---|-----------------|-----------------|-----------------|-----------------|
| <b>Income before federal income tax expense</b> | <b>3,164</b>    | <b>2,520</b>    | <b>5,893</b>    | <b>4,825</b>    |
| Federal income tax expense                      | 492             | 369             | 905             | 651             |
| <b>NET INCOME</b>                               | <b>\$ 2,672</b> | <b>\$ 2,151</b> | <b>\$ 4,988</b> | <b>\$ 4,174</b> |
| <b>Earnings per share</b>                       |                 |                 |                 |                 |
| <b>Basic</b>                                    | <b>\$ 0.35</b>  | <b>\$ 0.29</b>  | <b>\$ 0.66</b>  | <b>\$ 0.55</b>  |
| <b>Diluted</b>                                  | <b>\$ 0.34</b>  | <b>\$ 0.28</b>  | <b>\$ 0.64</b>  | <b>\$ 0.54</b>  |
| <b>Cash dividends per basic share</b>           | <b>\$ 0.19</b>  | <b>\$ 0.18</b>  | <b>\$ 0.38</b>  | <b>\$ 0.36</b>  |

See notes to interim condensed consolidated financial statements.

**Table of Contents****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)**

(Dollars in thousands)

|   | Three Months Ended |                 | Six Months Ended |                 |
|---|--------------------|-----------------|------------------|-----------------|
|   | June 30            |                 | June 30          |                 |
|   | 2011               | 2010            | 2011             | 2010            |
| <b>Net income</b>   | <b>\$ 2,672</b>    | <b>\$ 2,151</b> | <b>\$ 4,988</b>  | <b>\$ 4,174</b> |
| Unrealized holding gains on available-for-sale securities:                |                    |                 |                  |                 |
| Unrealized holding gains arising during the period                        | 3,576              | 4,633           | 5,329            | 5,993           |
| Reclassification adjustment for net realized gains included in net income |                    |                 |                  | (56)            |
| Net unrealized gains  | 3,576              | 4,633           | 5,329            | 5,937           |
| Tax effect  | (1,212)            | (1,704)         | (1,607)          | (2,193)         |
| Other comprehensive income, net of tax                                    | 2,364              | 2,929           | 3,722            | 3,744           |
| <b>COMPREHENSIVE INCOME</b>   | <b>\$ 5,036</b>    | <b>\$ 5,080</b> | <b>\$ 8,710</b>  | <b>\$ 7,918</b> |

See notes to interim condensed consolidated financial statements.

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**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**(UNAUDITED)**  
(Dollars in thousands)

|   | Six Months Ended<br>June 30 |                 |
|---|-----------------------------|-----------------|
|   | 2011                        | 2010            |
| <b>OPERATING ACTIVITIES</b>   |                             |                 |
| Net income  | \$ 4,988                    | \$ 4,174        |
| Reconciliation of net income to net cash provided by operations:            |                             |                 |
| Provision for loan losses   | 1,420                       | 2,263           |
| Impairment of foreclosed assets   | 35                          | 90              |
| Depreciation  | 1,282                       | 1,235           |
| Amortization and impairment of originated mortgage servicing rights         | 193                         | 283             |
| Amortization of acquisition intangibles                                     | 152                         | 172             |
| Net amortization of available-for-sale securities                           | 693                         | 442             |
| Gain on sale of available-for-sale securities                               |                             | (56)            |
| Net unrealized losses on trading securities                                 | 27                          | 38              |
| Net gain on sale of mortgage loans  | (182)                       | (167)           |
| Net unrealized gains on borrowings measured at fair value                   | (117)                       | (53)            |
| Increase in cash value of corporate owned life insurance                    | (287)                       | (292)           |
| Realized gain on redemption of corporate owned life insurance               |                             | (21)            |
| Share-based payment awards under equity compensation plan                   | 307                         | 332             |
| Origination of loans held for sale  | (17,247)                    | (22,311)        |
| Proceeds from loan sales  | 17,847                      | 24,295          |
| Net changes in operating assets and liabilities which provided (used) cash: |                             |                 |
| Trading securities  | 900                         | 6,302           |
| Accrued interest receivable   | (123)                       | 520             |
| Other assets  | 653                         | (593)           |
| Accrued interest payable and other liabilities                              | 684                         | (29)            |
| <b>Net cash provided by operating activities</b>                            | <b>11,225</b>               | <b>16,624</b>   |
| <b>INVESTING ACTIVITIES</b>   |                             |                 |
| Net change in certificates of deposit held in other financial institutions  | 4,934                       | (7,043)         |
| Activity in available-for-sale securities                                   |                             |                 |
| Maturities, calls, and sales  | 33,799                      | 36,924          |
| Purchases   | (78,664)                    | (40,249)        |
| Loan principal originations and collections, net                            | (13,462)                    | (7,627)         |
| Proceeds from sales of foreclosed assets                                    | 859                         | 1,662           |
| Purchases of premises and equipment   | (884)                       | (2,093)         |
| Purchases of corporate owned life insurance                                 |                             | (175)           |
| Proceeds from the redemption of corporate owned life insurance              |                             | 154             |
| <b>Net cash used in investing activities</b>                                | <b>(53,418)</b>             | <b>(18,447)</b> |

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**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (continued)**  
**(UNAUDITED)**  
(Dollars in thousands)

|   | Six Months Ended<br>June 30 |                  |
|---|-----------------------------|------------------|
|   | 2011                        | 2010             |
| <b>FINANCING ACTIVITIES</b>   |                             |                  |
| Acceptances and withdrawals of deposits, net                            | 46,860                      | 22,161           |
| Net increase (decrease) in other borrowed funds                         | 1,680                       | (9,158)          |
| Cash dividends paid on common stock                                     | (2,881)                     | (2,712)          |
| Proceeds from issuance of common stock                                  | 1,092                       | 1,081            |
| Common stock repurchased  | (648)                       | (889)            |
| Common stock purchased for deferred compensation obligations            | (227)                       | (254)            |
| <b>Net cash provided by financing activities</b>                        | <b>45,876</b>               | <b>10,229</b>    |
| <b>INCREASE IN CASH AND CASH EQUIVALENTS</b>                            |                             |                  |
| Cash and cash equivalents at beginning of period                        | 18,109                      | 22,706           |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                       | <b>\$ 21,792</b>            | <b>\$ 31,112</b> |
| <b>SUPPLEMENTAL CASH FLOWS INFORMATION:</b>                             |                             |                  |
| Interest paid   | \$ 8,156                    | \$ 8,744         |
| Federal income taxes paid   | 365                         | 136              |
| <b>SUPPLEMENTAL NONCASH INFORMATION:</b>                                |                             |                  |
| Transfers of loans to foreclosed assets                                 | \$ 1,057                    | \$ 1,668         |
| Common stock issued for deferred compensation obligations               | 254                         | 448              |
| Common stock repurchased from an associated grantor trust (Rabbi Trust) | (266)                       | (537)            |
| See notes to interim condensed consolidated financial statements.       |                             |                  |

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**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**(Dollars in thousands except per share amounts)**

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In management's opinion, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation's annual report for the year ended December 31, 2010.

The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation's annual report for the year ended December 31, 2010.

**NOTE 2 ACCOUNTING STANDARDS UPDATES**

**Recently Adopted Accounting Standards Updates**

Accounting Standards Update (ASU) No. 2010-06: *Improving Disclosures about Fair Value Measurement*

In January 2010, ASU No. 2010-06 amended Accounting Standards Codification (ASC) Topic 820 Fair Value Measurements and Disclosures to add new disclosures for: (1) Significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and (2) Presenting separately information about purchases, sales, issuances and settlements for Level 3 fair value instruments (as opposed to reporting activity as net).

ASU No. 2010-06 also clarified existing disclosures by requiring reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The new authoritative guidance was effective for interim and annual periods beginning after December 15, 2009 except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements, which was effective for interim and annual periods beginning after December 15, 2010. The new guidance did not have a significant impact on the Corporation's consolidated financial statements.

**Pending Accounting Standards Updates**

ASU No. 2011-01: *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20.*

In January 2011, ASU No. 2011-01 amended ASC Topic 310, Receivables to temporarily delay the effective date of new disclosures related to troubled debt restructurings as required in ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which was initially intended to be effective for interim and annual periods ending after December 15, 2010. The effective date of the new disclosures about troubled debt restructurings has been delayed to coordinate with the newly issued guidance for determining what constitutes a troubled debt restructuring. The new disclosures will be effective for interim and annual periods beginning on or after June 15, 2011.

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**ASU No. 2011-02: A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring.**

In April 2011, ASU No. 2011-02 amended ASC Topic 310, *Receivables* to clarify authoritative guidance as to what loan modifications constitute concessions, and would therefore be considered a troubled debt restructuring.

Classification as a troubled debt restructuring will automatically classify such loans as impaired. ASU No. 2011-02 clarifies that:

If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the modified debt, the modification would be considered to be at a below-market rate, which may indicate that the creditor has granted a concession.

A modification that results in a temporary or permanent increase in the contractual interest rate cannot be presumed to be at a rate that is at or above a market rate and therefore could still be considered a concession.

A creditor must consider whether a borrower's default is probable on any of its debt in the foreseeable future when assessing financial difficulty.

A modification that results in an insignificant delay in payments is not a concession.

In addition, ASU No. 2011-02 clarifies that a creditor is precluded from using the effective interest rate test in the debtor's guidance on modification of payables (ASC Topic 470, *Debt*) when evaluating whether a modification constitutes a troubled debt restructuring. The new authoritative guidance is effective for interim and annual periods beginning on or after June 15, 2011 and is likely to increase the volume of loans that the Corporation classifies as troubled debt restructurings. The Corporation is currently in the process of evaluating the extent of the impact that this standard will have on the Corporation's financial statements.

**ASU No. 2011-03: Reconsideration of Effective Control for Repurchase Agreements**

In April 2011, ASU No. 2011-03 amended ASC Topic 310, *Transfers and Servicing* to eliminate from the assessment of effective control, the criteria calling for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed upon terms, even in the event of the transferee's default. The assessment of effective control should instead focus on the transferor's contractual rights and obligations. The new authoritative guidance is effective for interim and annual periods beginning on or after December 15, 2011 and is not expected to impact the Corporation's consolidated financial statements.

**ASU No. 2011-04: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS**

In May 2011, ASU No. 2011-04 amended ASC Topic 820, *Fair Value Measurement* to align fair value measurements and disclosures in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). The ASU changes the wording used to describe the requirements in GAAP for measuring fair value and disclosures about fair value.

The ASU clarifies the application of existing fair value measurements and disclosure requirements related to:

The application of highest and best use and valuation premise concepts.

Measuring the fair value of an instrument classified in a reporting entity's stockholders' equity.

Disclosure about fair value measurements within Level 3 of the fair value hierarchy.

The ASU also changes particular principles or requirements for measuring fair value and disclosing information measuring fair value and disclosures related to:

Measuring the fair value of financial instruments that are managed within a portfolio.

Application of premiums and discounts in a fair value measurement.

The new authoritative guidance is effective for interim and annual periods beginning on or after December 15, 2011 and is not expected to have a significant impact on the Corporation's consolidated financial statements.

**Table of Contents****ASU No. 2011-05: Presentation of Comprehensive Income**

In June 2011, ASU No. 2011-05 amended ASC Topic 220, Comprehensive Income to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. In addition, to increase the prominence of items reported in other comprehensive income, and to facilitate the convergence of GAAP and IFRS, the FASB eliminated the option to present components of other comprehensive income as part of the statement of changes in shareholders' equity.

The new authoritative guidance is effective for interim and annual periods beginning on or after December 15, 2011 and is not expected to have a significant impact on Corporation's consolidated financial statements since the Corporation has always elected to present a separate statement of comprehensive income.

**NOTE 3 COMPUTATION OF EARNINGS PER SHARE**

Basic earnings per share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan).

Earnings per common share have been computed based on the following:

|   | Three Months Ended |                | Six Months Ended |                |
|---|--------------------|----------------|------------------|----------------|
|   | June 30            |                | June 30          |                |
|   | 2011               | 2010           | 2011             | 2010           |
| Average number of common shares outstanding for basic calculation                               | 7,570,752          | 7,544,629      | 7,564,060        | 7,542,693      |
| Average potential effect of shares in the Directors Plan (1)                                    | 194,964            | 185,950        | 194,051          | 184,178        |
| Average number of common shares outstanding used to calculate diluted earnings per common share | 7,765,716          | 7,730,579      | 7,758,111        | 7,726,871      |
| Net income  | \$ 2,672           | \$ 2,151       | \$ 4,988         | \$ 4,174       |
| <b>Earnings per share</b>   |                    |                |                  |                |
| <b>Basic</b>  | <b>\$ 0.35</b>     | <b>\$ 0.29</b> | <b>\$ 0.66</b>   | <b>\$ 0.55</b> |
| <b>Diluted</b>  | <b>\$ 0.34</b>     | <b>\$ 0.28</b> | <b>\$ 0.64</b>   | <b>\$ 0.54</b> |

(1) Exclusive of shares held in the Rabbi Trust



**Table of Contents****NOTE 4 TRADING SECURITIES**

Trading securities, at fair value, consist of the following investments at:

|                                   | June 30<br>2011 | December<br>31<br>2010 |
|-----------------------------------|-----------------|------------------------|
| States and political subdivisions | <b>\$4,910</b>  | <b>\$ 5,837</b>        |

Included in the net trading losses of \$27 during the first six months of 2011 were \$32 of net unrealized trading losses on securities that relate to the Corporation's trading portfolio as of June 30, 2011.

**NOTE 5 AVAILABLE-FOR-SALE SECURITIES**

The amortized cost and fair value of available-for-sale securities, with gross unrealized gains and losses, are as follows at:

|                                     | June 30, 2011     |                              |                               |                   |
|-------------------------------------|-------------------|------------------------------|-------------------------------|-------------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
| Government sponsored enterprises    | \$ 5,394          | \$ 9                         | \$                            | \$ 5,403          |
| States and political subdivisions   | 163,374           | 4,181                        | 221                           | 167,334           |
| Auction rate money market preferred | 3,200             |                              | 366                           | 2,834             |
| Preferred stocks                    | 7,800             | 34                           | 264                           | 7,570             |
| Mortgage-backed securities          | 104,992           | 2,268                        | 289                           | 106,971           |
| Collateralized mortgage obligations | 88,847            | 1,381                        | 115                           | 90,113            |
| <b>Total</b>                        | <b>\$ 373,607</b> | <b>\$ 7,873</b>              | <b>\$ 1,255</b>               | <b>\$ 380,225</b> |

|                                     | December 31, 2010 |                              |                               |                   |
|-------------------------------------|-------------------|------------------------------|-------------------------------|-------------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
| Government sponsored enterprises    | \$ 5,394          | \$ 10                        | \$                            | \$ 5,404          |
| States and political subdivisions   | 167,328           | 3,349                        | 960                           | 169,717           |
| Auction rate money market preferred | 3,200             |                              | 335                           | 2,865             |
| Preferred stocks                    | 7,800             |                              | 864                           | 6,936             |
| Mortgage-backed securities          | 101,096           | 1,633                        | 514                           | 102,215           |
| Collateralized mortgage obligations | 44,617            | 103                          | 1,133                         | 43,587            |
| <b>Total</b>                        | <b>\$ 329,435</b> | <b>\$ 5,095</b>              | <b>\$ 3,806</b>               | <b>\$ 330,724</b> |

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The amortized cost and fair value of available-for-sale securities by contractual maturity at June 30, 2011 are as follows:

|                                     | Due in<br>One<br>Year<br>or Less | Maturing   |  |                       | Securities                              |                   |
|-------------------------------------|----------------------------------|--|--|-----------------------|---|-------------------|
|                                     |                                  | After One<br>Year But<br>Within<br>Five<br>Years | After<br>Five<br>Years But<br>Within<br>Ten<br>Years | After<br>Ten<br>Years | With<br>Variable<br>Monthly<br>Payments | Total             |
| Government sponsored enterprises    | \$                               | \$ 5,000   | \$ 394   | \$                    | \$                                      | \$ 5,394          |
| States and political subdivisions   | 3,583                            | 33,405   | 84,853   | 41,533                |   | 163,374           |
| Auction rate money market preferred |                                  |  |  |                       | 3,200                                   | 3,200             |
| Preferred stocks                    |                                  |  |  |                       | 7,800                                   | 7,800             |
| Mortgage-backed securities          |                                  |  |  |                       | 104,992                                 | 104,992           |
| Collateralized mortgage obligations |                                  |  |  |                       | 88,847                                  | 88,847            |
| <b>Total amortized cost</b>         | <b>\$ 3,583</b>                  | <b>\$ 38,405</b>                                 | <b>\$ 85,247</b>                                     | <b>\$ 41,533</b>      | <b>\$ 204,839</b>                       | <b>\$ 373,607</b> |
| <b>Fair value</b>                   | <b>\$ 3,574</b>                  | <b>\$ 39,475</b>                                 | <b>\$ 87,853</b>                                     | <b>\$ 52,222</b>      | <b>\$ 197,101</b>                       | <b>\$ 380,225</b> |

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, auction rate money market preferreds, preferred stocks, mortgage-backed securities, and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the activity related to sales of available-for-sale securities is as follows during the six month periods ended June 30, 2010:

|                                   |          |
|-----------------------------------|----------|
| Proceeds from sales of securities | \$ 3,722 |
| Gross realized gains              | \$ 59    |
| Gross realized losses             | (3)      |
| Net realized gains                | \$ 56    |
| Applicable income tax expense     | \$ 19    |

There were no sales of available-for-sale securities in the first six months of 2011. The cost basis used to determine the realized gains or losses of securities sold was the amortized cost of the individual investment security as of the trade date.

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Information pertaining to available-for-sale securities with gross unrealized losses at June 30, 2011 and December 31, 2010 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

|                                     | Less Than Twelve Months           |                  | June 30, 2011<br>Over Twelve Months |                 | Total<br>Unrealized<br>Losses |
|-------------------------------------|-----------------------------------|------------------|-------------------------------------|-----------------|-------------------------------|
|                                     | Gross<br>Unrealized<br>Losses     | Fair<br>Value    | Gross<br>Unrealized<br>Losses       | Fair<br>Value   |                               |
|                                     | States and political subdivisions | \$ 221           | \$ 13,555                           | \$              |                               |
| Auction rate money market preferred |                                   |                  | 366                                 | 2,834           | 366                           |
| Preferred stocks                    |                                   |                  | 264                                 | 3,536           | 264                           |
| Mortgage-backed securities          | 289                               | 23,163           |                                     |                 | 289                           |
| Collateralized mortgage obligations | 115                               | 4,898            |                                     |                 | 115                           |
| <b>Total</b>                        | <b>\$ 625</b>                     | <b>\$ 41,616</b> | <b>\$ 630</b>                       | <b>\$ 6,370</b> | <b>\$ 1,255</b>               |

**Number of securities in an unrealized loss position:**

|  |           |          |           |
|--|-----------|----------|-----------|
|  | <b>37</b> | <b>4</b> | <b>41</b> |
|--|-----------|----------|-----------|

|                                     | Less Than Twelve Months           |                   | December 31, 2010<br>Over Twelve Months |                 | Total<br>Unrealized<br>Losses |
|-------------------------------------|-----------------------------------|-------------------|---|-----------------|-------------------------------|
|                                     | Gross<br>Unrealized<br>Losses     | Fair<br>Value     | Gross<br>Unrealized<br>Losses           | Fair<br>Value   |                               |
|                                     | States and political subdivisions | \$ 960            | \$ 29,409                               | \$              |                               |
| Auction rate money market preferred |                                   |                   | 335                                     | 2,865           | 335                           |
| Preferred stocks                    |                                   |                   | 864                                     | 2,936           | 864                           |
| Mortgage-backed securities          | 514                               | 38,734            |   |                 | 514                           |
| Collateralized mortgage obligations | 1,133                             | 33,880            |   |                 | 1,133                         |
| <b>Total</b>                        | <b>\$ 2,607</b>                   | <b>\$ 102,023</b> | <b>\$ 1,199</b>                         | <b>\$ 5,801</b> | <b>\$ 3,806</b>               |

**Number of securities in an unrealized loss position:**

|  |           |          |           |
|--|-----------|----------|-----------|
|  | <b>82</b> | <b>4</b> | <b>86</b> |
|--|-----------|----------|-----------|

The Corporation invested \$11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, \$7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a hybrid of market value and discounted cash flow analysis as of June 30, 2011 and a discounted cash flow analysis as of December 31, 2010. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, the current volume of trading activity, and recent trade prices. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The

Corporation calculated the present value assuming a 3 year nonamortizing balloon using weighted average discount rates between 5.70% and 6.97% as of June 30, 2011.

As of June 30, 2011, the Corporation held an auction rate money market preferred security and preferred stocks which continued to be in an unrealized loss position as a result of the securities' interest rates, as they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has determined that any declines in the fair value of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the security. Additionally, none of these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As a result, the Corporation has not recognized an other-than-temporary impairment related to these declines in fair value.

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As of June 30, 2011 and December 31, 2010, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred securities and preferred stocks, should be considered other-than-temporarily-impaired (OTTI). Such analyses considered, among other factors, the following criteria:

Has the value of the investment declined more than what is deemed to be reasonable based on a risk and maturity adjusted discount rate?

Is the investment credit rating below investment grade?

Is it probable that the issuer will be unable to pay the amount when due?

Is it more likely than not that the Corporation will not have to sell the security before recovery of its cost basis?

Has the duration of the investment been extended?

Based on the Corporation's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any such securities are other-than-temporarily impaired as of June 30, 2011 or December 31, 2010.

**NOTE 6 LOANS AND ALLOWANCE FOR LOAN LOSSES**

A summary of the major classifications of loans is as follows as of:

|  | June 30<br>2011   | December 31<br>2010 |
|--|-------------------|---------------------|
| Mortgage loans on real estate                  |                   |                     |
| Residential 1-4 family                         | \$ 211,879        | \$ 207,749          |
| Commercial                                     | 248,709           | 239,810             |
| Agricultural                                   | 42,817            | 44,246              |
| Construction and land development              | 9,838             | 12,250              |
| Second mortgages                               | 23,810            | 26,712              |
| Equity lines of credit                         | 38,663            | 37,318              |
| <b>Total mortgage loans</b>                    | <b>575,716</b>    | <b>568,085</b>      |
| Commercial and agricultural loans              |                   |                     |
| Commercial                                     | 110,234           | 109,042             |
| Agricultural production                        | 29,309            | 27,200              |
| <b>Total commercial and agricultural loans</b> | <b>139,543</b>    | <b>136,242</b>      |
| Consumer installment loans                     | 31,035            | 30,977              |
| <b>Total loans</b>                             | <b>746,294</b>    | <b>735,304</b>      |
| Less: allowance for loan losses                | 12,378            | 12,373              |
| <b>Net loans</b>                               | <b>\$ 733,916</b> | <b>\$ 722,931</b>   |

The Corporation grants commercial, agricultural, consumer and residential loans to customers situated primarily in Isabella, Gratiot, Mecosta, Midland, Western Saginaw, Montcalm and Southern Clare counties in Michigan. The ability of the borrowers to honor their repayment obligations is often dependent upon the real estate, agricultural, light manufacturing, retail, gaming and tourism, higher education, and general economic conditions of this region. Substantially all of the consumer and residential mortgage loans are secured by various items of property, while commercial loans are secured primarily by real estate, business assets, and personal guarantees; a portion of loans are

unsecured.

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Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loans losses, and any deferred fees or costs on originated loans. Interest income on loans is accrued over the term of the loan based on the principal amount outstanding. Loan origination fees and certain direct loan origination costs are capitalized and recognized as a component of interest income over the term of the loan using the constant yield method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

For loans that are placed on non-accrual status or charged off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected is charged against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

Commercial loans include loans for commercial real estate, farmland and agricultural production, state and political subdivisions, and commercial operating loans. The largest concentration of commercial loans is commercial real estate. Repayment of commercial loans is often dependent upon the successful operation and management of a business; thus, these loans generally involve greater risk than other types of lending. The Corporation minimizes its risk by limiting the amount of loans to any one borrower to \$12,500. Borrowers with credit needs of more than \$12,500 are serviced through the use of loan participations with other commercial banks. Commercial real estate loans generally require loan to value limits of less than 80%. Depending upon the type of loan, past credit history, and current operating results, the Corporation may require the borrower to pledge accounts receivable, inventory, and fixed assets. Personal guarantees are generally required from the owners of closely held corporations, partnerships, and proprietorships. In addition, the Corporation requires annual financial statements, prepares cash flow analyses, and reviews credit reports as deemed necessary.

The Corporation offers adjustable rate mortgages, fixed rate balloon mortgages, and fixed rate mortgage loans which typically have amortization periods up to a maximum of 30 years. Fixed rate loans with an amortization of greater than 15 years are generally sold upon origination to the Federal Home Loan Mortgage Association. Fixed rate residential mortgage loans with an amortization of 15 years or less may be held in the Corporation's portfolio, held for future sale, or sold upon origination. Factors used in determining when to sell these mortgages include management's judgment about the direction of interest rates, the Corporation's need for fixed rate assets in the management of its interest rate sensitivity, and overall loan demand.

Construction and land development loans consist primarily of 1 to 4 family residential properties. These loans primarily have a 6 to 9 month maturity and are made using the same underwriting criteria as residential mortgages. Loan proceeds are disbursed in increments as construction progresses and inspections warrant. Construction loans are typically converted to permanent loans at the completion of construction.

Lending policies generally limit the maximum loan to value ratio on residential mortgages to 95% of the lower of the appraised value of the property or the purchase price, with the condition that private mortgage insurance is required on loans with loan to value ratios in excess of 80%. Substantially all loans upon origination have a loan to value ratio of less than 80%. Underwriting criteria for residential real estate loans include: evaluation of the borrower's ability to make monthly payments, the value of the property securing the loan, ensuring the payment of principal, interest, taxes, and hazard insurance does not exceed 28% of a borrower's gross income, all debt servicing does not exceed 36% of income, acceptable credit reports, verification of employment, income, and financial information. Appraisals are performed by independent appraisers. All mortgage loan requests are reviewed by a mortgage loan committee or through a secondary market automated underwriting system; loans in excess of \$400 require the approval of the Bank's Internal Loan Committee, Board of Directors, or its loan committee.

Consumer loans granted include automobile loans, secured and unsecured personal loans, credit cards, student loans, and overdraft protection related loans. Loans are amortized generally for a period of up to 6 years. The underwriting emphasis is on a borrower's ability to pay rather than collateral value. No consumer loans are sold to the secondary market.



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A summary of changes in the allowance for loan losses by loan segments follows:

**Allowance for Credit Losses and Recorded Investment in Financing Receivables  
For the Three Months Ended June 30, 2011**

|                                  | Commercial      | Agricultural  | Residential<br>Real<br>Estate | Consumer      | Unallocated     | Total            |
|----------------------------------|-----------------|---------------|-------------------------------|---------------|-----------------|------------------|
| <b>Allowance for loan losses</b> |                 |               |                               |               |                 |                  |
| April 1, 2011                    | \$ 6,246        | \$ 776        | \$ 3,422                      | \$ 622        | \$ 1,315        | \$ 12,381        |
| Loans charged off                | (214)           | (1)           | (555)                         | (139)         |                 | (909)            |
| Recoveries                       | 209             |               | 29                            | 65            |                 | 303              |
| Provision for loan losses        | 497             | (11)          | (11)                          | 112           | 16              | 603              |
| <b>June 30, 2011</b>             | <b>\$ 6,738</b> | <b>\$ 764</b> | <b>\$ 2,885</b>               | <b>\$ 660</b> | <b>\$ 1,331</b> | <b>\$ 12,378</b> |

**Allowance for Credit Losses and Recorded Investment in Financing Receivables  
For the Six Months Ended June 30, 2011**

|                                  | Commercial      | Agricultural  | Residential<br>Real<br>Estate | Consumer      | Unallocated     | Total            |
|----------------------------------|-----------------|---------------|-------------------------------|---------------|-----------------|------------------|
| <b>Allowance for loan losses</b> |                 |               |                               |               |                 |                  |
| January 1, 2011                  | \$ 6,048        | \$ 1,033      | \$ 3,198                      | \$ 605        | \$ 1,489        | \$ 12,373        |
| Loans charged off                | (869)           | (1)           | (878)                         | (284)         |                 | (2,032)          |
| Recoveries                       | 346             |               | 103                           | 168           |                 | 617              |
| Provision for loan losses        | 1,213           | (268)         | 462                           | 171           | (158)           | 1,420            |
| <b>June 30, 2011</b>             | <b>\$ 6,738</b> | <b>\$ 764</b> | <b>\$ 2,885</b>               | <b>\$ 660</b> | <b>\$ 1,331</b> | <b>\$ 12,378</b> |

**Allowance for loan losses as of June 30, 2011**

|                                       |                 |               |                 |               |                 |                  |
|---------------------------------------|-----------------|---------------|-----------------|---------------|-----------------|------------------|
| Individually evaluated for impairment | \$ 485          | \$ 563        | \$ 812          | \$            | \$              | \$ 1,860         |
| Collectively evaluated for impairment | 6,253           | 201           | 2,073           | 660           | 1,331           | 10,518           |
| <b>Total</b>                          | <b>\$ 6,738</b> | <b>\$ 764</b> | <b>\$ 2,885</b> | <b>\$ 660</b> | <b>\$ 1,331</b> | <b>\$ 12,378</b> |

**Loans as of June 30, 2011**

|                                       |           |          |          |        |  |           |
|---------------------------------------|-----------|----------|----------|--------|--|-----------|
| Individually evaluated for impairment | \$ 10,224 | \$ 3,161 | \$ 5,598 | \$     |  | \$ 18,983 |
| Collectively evaluated for impairment | 348,719   | 68,965   | 278,592  | 31,035 |  | 727,311   |

|              |                   |                  |                   |                  |                   |
|--------------|-------------------|------------------|-------------------|------------------|-------------------|
| <b>Total</b> | <b>\$ 358,943</b> | <b>\$ 72,126</b> | <b>\$ 284,190</b> | <b>\$ 31,035</b> | <b>\$ 746,294</b> |
|--------------|-------------------|------------------|-------------------|------------------|-------------------|

**Table of Contents****Allowance for Credit Losses and Recorded Investment in Financing Receivables  
As of December 31, 2010**

|                                       | Commercial        | Agricultural     | Residential<br>Real<br>Estate | Consumer         | Unallocated     | Total             |
|---------------------------------------|-------------------|------------------|-------------------------------|------------------|-----------------|-------------------|
| <b>Allowance for loan losses</b>      |                   |                  |                               |                  |                 |                   |
| Individually evaluated for impairment | \$ 490            | \$ 558           | \$ 732                        | \$               | \$              | \$ 1,780          |
| Collectively evaluated for impairment | 5,558             | 475              | 2,466                         | 605              | 1,489           | 10,593            |
| <b>Total</b>                          | <b>\$ 6,048</b>   | <b>\$ 1,033</b>  | <b>\$ 3,198</b>               | <b>\$ 605</b>    | <b>\$ 1,489</b> | <b>\$ 12,373</b>  |
| <b>Loans</b>                          |                   |                  |                               |                  |                 |                   |
| Individually evaluated for impairment | \$ 4,890          | \$ 2,629         | \$ 4,866                      | \$               |                 | \$ 12,385         |
| Collectively evaluated for impairment | 343,962           | 68,817           | 279,163                       | 30,977           |                 | 722,919           |
| <b>Total</b>                          | <b>\$ 348,852</b> | <b>\$ 71,446</b> | <b>\$ 284,029</b>             | <b>\$ 30,977</b> |                 | <b>\$ 735,304</b> |

Following is a summary of changes in the allowance for loan losses for the three and six months ended June 30, 2010:

|                                | Three<br>Months<br>Ended<br>June 30,<br>2010 | Six Months<br>Ended<br>June 30,<br>2010 |
|--------------------------------|--|---|
| Balance at beginning of period | 12,987                                       | \$ 12,979                               |
| Loans charged off              | (1,366)                                      | (2,969)                                 |
| Recoveries                     | 341  | 745                                     |
| Provision charged to income    | 1,056  | 2,263                                   |
| <b>June 30, 2010</b>           | <b>\$ 13,018</b>                             | <b>\$ 13,018</b>                        |

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The primary factors behind the determination of the level of the allowance for loan losses (ALLL) are specific allocations for impaired loans, historical loss percentages, as well as unallocated components. Specific allocations for impaired loans are primarily determined based on the difference between the net realizable value of the loans

underlying collateral or the net present value of the projected payment stream and its recorded investment. Historical loss allocations are calculated at the loan class and segment levels based on a migration analysis of the loan portfolio over the preceding three years. An unallocated component is maintained to cover uncertainties that management believes affect its estimate of probable losses based on qualitative factors. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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The following table displays the credit quality indicators for commercial and agricultural credit exposures based on internally assigned credit ratings as of:

| Rating                | June 30, 2011     |                   |                   |                  |                  |                  |
|-----------------------|-------------------|-------------------|-------------------|------------------|------------------|------------------|
|                       | Commercial        |                   |                   | Agricultural     |                  |                  |
|                       | Real Estate       | Other             | Total             | Real Estate      | Other            | Total            |
| 1 - Excellent         | \$                | \$ 10             | \$ 10             | \$               | \$               | \$               |
| 2 - High quality      | 10,344            | 18,807            | 29,151            | 2,713            | 1,388            | 4,101            |
| 3 - High satisfactory | 78,568            | 24,502            | 103,070           | 11,116           | 3,793            | 14,909           |
| 4 - Low satisfactory  | 120,620           | 56,494            | 177,114           | 22,727           | 15,352           | 38,079           |
| 5 - Special mention   | 21,839            | 7,514             | 29,353            | 3,879            | 4,118            | 7,997            |
| 6 - Substandard       | 13,156            | 2,859             | 16,015            | 2,192            | 4,123            | 6,315            |
| 7 - Vulnerable        | 377               | 1                 | 378               |                  |                  |                  |
| 8 - Doubtful          | 3,805             | 47                | 3,852             | 190              | 535              | 725              |
| <b>Total</b>          | <b>\$ 248,709</b> | <b>\$ 110,234</b> | <b>\$ 358,943</b> | <b>\$ 42,817</b> | <b>\$ 29,309</b> | <b>\$ 72,126</b> |

| Rating                | December 31, 2010 |                   |                   |                  |                  |                  |
|-----------------------|-------------------|-------------------|-------------------|------------------|------------------|------------------|
|                       | Commercial        |                   |                   | Agricultural     |                  |                  |
|                       | Real Estate       | Other             | Total             | Real Estate      | Other            | Total            |
| 2 - High quality      | \$ 10,995         | \$ 13,525         | \$ 24,520         | \$ 3,792         | \$ 1,134         | \$ 4,926         |
| 3 - High satisfactory | 74,912            | 30,322            | 105,234           | 11,247           | 3,235            | 14,482           |
| 4 - Low satisfactory  | 119,912           | 57,403            | 177,315           | 22,384           | 14,862           | 37,246           |
| 5 - Special mention   | 19,560            | 6,507             | 26,067            | 4,169            | 3,356            | 7,525            |
| 6 - Substandard       | 10,234            | 1,104             | 11,338            | 2,654            | 4,613            | 7,267            |
| 7 - Vulnerable        | 3,339             | 54                | 3,393             |                  |                  |                  |
| 8 - Doubtful          | 858               | 127               | 985               |                  |                  |                  |
| <b>Total</b>          | <b>\$ 239,810</b> | <b>\$ 109,042</b> | <b>\$ 348,852</b> | <b>\$ 44,246</b> | <b>\$ 27,200</b> | <b>\$ 71,446</b> |

Internally assigned risk ratings are reviewed, at a minimum, when loans are renewed or when management has knowledge of improvements or deterioration of the credit quality of individual credits. Descriptions of the internally assigned risk ratings for commercial and agricultural loans are as follows:

**1. EXCELLENT Substantially Risk Free**

Credit has strong financial condition and solid earnings history, characterized by:

High liquidity, strong cash flow, low leverage.

Unquestioned ability to meet all obligations when due.

Experienced management, with management succession in place.

Secured by cash.

2. **HIGH QUALITY Limited Risk**

Credit with sound financial condition and has a positive trend in earnings supplemented by:  
Favorable liquidity and leverage ratios.

Ability to meet all obligations when due.

Management with successful track record.

Steady and satisfactory earnings history.

If loan is secured, collateral is of high quality and readily marketable.

Access to alternative financing.

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Well defined primary and secondary source of repayment.

If supported by guaranty, the financial strength and liquidity of the guarantor(s) are clearly evident.

**3. HIGH SATISFACTORY Reasonable Risk**

Credit with satisfactory financial condition and further characterized by:  
Working capital adequate to support operations.

Cash flow sufficient to pay debts as scheduled.

Management experience and depth appear favorable.

Loan performing according to terms.

If loan is secured, collateral is acceptable and loan is fully protected.

**4. LOW SATISFACTORY Acceptable Risk**

Credit with bankable risks, although some signs of weaknesses are shown:  
Would include most start-up businesses.

Occasional instances of trade slowness or repayment delinquency may have been 10-30 days slow within the past year.

Management abilities apparent yet unproven.

Weakness in primary source of repayment with adequate secondary source of repayment.

Loan structure generally in accordance with policy.

If secured, loan collateral coverage is marginal.

Adequate cash flow to service debt, but coverage is low.

**To be classified as less than satisfactory, only one of the following criteria must be met.**

**5. SPECIAL MENTION- Criticized**

Credit constitutes an undue and unwarranted credit risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances surrounding a specific loan:

Downward trend in sales, profit levels and margins.

Impaired working capital position.

Cash flow is strained in order to meet debt repayment.

Loan delinquency (30-60 days) and overdrafts may occur.

Shrinking equity cushion.

Diminishing primary source of repayment and questionable secondary source.

Management abilities are questionable.

Weak industry conditions.

Litigation pending against the borrower.

Loan may need to be restructured to improve collateral position or reduce payments.

Collateral / guaranty offers limited protection.

Negative debt service coverage, however the credit is well collateralized and payments are current.

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**6. SUBSTANDARD Classified**

Credit where the borrower's current net worth, paying capacity, and value of the collateral pledged is inadequate. There is a distinct possibility that the Corporation will implement collection procedures if the loan deficiencies are not corrected. In addition, the following characteristics may apply:

Sustained losses have severely eroded the equity and cash flow.

Deteriorating liquidity.

Serious management problems or internal fraud.

Original repayment terms liberalized.

Likelihood of bankruptcy.

Inability to access other funding sources.

Reliance on secondary source of repayment.

Litigation filed against borrower.

Collateral provides little or no value.

Requires excessive attention of the loan officer.

Borrower is uncooperative with loan officer.

**7. VULNERABLE Classified**

Credit is considered Substandard and warrants placing on nonaccrual. Risk of loss is being evaluated and exit strategy options are under review. Other characteristics that may apply:

Insufficient cash flow to service debt.

Minimal or no payments being received.

Limited options available to avoid the collection process.

Transition status, expect action will take place to collect loan without immediate progress being made.

**8. DOUBTFUL Workout**

Credit has all the weaknesses inherent in a Substandard loan with the added characteristic that collection and/or liquidation is pending. The possibility of a loss is extremely high, but its classification as a loss is deferred until liquidation procedures are completed, or reasonably estimable. Other characteristics that may apply:

Normal operations are severely diminished or have ceased.

Seriously impaired cash flow.

Original repayment terms materially altered.

Secondary source of repayment is inadequate.

Survivability as a going concern is impossible.

Collection process has begun.

Bankruptcy petition has been filed.

Judgments have been filed.

Portion of the loan balance has been charged-off.

**9. LOSS Charge off**

Credits are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification is for charged off loans but does not mean that the asset has absolutely no recovery or salvage value. These loans are further characterized by:

Liquidation or reorganization under bankruptcy, with poor prospects of collection.

Fraudulently overstated assets and/or earnings.

Collateral has marginal or no value.

Debtor cannot be located.

Over 120 days delinquent.

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The Corporation's primary credit quality indicators for residential real estate and consumer loans is the individual loan's past due aging. The following tables summarize the Corporation's past due and current loans as of:

|                                   | <b>June 30, 2011</b>               |                          |                   |                  |                   |                   |
|-----------------------------------|------------------------------------|--------------------------|-------------------|------------------|-------------------|-------------------|
|                                   | Accruing Interest<br>and Past Due: |                          | Total<br>Past Due |                  |                   |                   |
|                                   | 30-89<br>Days                      | 90<br>Days<br>or<br>More | and               |                  |                   |                   |
|                                   |                                    | Nonaccrual               | Nonaccrual        | Current          | Total             |                   |
| Commercial                        |                                    |                          |                   |                  |                   |                   |
| Commercial real estate            | \$ 1,713                           | \$ 525                   | \$ 3,442          | \$ 5,680         | \$ 243,029        | \$ 248,709        |
| Commercial other                  | 549                                |                          | 29                | 578              | 109,656           | 110,234           |
| <b>Total commercial</b>           | <b>2,262</b>                       | <b>525</b>               | <b>3,471</b>      | <b>6,258</b>     | <b>352,685</b>    | <b>358,943</b>    |
| Agricultural                      |                                    |                          |                   |                  |                   |                   |
| Agricultural real estate          | 202                                |                          | 189               | 391              | 42,426            | 42,817            |
| Agricultural other                | 3                                  |                          | 535               | 538              | 28,771            | 29,309            |
| <b>Total agricultural</b>         | <b>205</b>                         |                          | <b>724</b>        | <b>929</b>       | <b>71,197</b>     | <b>72,126</b>     |
| Residential mortgage              |                                    |                          |                   |                  |                   |                   |
| Senior liens                      | 2,044                              | 139                      | 1,790             | 3,973            | 217,744           | 221,717           |
| Junior liens                      | 173                                |                          | 55                | 228              | 23,582            | 23,810            |
| Home equity lines of credit       | 663                                |                          |                   | 663              | 38,000            | 38,663            |
| <b>Total residential mortgage</b> | <b>2,880</b>                       | <b>139</b>               | <b>1,845</b>      | <b>4,864</b>     | <b>279,326</b>    | <b>284,190</b>    |
| Consumer                          |                                    |                          |                   |                  |                   |                   |
| Secured                           | 159                                | 12                       |                   | 171              | 25,775            | 25,946            |
| Unsecured                         | 33                                 |                          |                   | 33               | 5,056             | 5,089             |
| <b>Total consumer</b>             | <b>192</b>                         | <b>12</b>                |                   | <b>204</b>       | <b>30,831</b>     | <b>31,035</b>     |
| <b>Total</b>                      | <b>\$ 5,539</b>                    | <b>\$ 676</b>            | <b>\$ 6,040</b>   | <b>\$ 12,255</b> | <b>\$ 734,039</b> | <b>\$ 746,294</b> |

|                        | <b>December 31, 2010</b>           |                          |                   |          |            |            |
|------------------------|------------------------------------|--------------------------|-------------------|----------|------------|------------|
|                        | Accruing Interest<br>and Past Due: |                          | Total<br>Past Due |          |            |            |
|                        | 30-89<br>Days                      | 90<br>Days<br>or<br>More | and               |          |            |            |
|                        |                                    | Nonaccrual               | Nonaccrual        | Current  | Total      |            |
| Commercial             |                                    |                          |                   |          |            |            |
| Commercial real estate | \$ 4,814                           | \$ 125                   | \$ 4,001          | \$ 8,940 | \$ 230,870 | \$ 239,810 |
| Commercial other       | 381                                |                          | 139               | 520      | 108,522    | 109,042    |

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|                             |                  |               |                 |                  |                   |                   |
|-----------------------------|------------------|---------------|-----------------|------------------|-------------------|-------------------|
| Total commercial            | 5,195            | 125           | 4,140           | 9,460            | 339,392           | 348,852           |
| Agricultural                |                  |               |                 |                  |                   |                   |
| Agricultural real estate    | 92               |               |                 | 92               | 44,154            | 44,246            |
| Agricultural other          | 4                | 50            |                 | 54               | 27,146            | 27,200            |
| Total agricultural          | 96               | 50            |                 | 146              | 71,300            | 71,446            |
| Residential mortgage        |                  |               |                 |                  |                   |                   |
| Senior liens                | 5,265            | 310           | 1,421           | 6,996            | 213,003           | 219,999           |
| Junior liens                | 476              |               | 49              | 525              | 26,187            | 26,712            |
| Home equity lines of credit | 598              |               |                 | 598              | 36,720            | 37,318            |
| Total residential mortgage  | 6,339            | 310           | 1,470           | 8,119            | 275,910           | 284,029           |
| Consumer                    |                  |               |                 |                  |                   |                   |
| Secured                     | 298              |               |                 | 298              | 24,781            | 25,079            |
| Unsecured                   | 10               | 1             |                 | 11               | 5,887             | 5,898             |
| Total consumer              | 308              | 1             |                 | 309              | 30,668            | 30,977            |
| <b>Total</b>                | <b>\$ 11,938</b> | <b>\$ 486</b> | <b>\$ 5,610</b> | <b>\$ 18,034</b> | <b>\$ 717,270</b> | <b>\$ 735,304</b> |

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The following is a summary of information pertaining to impaired loans as of:

|   | June 30, 2011          |                                |                        | December 31, 2010      |                                |                        |
|---|------------------------|--------------------------------|------------------------|------------------------|--------------------------------|------------------------|
|   | Outstanding<br>Balance | Unpaid<br>Principal<br>Balance | Valuation<br>Allowance | Outstanding<br>Balance | Unpaid<br>Principal<br>Balance | Valuation<br>Allowance |
| <b>Impaired loans with a valuation allowance</b>          |                        |                                |                        |                        |                                |                        |
| Commercial real estate                                    | \$ 3,969               | \$ 4,104                       | \$ 485                 | \$ 3,010               | \$ 4,110                       | \$ 472                 |
| Commercial other  |                        |                                |                        | 18                     | 18                             | 18                     |
| Agricultural other  | 1,356                  | 1,356                          | 563                    | 2,196                  | 2,196                          | 558                    |
| Residential mortgage senior liens                         | 5,398                  | 6,717                          | 774                    | 4,292                  | 5,236                          | 698                    |
| Residential mortgage junior liens                         | 200                    | 277                            | 38                     | 172                    | 250                            | 34                     |
| <b>Total impaired loans with a valuation allowance</b>    | <b>\$ 10,923</b>       | <b>\$ 12,454</b>               | <b>\$ 1,860</b>        | <b>\$ 9,688</b>        | <b>\$ 11,810</b>               | <b>\$ 1,780</b>        |
| <b>Impaired loans without a valuation allowance</b>       |                        |                                |                        |                        |                                |                        |
| Commercial real estate                                    | \$ 4,560               | \$ 6,953                       |                        | \$ 1,742               | \$ 2,669                       |                        |
| Commercial other  | 1,767                  | 1,808                          |                        | 169                    | 269                            |                        |
| Agricultural real estate                                  | 190                    | 190                            |                        |                        |                                |                        |
| Agricultural other  | 1,281                  | 1,281                          |                        |                        |                                |                        |
| Residential mortgage senior liens                         |                        |                                |                        | 401                    | 501                            |                        |
| Residential mortgage junior liens                         |                        |                                |                        |                        |                                |                        |
| Consumer secured  | 27                     | 64                             |                        | 48                     | 85                             |                        |
| <b>Total impaired loans without a valuation allowance</b> | <b>\$ 7,825</b>        | <b>\$ 10,296</b>               |                        | <b>\$ 2,360</b>        | <b>\$ 3,524</b>                |                        |
| <b>Impaired loans</b>                                     |                        |                                |                        |                        |                                |                        |
| Commercial  | \$ 10,296              | \$ 12,865                      | \$ 485                 | \$ 4,939               | \$ 7,066                       | \$ 490                 |
| Agricultural  | 2,827                  | 2,827                          | 563                    | 2,196                  | 2,196                          | 558                    |
| Residential mortgage                                      | 5,598                  | 6,994                          | 812                    | 4,865                  | 5,987                          | 732                    |
| Consumer  | 27                     | 64                             |                        | 48                     | 85                             |                        |
| <b>Total impaired loans</b>                               | <b>\$ 18,748</b>       | <b>\$ 22,750</b>               | <b>\$ 1,860</b>        | <b>\$ 12,048</b>       | <b>\$ 15,334</b>               | <b>\$ 1,780</b>        |

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The following is a summary of information pertaining to impaired loans for the three and six month periods ended June 30, 2011:

|   | Three Months Ended<br>June 30, 2011 |                                  | Six Months Ended<br>June 30, 2011 |                                  |
|---|-------------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|   | Average<br>Outstanding<br>Balance   | Interest<br>Income<br>Recognized | Average<br>Outstanding<br>Balance | Interest<br>Income<br>Recognized |
| <b>Impaired loans with a valuation allowance</b>          |                                     |                                  |                                   |                                  |
| Commercial real estate                                    | \$ 2,570                            | \$ 96                            | \$ 3,490                          | \$ 120                           |
| Commercial other  |                                     |                                  | 9                                 |                                  |
| Agricultural other  | 1,776                               | 9                                | 1,776                             | 42                               |
| Residential mortgage senior liens                         | 4,980                               | 70                               | 4,845                             | 106                              |
| Residential mortgage junior liens                         | 184                                 | 3                                | 186                               | 4                                |
| <b>Total impaired loans with a valuation allowance</b>    | <b>\$ 9,510</b>                     | <b>\$ 178</b>                    | <b>\$ 10,306</b>                  | <b>\$ 272</b>                    |
| <b>Impaired loans without a valuation allowance</b>       |                                     |                                  |                                   |                                  |
| Commercial real estate                                    | \$ 4,085                            | \$ 69                            | \$ 3,151                          | \$ 102                           |
| Commercial other  | 1,780                               | 28                               | 968                               | 88                               |
| Agricultural real estate                                  | 190                                 |                                  | 95                                | (1)                              |
| Agricultural other  | 641                                 | 39                               | 641                               | 39                               |
| Residential mortgage senior liens                         | 337                                 | (6)                              | 201                               |                                  |
| Residential mortgage junior liens                         | 1                                   |                                  |                                   |                                  |
| Consumer secured  | 36                                  | 1                                | 38                                | 3                                |
| <b>Total impaired loans without a valuation allowance</b> | <b>\$ 7,070</b>                     | <b>\$ 131</b>                    | <b>\$ 5,094</b>                   | <b>\$ 231</b>                    |
| <b>Impaired loans</b>                                     |                                     |                                  |                                   |                                  |
| Commercial  | \$ 8,435                            | \$ 193                           | \$ 7,618                          | \$ 310                           |
| Agricultural  | 2,607                               | 48                               | 2,512                             | 80                               |
| Residential mortgage                                      | 5,502                               | 67                               | 5,232                             | 110                              |
| Consumer  | 36                                  | 1                                | 38                                | 3                                |
| <b>Total impaired loans</b>                               | <b>\$ 16,580</b>                    | <b>\$ 309</b>                    | <b>\$ 15,400</b>                  | <b>\$ 503</b>                    |
| <b>Total impaired loans June 30, 2010</b>                 |                                     |                                  | <b>\$ 12,396</b>                  | <b>\$ 168</b>                    |

Loans may be classified as impaired if they meet one or more of the following criteria:

1. There has been a chargeoff of its principal balance (in whole or in part);
2. The loan has been classified as a troubled debt restructuring; or
3. The loan is in nonaccrual status.

Impairment is measured on a loan by loan basis for commercial, commercial real estate loans, agricultural, or agricultural mortgage loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer loans for impairment allocations and related disclosures. Interest income is recognized on impaired loans in nonaccrual status on the cash basis, but only after all principal has been collected. For impaired loans not in nonaccrual status, interest income is recognized daily as earned according to the terms of the loan agreement.

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No additional funds are committed to be advanced in connection with impaired loans, which include troubled debt restructurings.

The following is a summary of troubled debt restructurings as of:

|                              | June 30<br>2011 | December<br>31<br>2010 |
|------------------------------|-----------------|------------------------|
| Troubled debt restructurings | \$ 11,273       | \$ 5,763               |

**NOTE 7 EQUITY SECURITIES WITHOUT READILY DETERMINABLE FAIR VALUES**

Included in equity securities without readily determinable fair values are restricted securities, which are carried at cost, and investments in nonconsolidated entities accounted for under the equity method of accounting.

Equity securities without readily determinable fair values consist of the following as of:

|  | June 30<br>2011  | December<br>31<br>2010 |
|--|------------------|------------------------|
| Federal Home Loan Bank Stock                 | \$ 7,380         | \$ 7,596               |
| Investment in Corporate Settlement Solutions | 6,509            | 6,793                  |
| Federal Reserve Bank Stock                   | 1,879            | 1,879                  |
| Investment in Valley Financial Corporation   | 1,000            | 1,000                  |
| Other  | 293              | 296                    |
| <b>Total</b>                                 | <b>\$ 17,061</b> | <b>\$ 17,564</b>       |

**NOTE 8 BORROWED FUNDS**

Borrowed funds consist of the following obligations as of:

|  | June 30, 2011     |              | December 31,<br>2010 |              |
|--|-------------------|--------------|----------------------|--------------|
|  | Amount            | Rate         | Amount               | Rate         |
| Federal Home Loan Bank advances  | \$ 132,306        | 3.44%        | \$ 113,423           | 3.64%        |
| Securities sold under agreements to repurchase without stated maturity dates | 40,110            | 0.25%        | 45,871               | 0.25%        |
| Securities sold under agreements to repurchase with stated maturity dates    | 16,864            | 3.32%        | 19,623               | 3.01%        |
| Federal funds purchased  | 7,200             | 0.50%        | 16,000               | 0.60%        |
| <b>Total</b>   | <b>\$ 196,480</b> | <b>2.67%</b> | <b>\$ 194,917</b>    | <b>2.53%</b> |

The Federal Home Loan Bank borrowings are collateralized by a blanket lien on all qualified 1-to-4 family mortgage loans and U.S. government and federal agency securities. Advances are also secured by FHLB stock owned by the Corporation. The Corporation had the ability to borrow up to an additional \$113,295 based on the assets pledged as collateral as of June 30, 2011.

Securities sold under agreements to repurchase are classified as secured borrowings. Securities sold under agreements to repurchase without stated maturity dates generally mature within one to four days from the transaction date.

Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The securities underlying the agreements have a carrying value and a fair value of \$84,724 and \$86,381 at June 30, 2011 and December 31, 2010, respectively. Such securities remain under the control of the Corporation. The Corporation may be required to provide additional collateral based on the fair value of underlying securities.



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Securities sold under repurchase agreements without stated maturity dates and federal funds purchased generally mature within one to four days from the transaction date. The following table provides a summary of short term borrowings for the three and six month periods ended June 30:

|   | 2011                            |                           | Three Months Ended June 30      |                           |  | Weighted<br>Average<br>Interest Rate<br>During the<br>Period |
|---|---------------------------------|---------------------------|---------------------------------|---------------------------|--|--|
|   | Maximum<br>Month-End<br>Balance | QTD<br>Average<br>Balance | Maximum<br>Month-End<br>Balance | QTD<br>Average<br>Balance | 2010   |  |
|   |                                 |                           |                                 |                           | Weighted<br>Average<br>Interest Rate<br>During the<br>Period |  |
| Securities sold under<br>agreements to<br>repurchase without<br>stated maturity dates | \$43,138                        | \$44,680                  | 0.25%                           | \$43,005                  | \$39,667   | 0.30%  |
| Federal funds<br>purchased  | 18,300                          | 4,539                     | 0.54%                           |                           | 42   | 0.50%  |
|   | 2011                            |                           | Six Months Ended June 30        |                           |  | Weighted<br>Average<br>Interest Rate<br>During the<br>Period |
|   | Maximum<br>Month-End<br>Balance | YTD<br>Average<br>Balance | Maximum<br>Month-End<br>Balance | YTD<br>Average<br>Balance | 2010   |  |
|   |                                 |                           |                                 |                           | Weighted<br>Average<br>Interest Rate<br>During the<br>Period |  |
| Securities sold under<br>agreements to<br>repurchase without<br>stated maturity dates | \$43,138                        | \$40,715                  | 0.25%                           | \$43,005                  | \$37,637   | 0.30%  |
| Federal funds<br>purchased  | 18,300                          | 2,906                     | 0.53%                           |                           | 188  | 0.50%  |

The Corporation had pledged certificates of deposit held in other financial institutions, trading securities, available-for-sale securities, and 1-4 family mortgage loans in the following amounts at:

|   | June 30<br>2011   | December 31<br>2010 |
|---|-------------------|---------------------|
| Pledged to secure borrowed funds  | \$ 293,362        | \$ 297,297          |
| Pledged to secure repurchase agreements   | 84,724            | 86,381              |
| Pledged for public deposits and for other purposes necessary or required by law | 17,914            | 14,626              |
| <b>Total</b>  | <b>\$ 396,000</b> | <b>\$ 398,304</b>   |

The Corporation had no investment securities that are restricted to be pledged for specific purposes.

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A summary of expenses included in other noninterest expenses are as follows for the three and six month periods ended June 30:

|                                   | Three Months Ended<br>June 30 |                 | Six Months Ended<br>June 30 |                 |
|-----------------------------------|-------------------------------|-----------------|-----------------------------|-----------------|
|                                   | 2011                          | 2010            | 2011                        | 2010            |
| Marketing and community relations | \$ 527                        | \$ 272          | \$ 750                      | \$ 660          |
| Directors fees                    | 206                           | 236             | 417                         | 445             |
| Audit and SOX compliance fees     | 167                           | 101             | 323                         | 346             |
| Foreclosed asset and collection   | 177                           | 155             | 277                         | 354             |
| Education and travel              | 99                            | 98              | 204                         | 212             |
| Postage and freight               | 96                            | 100             | 196                         | 183             |
| Printing and supplies             | 89                            | 101             | 189                         | 197             |
| Amortization of deposit premium   | 76                            | 86              | 152                         | 172             |
| Legal fees                        | 54                            | 115             | 116                         | 198             |
| Consulting fees                   | 67                            | 54              | 100                         | 100             |
| All other                         | 404                           | 440             | 734                         | 751             |
| <b>Total other</b>                | <b>\$ 1,962</b>               | <b>\$ 1,758</b> | <b>\$ 3,458</b>             | <b>\$ 3,618</b> |

**NOTE 10 FEDERAL INCOME TAXES**

The reconciliation of the provision for federal income taxes and the amount computed at the federal statutory tax rate of 34% of income before federal income tax expense is as follows for the three and six month periods ended June 30:

|   | Three Months Ended<br>June 30 |               | Six Months Ended<br>June 30 |               |
|---|-------------------------------|---------------|-----------------------------|---------------|
|   | 2011                          | 2010          | 2011                        | 2010          |
| Income taxes at 34% statutory rate            | \$ 1,076                      | \$ 857        | \$ 2,004                    | \$ 1,641      |
| Effect of nontaxable income                   |                               |               |                             |               |
| Interest income on tax exempt municipal bonds | (385)                         | (352)         | (768)                       | (704)         |
| Earnings on corporate owned life insurance    | (50)                          | (49)          | (98)                        | (106)         |
| Other   | (162)                         | (95)          | (256)                       | (191)         |
| Total effect of nontaxable income             | (597)                         | (496)         | (1,122)                     | (1,001)       |
| Effect of nondeductible expenses              | 13                            | 8             | 23                          | 11            |
| <b>Federal income tax expense</b>             | <b>\$ 492</b>                 | <b>\$ 369</b> | <b>\$ 905</b>               | <b>\$ 651</b> |

Included in other comprehensive income for the three and six month periods ended June 30 are changes in unrealized holding gains of \$8 and \$603 in 2011 and losses of \$377 and \$510 in 2010, respectively, related to auction rate money market preferred stock securities and preferred stocks. For federal income tax purposes, these securities are considered equity investments. As such, no deferred federal income taxes related to unrealized holding gains or losses are expected or recorded.

**Table of Contents****NOTE 11 DEFINED BENEFIT PENSION PLAN**

The Corporation has a non contributory defined benefit pension plan, which was curtailed effective March 1, 2007. As a result of the curtailment, future salary increases are no longer considered and plan benefits are based on years of service and the employees' five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. The Corporation made no contributions to the pension plan during three or six month periods ended June 30, 2011 or 2010. The Corporation anticipates contributing \$140 to the plan in the 3<sup>rd</sup> quarter of 2011.

Following are the components of net periodic benefit cost for the three and six month periods ended June 30:

|   | Three Months Ended |              | Six Months Ended |              |
|---|--------------------|--------------|------------------|--------------|
|   | June 30            |              | June 30          |              |
|   | 2011               | 2010         | 2011             | 2010         |
| Interest cost on projected benefit obligation   | \$ 127             | \$ 133       | \$ 254           | \$ 266       |
| Expected return on plan assets                  | (130)              | (123)        | (261)            | (246)        |
| Amortization of unrecognized actuarial net loss | 39                 | 39           | 77               | 77           |
| <b>Net periodic benefit cost</b>                | <b>\$ 36</b>       | <b>\$ 49</b> | <b>\$ 70</b>     | <b>\$ 97</b> |

**NOTE 12 FAIR VALUE****Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis**

Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, the Corporation uses present value techniques and other valuation methods to estimate the fair values of its financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Corporation's consolidated balance sheets are as follows:

|  | June 30, 2011        |                | December 31, 2010    |                |
|--|----------------------|----------------|----------------------|----------------|
|  | Estimated Fair Value | Carrying Value | Estimated Fair Value | Carrying Value |
| <b>ASSETS</b>  |                      |                |                      |                |
| Cash and demand deposits due from banks                      | \$ 21,792            | \$ 21,792      | \$ 18,109            | \$ 18,109      |
| Certificates of deposit held in other financial institutions | 10,935               | 10,874         | 15,908               | 15,808         |
| Mortgage loans available-for-sale                            | 764                  | 764            | 1,182                | 1,182          |
| Net loans  | 747,891              | 733,916        | 734,634              | 722,931        |
| Accrued interest receivable                                  | 5,579                | 5,579          | 5,456                | 5,456          |
| Equity securities without readily determinable fair values   | 17,061               | 17,061         | 17,564               | 17,564         |
| Originated mortgage servicing rights                         | 2,617                | 2,617          | 2,673                | 2,667          |
| <b>LIABILITIES</b>   |                      |                |                      |                |
| Deposits with no stated maturities                           | 457,352              | 457,352        | 424,978              | 424,978        |
| Deposits with stated maturities                              | 475,564              | 466,847        | 454,332              | 452,361        |
| Borrowed funds   | 198,411              | 186,174        | 190,180              | 184,494        |
| Accrued interest payable                                     | 1,001                | 1,001          | 1,003                | 1,003          |

**Table of Contents****Financial Instruments Recorded at Fair Value**

The table below presents the recorded amount of assets and liabilities measured at fair value on:

| Description  | June 30, 2011 |            |           | December 31, 2010 |            |           |
|--|---------------|------------|-----------|-------------------|------------|-----------|
|  | Total         | Level 2    | Level 3   | Total             | Level 2    | Level 3   |
| <b>Recurring items</b>                                   |               |            |           |                   |            |           |
| Trading securities                                       |               |            |           |                   |            |           |
| States and political subdivisions                        | \$ 4,910      | \$ 4,910   | \$        | \$ 5,837          | \$ 5,837   | \$        |
| Total trading securities                                 | 4,910         | 4,910      |           | 5,837             | 5,837      |           |
| Available-for-sale investment securities                 |               |            |           |                   |            |           |
| Government sponsored enterprises                         | 5,403         | 5,403      |           | 5,404             | 5,404      |           |
| States and political subdivisions                        | 167,334       | 167,334    |           | 169,717           | 169,717    |           |
| Auction rate money market preferred                      | 2,834         |            | 2,834     | 2,865             |            | 2,865     |
| Preferred stock  | 7,570         |            | 7,570     | 6,936             |            | 6,936     |
| Mortgage-backed  | 106,971       | 106,971    |           | 102,215           | 102,215    |           |
| Collateralized mortgage obligations                      | 90,113        | 90,113     |           | 43,587            | 43,587     |           |
| Total available-for-sale investment securities           | 380,225       | 369,821    | 10,404    | 330,724           | 320,923    | 9,801     |
| Borrowed funds   | 10,306        | 10,306     |           | 10,423            | 10,423     |           |
| <b>Nonrecurring items</b>                                |               |            |           |                   |            |           |
| Impaired loans   | 18,748        |            | 18,748    | 12,048            |            | 12,048    |
| Originated mortgage servicing rights                     | 2,617         | 2,617      |           | 2,667             | 2,667      |           |
| Foreclosed assets  | 2,230         | 2,230      |           | 2,067             | 2,067      |           |
|  | \$ 419,036    | \$ 389,884 | \$ 29,152 | \$ 363,766        | \$ 341,917 | \$ 21,849 |
| Percent of assets and liabilities measured at fair value |               |            |           |                   |            |           |
|  |               | 93.04%     | 6.96%     |                   | 93.99%     | 6.01%     |

As of June 30, 2011 and December 31, 2010, the Corporation had no assets or liabilities measured utilizing Level 1 valuation techniques.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, as well as a description of the methods and significant assumptions used to estimate fair value disclosures for financial instruments not recorded at fair value in their entirety on a recurring basis. For financial assets and liabilities recorded at fair value, the description includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

*Cash and demand deposits due from banks:* The carrying amounts of cash and short term investments, including Federal funds sold, approximate fair values.

*Certificates of deposit held in other financial institutions:* Interest bearing balances held in unaffiliated financial institutions include certificates of deposit and other short term interest bearing balances that mature within 3 years. Fair value is determined using prices for similar assets with similar characteristics.

*Investment securities:* Investment securities are recorded at fair value on a recurring basis. Level 2 fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include bonds issued by government sponsored enterprises, states and political subdivisions, mortgage-backed securities, and collateralized mortgage obligations issued by government sponsored enterprises.

Securities classified as Level 3 include securities in less liquid markets and include auction rate money market preferred securities and preferred stocks. Due to the limited trading activity of these securities, the fair values were estimated utilizing a hybrid of market value and discounted cash flow analysis as of June 30, 2011 and a discounted cash flow analysis as of December 31, 2010. These

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analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, the current volume of trading activity, and recent trade prices. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 3 year nonamortizing balloon using weighted average discount rates between 5.70% and 6.97% as of June 30, 2011.

*Mortgage loans available-for-sale:* Mortgage loans available-for-sale are carried at the lower of cost or fair value. The fair value of mortgage loans available-for-sale are based on what price secondary markets are currently offering for portfolios with similar characteristics. As such, the Corporation classifies loans subjected to nonrecurring fair value adjustments as Level 2.

*Loans:* For variable rate loans with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of changes in the credit quality of borrowers since the loans were originated.

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will be significantly different than the contractual terms of the original loan agreement are considered impaired. Once a loan is identified as impaired, management measures the estimated impairment. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

The Corporation reviews the net realizable values of the underlying collateral for collateral dependent impaired loans on at least a quarterly basis for all loan types. To determine the collateral value, management utilizes independent appraisals, broker price opinions, or internal evaluations. These valuations are reviewed to determine whether an additional discount should be applied given the age of market information that may have been considered as well as other factors such as costs to carry and sell an asset if it is determined that the collateral will be liquidated in connection with the ultimate settlement of the loan. The Corporation uses this valuation to determine if any charge offs or specific reserves are necessary. The Corporation may obtain new valuations in certain circumstances, including when there has been significant deterioration in the condition of the collateral, if the foreclosure process has begun, or if the existing valuation is deemed to be outdated.

Impaired loans where an allowance is established based on the net realizable value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraisal value, the Corporation records the loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value collateral is further impaired below the appraised value, the Corporation records the impaired loans as nonrecurring Level 3.

*Accrued interest:* The carrying amounts of accrued interest approximate fair value.

*Goodwill and other intangible assets:* Acquisition intangibles and goodwill are subject to impairment testing. A projected cash flow valuation method is used in the completion of impairment testing. This valuation method requires a significant degree of management judgment. In the event the projected undiscounted net operating cash flows are less than the carrying value, the asset is recorded at fair value as determined by the valuation model. If the testing resulted in impairment, the Corporation would classify goodwill and other acquisition intangibles subjected to nonrecurring fair value adjustments as Level 3. For the six month periods ended June 30, 2011 and 2010, there were no impairments recorded on goodwill and other acquisition intangibles.

*Equity securities without readily determinable fair values:* The Corporation has investments in equity securities without readily determinable fair values as well as investments in joint ventures. The assets are individually reviewed for impairment on an annual basis, or more frequently if an indication of impairment exists, by comparing the carrying value to the estimated fair value. The lack of an independent source to validate fair value estimates, including the impact of future capital calls and transfer restrictions, is an inherent limitation in the valuation process. The

Corporation classifies nonmarketable equity securities and its investments in joint ventures subjected to nonrecurring fair value adjustments as Level 3. For the six month periods ended June 30, 2011 and 2010, there were no impairments recorded on equity securities without readily determinable fair values.

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*Foreclosed assets:* Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Net realizable value is based upon independent market prices, appraised values of the collateral, or management's estimation of the value of the collateral and as such, the Corporation classifies foreclosed assets as a nonrecurring Level 2. When management determines that the net realizable value of the collateral is further impaired below the appraised value but there is no observable market price, the Corporation records the foreclosed asset as nonrecurring Level 3.

*Originated mortgage servicing rights:* Originated mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, originated mortgage servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subject to nonrecurring fair value adjustments as Level 2.

*Deposits:* Demand, savings, and money market deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate certificates of deposit approximate their recorded carrying value. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

*Borrowed funds:* The carrying amounts of federal funds purchased, borrowings under overnight repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values. The fair values of the Corporation's other borrowed funds are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing arrangements.

The Corporation has elected to measure a portion of borrowed funds at fair value. These borrowings are recorded at fair value on a recurring basis, with the fair value measurement estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements. Changes in the fair value of these borrowings are included in noninterest income. As such, the Corporation classifies other borrowed funds as Level 2.

*Commitments to extend credit, standby letters of credit and undisbursed loans:* Fair values for off balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties' credit standings. The Corporation does not charge fees for lending commitments; thus it is not practicable to estimate the fair value of these instruments.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement.

The table below represents the activity in available-for-sale investment securities measured with Level 3 inputs on a recurring basis for the three and six month periods ended June 30:

|                                       | Three Months Ended |          | Six Months Ended |           |
|---------------------------------------|--------------------|----------|------------------|-----------|
|                                       | June 30            |          | June 30          |           |
|                                       | 2011               | 2010     | 2011             | 2010      |
| Level 3 inputs at beginning of period | \$ 10,396          | \$ 9,894 | \$ 9,801         | \$ 10,027 |
| Net unrealized gains (losses)         | 8                  | (377)    | 603              | (510)     |
| Level 3 inputs June 30                | \$ 10,404          | \$ 9,517 | \$ 10,404        | \$ 9,517  |



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The changes in fair value of assets and liabilities recorded at fair value through earnings on a recurring basis and changes in assets and liabilities recorded at fair value on a nonrecurring basis, for which an impairment, or reduction of an impairment, was recognized in the three and six month periods ended June 30, 2011 and 2010, are summarized as follows:

| Description                          | Three Months Ended June 30          |   |                |                                     |   |                 |
|--------------------------------------|-------------------------------------|---|----------------|-------------------------------------|---|-----------------|
|                                      | Trading<br>Gains<br>and<br>(Losses) | 2011<br>Other<br>Gains<br>and<br>(Losses) | Total          | Trading<br>Gains<br>and<br>(Losses) | 2010<br>Other<br>Gains<br>and<br>(Losses) | Total           |
| <b>Recurring Items</b>               |                                     |   |                |                                     |   |                 |
| Trading securities                   | \$ (8)                              | \$  | \$ (8)         | \$ (37)                             | \$  | \$ (37)         |
| Borrowed funds                       |                                     | 37  | 37             |                                     | (3)                                       | (3)             |
| <b>Nonrecurring Items</b>            |                                     |   |                |                                     |   |                 |
| Foreclosed assets                    |                                     | (25)                                      | (25)           |                                     | (13)                                      | (13)            |
| Originated mortgage servicing rights |                                     | (25)                                      | (25)           |                                     | (185)                                     | (185)           |
| <b>Total</b>                         | <b>\$ (8)</b>                       | <b>\$ (13)</b>                            | <b>\$ (21)</b> | <b>\$ (37)</b>                      | <b>\$ (201)</b>                           | <b>\$ (238)</b> |

| Description                          | Six Months Ended June 30            |   |              |                                     |   |                 |
|--------------------------------------|-------------------------------------|---|--------------|-------------------------------------|---|-----------------|
|                                      | Trading<br>Gains<br>and<br>(Losses) | 2011<br>Other<br>Gains<br>and<br>(Losses) | Total        | Trading<br>Gains<br>and<br>(Losses) | 2010<br>Other<br>Gains<br>and<br>(Losses) | Total           |
| <b>Recurring items</b>               |                                     |   |              |                                     |   |                 |
| Trading securities                   | \$ (27)                             | \$  | \$ (27)      | \$ (38)                             | \$  | \$ (38)         |
| Borrowed funds                       |                                     | 117                                       | 117          |                                     | 53  | 53              |
| <b>Nonrecurring items</b>            |                                     |   |              |                                     |   |                 |
| Foreclosed assets                    |                                     | (35)                                      | (35)         |                                     | (90)                                      | (90)            |
| Originated mortgage servicing rights |                                     | (18)                                      | (18)         |                                     | (149)                                     | (149)           |
| <b>Total</b>                         | <b>\$ (27)</b>                      | <b>\$ 64</b>                              | <b>\$ 37</b> | <b>\$ (38)</b>                      | <b>\$ (186)</b>                           | <b>\$ (224)</b> |

The activity in borrowings which the Corporation has elected to carry at fair value was as follows for the three and six month periods ended June 30:

|   |                     | Three Months Ended<br>June 30 |                  | Six Months Ended<br>June 30 |                  |
|---|---------------------|-------------------------------|------------------|-----------------------------|------------------|
|   |                     | 2011                          | 2010             | 2011                        | 2010             |
| Borrowings carried at fair value        | beginning of period | \$ 10,343                     | \$ 17,748        | \$ 10,423                   | \$ 17,804        |
| Paydowns and maturities                 |                     |                               | (5,000)          |                             | (5,000)          |
| Net change in fair value                |                     | (37)                          | 3                | (117)                       | (53)             |
| <b>Borrowings carried at fair value</b> | <b>June 30</b>      | <b>\$ 10,306</b>              | <b>\$ 12,751</b> | <b>\$ 10,306</b>            | <b>\$ 12,751</b> |

|                                 |                |                  |                  |                  |                  |
|---------------------------------|----------------|------------------|------------------|------------------|------------------|
| <b>Unpaid principal balance</b> | <b>June 30</b> | <b>\$ 10,000</b> | <b>\$ 12,154</b> | <b>\$ 10,000</b> | <b>\$ 12,154</b> |
|---------------------------------|----------------|------------------|------------------|------------------|------------------|

**NOTE 13 OPERATING SEGMENTS**

The Corporation's reportable segments are based on legal entities that account for at least 10% of net operating results. Retail banking operations as of June 30, 2011 and 2010 and each of the three and six month periods then ended, represented 90% or more of the Corporation's total assets and operating results. As such, no additional segment reporting is presented.

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**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**ISABELLA BANK CORPORATION FINANCIAL REVIEW**

(All dollars in thousands)

The following is management's discussion and analysis of the financial condition and results of operations for Isabella Bank Corporation. This discussion and analysis is intended to provide a better understanding of the unaudited interim condensed consolidated financial statements and statistical data included elsewhere in this Form 10-Q. This analysis should be read in conjunction with the Corporation's 2010 annual report and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 3 of this report.

**Executive Summary**

Isabella Bank Corporation, as well as all other financial institutions in Michigan and across the entire country, continues to experience the negative impacts on its operations from the persistent weak economy. The current economic environment has led to historically high levels of loans charged off and foreclosed asset and collection expenses.

In spite of the current economic downturn, the Corporation continues to be profitable, with net income of \$4,988 for the six month period ended June 30, 2011. The Corporation's nonperforming loans have increased slightly to 0.90% of total loans as of June 30, 2011 compared to 0.83% as of December 31, 2010. The ratio of nonperforming loans to total loans for all banks in the Corporation's peer group was 3.43% as of March 31, 2011 (June 30, 2011 peer group ratios are not yet available). The Corporation's interest margins also continue to be strong, as the net yield on interest earning assets (on a fully tax equivalent basis) was 3.93% for the six month period ended June 30, 2011.

**Recent Legislation**

The Health Care and Education Act of 2010 and the Patient Protection and Affordable Care Act could have a significant impact on the Corporation's operating results in future periods. Aside from the potential increases in the Corporation's health care costs, the implementation of the new rules and requirements is likely to require a substantial commitment from the Corporation's management.

In 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act makes sweeping changes in the regulation of financial institutions aimed at strengthening the sound operation of the financial services sector. Many of the provisions in the Dodd-Frank Act will not become effective until future years. The Dodd-Frank Act includes the following provisions, among other things:

Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees for financial institutions with assets in excess of \$10,000,000;

Creates a new Consumer Financial Protection Bureau that will have rulemaking and enforcement authority for a wide range of consumer protection laws affecting financial institutions;

Increases leverage and risk-based capital requirements, FDIC premiums and examination fees;

Provides for new disclosure, say-on-pay, and other rules relating to executive compensation and corporate governance for public companies, including public financial institutions;

Permanently increases the federal deposit insurance coverage limit to \$250;

Provides for mortgage reform addressing a customer's ability to repay, restricts variable-rate lending, and makes more loans subject to disclosure requirements and other restrictions; and

Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

Uncertainty remains as to the ultimate impact of the Dodd-Frank Act on the financial services industry as a whole and on the Corporation. In particular, many provisions of the Dodd-Frank Act are subject to rulemaking, which make it

difficult to predict the impact of the Dodd-Frank Act on the Corporation, its customers and the financial services industry as a whole. The Dodd-Frank Act will likely result in increases in the Corporation's expenses, decreases to its revenues, and changes in the activities in which the Corporation engages, which could have a material adverse impact on the Corporation's financial performance and results of operations that cannot be foreseen. Management anticipates that the impact will be substantial.

**Table of Contents****CRITICAL ACCOUNTING POLICIES**

A summary of the Corporation's significant accounting policies is set forth in Note 1 of the Consolidated Financial Statements included in the Corporation's Annual Report for the year ended December 31, 2010. Of these significant accounting policies, the Corporation considers its policies regarding the allowance for loan losses, acquisition intangibles, and the determination of the fair value of investment securities to be its most critical accounting policies. The allowance for loan losses requires management's most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the appropriateness of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation's assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation's allowance for loan losses and related matters, see the detailed discussion to follow under the heading Allowance for Loan Losses.

United States generally accepted accounting principles require that the Corporation determine the fair value of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. The Corporation employs a variety of measures in the determination of the fair value, including the use of discounted cash flow analysis, market appraisals, and projected future revenue streams. For certain items that management believes it has the appropriate expertise to determine the fair value, management may choose to use its own calculations of the value. In other cases, where the value is not easily determined, the Corporation consults with outside parties to determine the fair value of the identified asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired entity and the value of its balance sheet, including identifiable intangibles, is recorded as goodwill. This goodwill is not amortized, but is tested for impairment on at least an annual basis.

The Corporation currently has both available-for-sale and trading investment securities that are carried at fair value. Changes in the fair value of available-for-sale investment securities are included as a component of other comprehensive income, while declines in the fair value of these securities below their cost that are other-than-temporary are reflected as realized losses in the consolidated statements of income. The change in value of trading investment securities is included in current earnings. Management evaluates available-for-sale securities for indications of losses that are considered other-than-temporary, if any, on a regular basis. The market values for available-for-sale and trading investment securities are typically obtained from outside sources and applied to individual securities within the portfolio.

The Corporation invested \$11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, \$7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a hybrid of market value and discounted cash flow analysis as of June 30, 2011 and a discounted cash flow analysis as of December 31, 2010. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, the current volume of trading activity, and recent trade prices. The discount rates used were determined by using the interest rates of similarly rated financial institutions debt based on the weighted average of a range of terms for corporate bond interest rates, which were obtained from published sources. All securities have call dates within the next year. The Corporation calculated the present value assuming a 3 year nonamortizing balloon using weighted average discount rates between 5.70% and 6.97% as of June 30, 2011.

As of June 30, 2011, the Corporation held an auction rate money market preferred security and preferred stocks which continued to be in an unrealized loss position as a result of the securities' interest rates, as they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has determined that any declines in the fair value of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the security. Additionally, none of these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is

more likely than not that the Corporation will not have to sell the securities before recovery of their cost basis. As a result, the Corporation has not recognized an other-than-temporary impairment related to these declines in fair value.

**Table of Contents****RESULTS OF OPERATIONS****Selected Financial Data**

The following table outlines the results of operations for the three and six month periods ended June 30, 2011 and 2010.

|  | Three Months Ended |          | Six Months Ended |           |
|--|--------------------|----------|------------------|-----------|
|  | June 30            |          | June 30          |           |
|  | 2011               | 2010     | 2011             | 2010      |
| <b>INCOME STATEMENT DATA</b>                       |                    |          |                  |           |
| Net interest income                                | \$ 10,568          | \$ 9,981 | \$ 20,753        | \$ 19,680 |
| Provision for loan losses                          | 603                | 1,056    | 1,420            | 2,263     |
| Net income   | 2,672              | 2,151    | 4,988            | 4,174     |
| <b>PER SHARE DATA</b>                              |                    |          |                  |           |
| Earnings per share                                 |                    |          |                  |           |
| Basic  | \$ 0.35            | \$ 0.29  | \$ 0.66          | \$ 0.55   |
| Diluted  | 0.34               | 0.28     | 0.64             | 0.54      |
| Cash dividends per common share                    | 0.19               | 0.18     | 0.38             | 0.36      |
| Book value (at end of period)                      | 20.00              | 19.39    | 20.00            | 19.39     |
| <b>RATIOS</b>                                      |                    |          |                  |           |
| Average primary capital to average assets          | 12.33%             | 13.07%   | 12.48%           | 13.32%    |
| Net income to average assets (annualized)          | 0.84               | 0.74     | 0.79             | 0.72      |
| Net income to average equity (annualized)          | 7.31               | 6.14     | 6.83             | 5.88      |
| Net income to average tangible equity (annualized) | 10.76              | 9.16     | 10.21            | 8.94      |

**Net Interest Income**

Net interest income equals interest income less interest expense and is the primary source of income for the Corporation. Interest income includes loan fees of \$655 and \$1,221 for the three and six month periods ended June 30, 2011, respectively, as compared to \$499 and \$902 during the same periods in 2010. For analytical purposes, net interest income is adjusted to a taxable equivalent basis by adding the income tax savings from interest on tax exempt loans and securities, thus making year to year comparisons more meaningful.

(Continued on page 38)

**Table of Contents****AVERAGE BALANCES, INTEREST RATE, AND NET INTEREST INCOME**

The following schedules present the daily average amount outstanding for each major category of interest earning assets, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities. This schedule also presents an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a fully taxable equivalent (FTE) basis using a 34% tax rate. Non accruing loans, for the purpose of the following computations, are included in the average loan amounts outstanding. Federal Reserve and Federal Home Loan Bank restricted equity holdings are included in other.

The following table displays the results for the three month periods ended June 30:

|   | 2011         |            |         | 2010         |            |         |
|---|--------------|------------|---------|--------------|------------|---------|
|   | Average      | Tax        | Average | Average      | Tax        | Average |
|   | Balance      | Equivalent | Yield\  | Balance      | Equivalent | Yield\  |
|   |              | Interest   | Rate    |              | Interest   | Rate    |
| <b>INTEREST EARNING ASSETS</b>            |              |            |         |              |            |         |
| Loans                                     | \$ 742,439   | \$ 11,464  | 6.18%   | \$ 725,881   | \$ 11,651  | 6.42%   |
| Taxable investment securities             | 233,681      | 1,836      | 3.14%   | 153,588      | 1,346      | 3.51%   |
| Nontaxable investment securities          | 134,898      | 1,864      | 5.53%   | 118,100      | 1,697      | 5.75%   |
| Trading account securities                | 5,089        | 71         | 5.58%   | 8,714        | 121        | 5.55%   |
| Other                                     | 33,529       | 133        | 1.59%   | 38,044       | 110        | 1.16%   |
| Total earning assets                      | 1,149,636    | 15,368     | 5.35%   | 1,044,327    | 14,925     | 5.72%   |
| <b>NON EARNING ASSETS</b>                 |              |            |         |              |            |         |
| Allowance for loan losses                 | (12,551)     |            |         | (13,317)     |            |         |
| Cash and demand deposits due from banks   | 19,361       |            |         | 15,878       |            |         |
| Premises and equipment                    | 24,135       |            |         | 24,577       |            |         |
| Accrued income and other assets           | 94,284       |            |         | 89,310       |            |         |
| Total assets                              | \$ 1,274,865 |            |         | \$ 1,160,775 |            |         |
| <b>INTEREST BEARING LIABILITIES</b>       |              |            |         |              |            |         |
| Interest bearing demand deposits          | \$ 150,696   | 47         | 0.12%   | \$ 133,501   | 35         | 0.10%   |
| Savings deposits                          | 195,856      | 122        | 0.25%   | 169,036      | 96         | 0.23%   |
| Time deposits                             | 464,685      | 2,607      | 2.24%   | 422,111      | 2,743      | 2.60%   |
| Borrowed funds                            | 193,669      | 1,325      | 2.74%   | 181,445      | 1,417      | 3.12%   |
| Total interest bearing liabilities        | 1,004,906    | 4,101      | 1.63%   | 906,093      | 4,291      | 1.89%   |
| <b>NONINTEREST BEARING LIABILITIES</b>    |              |            |         |              |            |         |
| Demand deposits                           | 110,976      |            |         | 102,634      |            |         |
| Other                                     | 12,831       |            |         | 11,938       |            |         |
| Shareholders equity                       | 146,152      |            |         | 140,110      |            |         |
| Total liabilities and shareholders equity | \$ 1,274,865 |            |         | \$ 1,160,775 |            |         |
| Net interest income (FTE)                 |              | \$ 11,267  |         |              | \$ 10,634  |         |



|  |       |       |
|--|-------|-------|
| Net yield on interest earning assets (FTE) | 3.92% | 4.07% |
|--|-------|-------|

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The following table displays the results for the six month periods ended June 30:

|   | Average<br>Balance | 2011<br>Tax<br>Equivalent<br>Interest | Average<br>Yield /<br>Rate | Average<br>Balance | 2010<br>Tax<br>Equivalent<br>Interest | Average<br>Yield /<br>Rate |
|---|--------------------|---------------------------------------|----------------------------|--------------------|---------------------------------------|----------------------------|
| <b>INTEREST EARNING ASSETS</b>                |                    |                                       |                            |                    |                                       |                            |
| Loans   | \$ 738,535         | \$ 22,825                             | 6.18%                      | \$ 725,038         | \$ 23,168                             | 6.39%                      |
| Taxable investment securities                 | 217,595            | 3,349                                 | 3.08%                      | 147,832            | 2,625                                 | 3.55%                      |
| Nontaxable investment securities              | 134,706            | 3,870                                 | 5.75%                      | 118,434            | 3,491                                 | 5.90%                      |
| Trading account securities                    | 5,308              | 148                                   | 5.58%                      | 9,868              | 262                                   | 5.31%                      |
| Other   | 38,405             | 267                                   | 1.39%                      | 35,892             | 214                                   | 1.19%                      |
| Total earning assets                          | 1,134,549          | 30,459                                | 5.37%                      | 1,037,064          | 29,760                                | 5.74%                      |
| <b>NON EARNING ASSETS</b>                     |                    |                                       |                            |                    |                                       |                            |
| Allowance for loan losses                     | (12,568)           |                                       |                            | (13,356)           |                                       |                            |
| Cash and demand deposits due<br>from banks    | 19,935             |                                       |                            | 15,994             |                                       |                            |
| Premises and equipment                        | 24,323             |                                       |                            | 24,450             |                                       |                            |
| Accrued income and other assets               | 93,446             |                                       |                            | 89,867             |                                       |                            |
| Total assets                                  | \$ 1,259,685       |                                       |                            | \$ 1,154,019       |                                       |                            |
| <b>INTEREST BEARING<br/>LIABILITIES</b>       |                    |                                       |                            |                    |                                       |                            |
| Savings deposits                              | \$ 150,962         | 93                                    | 0.12%                      | \$ 133,670         | 70                                    | 0.10%                      |
| Time deposits                                 | 193,002            | 246                                   | 0.25%                      | 167,469            | 185                                   | 0.22%                      |
| Borrowed funds                                | 461,030            | 5,222                                 | 2.27%                      | 419,571            | 5,502                                 | 2.62%                      |
|   | 188,306            | 2,593                                 | 2.75%                      | 183,763            | 2,934                                 | 3.19%                      |
| Total interest bearing liabilities            | 993,300            | 8,154                                 | 1.64%                      | 904,473            | 8,691                                 | 1.92%                      |
| <b>NONINTEREST BEARING<br/>LIABILITIES</b>    |                    |                                       |                            |                    |                                       |                            |
| Demand deposits                               | 109,189            |                                       |                            | 98,097             |                                       |                            |
| Other   | 11,046             |                                       |                            | 9,356              |                                       |                            |
| Shareholders equity                           | 146,150            |                                       |                            | 142,093            |                                       |                            |
| Total liabilities and shareholders<br>equity  | \$ 1,259,685       |                                       |                            | \$ 1,154,019       |                                       |                            |
| Net interest income (FTE)                     |                    | \$ 22,305                             |                            |                    | \$ 21,069                             |                            |
| Net yield on interest earning assets<br>(FTE) |                    |                                       | 3.93%                      |                    |                                       | 4.06%                      |



**Table of Contents****VOLUME AND RATE VARIANCE ANALYSIS**

The following table sets forth the effect of volume and rate changes on interest income and expense for the periods indicated. For the purpose of this table, changes in interest due to volume and rate were determined as follows:

Volume Variance change in volume multiplied by the previous year's rate.

Rate Variance change in the fully taxable equivalent (FTE) rate multiplied by the prior year's volume.

The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

|                                     | Three Months Ended<br>June 30, 2011 Compared to<br>June 30, 2010 |                                    |                                   | Six Months Ended<br>June 30, 2011 Compared to<br>June 30, 2010 |                                    |                                   |
|-------------------------------------|--|------------------------------------|-----------------------------------|--|------------------------------------|-----------------------------------|
|                                     | Increase (Decrease) Due to<br>Volume                             | Increase (Decrease) Due to<br>Rate | Increase (Decrease) Due to<br>Net | Increase (Decrease) Due to<br>Volume                           | Increase (Decrease) Due to<br>Rate | Increase (Decrease) Due to<br>Net |
| <b>CHANGES IN INTEREST INCOME</b>   |  |                                    |                                   |  |                                    |                                   |
| Loans                               | \$ 262   | \$ (449)                           | \$ (187)                          | \$ 426   | \$ (769)                           | \$ (343)                          |
| Taxable investment securities       | 641  | (151)                              | 490                               | 1,110  | (386)                              | 724                               |
| Nontaxable investment securities    | 234  | (67)                               | 167                               | 469  | (90)                               | 379                               |
| Trading account securities          | (51)   | 1                                  | (50)                              | (127)  | 13                                 | (114)                             |
| Other                               | (14)   | 37                                 | 23                                | 16   | 37                                 | 53                                |
| Total changes in interest income    | 1,072  | (629)                              | 443                               | 1,894  | (1,195)                            | 699                               |
| <b>CHANGES IN INTEREST EXPENSE</b>  |  |                                    |                                   |  |                                    |                                   |
| Interest bearing demand deposits    | 5  | 7                                  | 12                                | 10   | 13                                 | 23                                |
| Savings deposits                    | 16   | 10                                 | 26                                | 30   | 31                                 | 61                                |
| Time deposits                       | 261  | (397)                              | (136)                             | 513  | (793)                              | (280)                             |
| Borrowed funds                      | 91   | (183)                              | (92)                              | 71   | (412)                              | (341)                             |
| Total changes in interest expense   | 373  | (563)                              | (190)                             | 624  | (1,161)                            | (537)                             |
| Net change in interest margin (FTE) | \$ 699   | \$ (66)                            | \$ 633                            | \$ 1,270   | \$ (34)                            | \$ 1,236                          |

Despite the declines in interest rates over the last year (for both interest earning assets and interest bearing liabilities), the Corporation has been able to maintain adequate interest margins.

The Corporation anticipates that net interest margin yield will decline slightly during the remainder 2011 due to the following factors:

Based on the current economic conditions, management does not anticipate any changes in the target Fed Funds rate in the foreseeable future. As such, the Corporation does not anticipate significant, if any, changes in market rates. However, there is the potential for declines in rates earned on interest earning assets. Most of the potential declines would arise out of the Corporation's investment portfolio, as certain securities, are either called or matured during 2011 of which proceeds will likely be reinvested at significantly lower rates of return.

Average loans to assets was 58.6% in the first six months of 2011 as compared to 62.8% in 2010. The decline represents a shift of assets from higher yielding loans into lower yielding investments, which negatively impacts net interest margin yield.

The interest rates on many types of loans including home equity lines of credit and investment securities with acceptable credit and interest rate risks are currently priced at or below the Corporation's quarter to date net yield on interest earning



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assets of 3.92%. In order to earn additional net interest income, the Corporation is continuing to extend loans and purchase investments that will increase net income but decrease net interest margin yield.

While the Corporation's liability sensitive balance sheet has allowed it to benefit from decreases in interest rates, it also makes the Corporation sensitive to increases in deposit and borrowing rates. As part of the Corporation's goal to minimize the potential negative impacts of possible increases in future interest rates, management is actively working to lengthen the terms of its interest bearing liabilities. This lengthening has increased the Corporation's cost of funding, reducing net interest income in the short term.

**Allowance for Loan Losses**

The viability of any financial institution is ultimately determined by its management of credit risk. Loans outstanding represent the Corporation's single largest concentration of risk. The allowance for loan losses is management's estimation of probable losses inherent in the existing loan portfolio. Factors used to evaluate the loan portfolio, and thus to determine the current charge to expense, include recent loan loss history, financial condition of borrowers, amount of nonperforming and impaired loans, overall economic conditions and other factors. The following table summarizes the Corporation's charge off and recovery activity for the six month periods ended June 30:

|   | 2011              | 2010              | Variance         |
|---|-------------------|-------------------|------------------|
| Allowance for loan losses January 1                       | \$ 12,373         | \$ 12,979         | \$ (606)         |
| Loans charged off   |                   |                   |                  |
| Commercial and agricultural                               | (870)             | (1,144)           | 274              |
| Real estate mortgage                                      | (878)             | (1,589)           | 711              |
| Consumer  | (284)             | (236)             | (48)             |
| <b>Total loans charged off</b>                            | <b>(2,032)</b>    | <b>(2,969)</b>    | <b>937</b>       |
| Recoveries  |                   |                   |                  |
| Commercial and agricultural                               | 346               | 291               | 55               |
| Real estate mortgage                                      | 103               | 302               | (199)            |
| Consumer  | 168               | 152               | 16               |
| <b>Total recoveries</b>                                   | <b>617</b>        | <b>745</b>        | <b>(128)</b>     |
| Provision for loan losses                                 | 1,420             | 2,263             | (843)            |
| <b>Allowance for loan losses June 30</b>                  | <b>\$ 12,378</b>  | <b>\$ 13,018</b>  | <b>\$ (640)</b>  |
| Net loans charged off                                     | \$ 1,415          | \$ 2,224          | \$ (809)         |
| Year to date average loans outstanding                    | 738,535           | 725,038           | 13,497           |
| <b>Net loans charged off to average loans outstanding</b> | <b>0.19%</b>      | <b>0.31%</b>      | <b>-0.12%</b>    |
| <b>Total amount of loans outstanding</b>                  | <b>\$ 746,294</b> | <b>\$ 727,051</b> | <b>\$ 19,243</b> |
| <b>Allowance for loan losses as a % of loans</b>          | <b>1.66%</b>      | <b>1.79%</b>      | <b>-0.13%</b>    |

The Corporation originates and sells fixed rate residential real estate mortgages to the Federal Home Loan Mortgage Corporation (Freddie Mac). The Corporation has not originated loans for either trading or its own portfolio that would be classified as subprime, nor has it originated adjustable rate mortgages or financed loans for more than 80% of

market value unless insured by private third party insurance.

As shown in the preceding table, when comparing the first six months of 2011 to the same period in 2010, net loans charged off decreased by \$809. This improvement allowed the Corporation to reduce its provision for loan losses for the six month period ended June 30, 2011 as compared to 2010. While there have been marked improvements in the level of net loans charged off, which has contributed to the Corporation's ability to reduce its provision for loan losses, the overall local, regional and national economies have yet to show consistent improvement.

The Corporation allocates the allowance throughout its loan portfolio based on management's assessment of the underlying risks associated with each loan segment. Management's assessments include allocations based on specific impairment allocations, historical loss histories, internally assigned credit ratings, and past due and nonaccrual balances. A portion of the allowance for loan

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losses is not allocated to any one loan segment, but is instead a reflection of other qualitative risks within the Corporation's loan portfolio.

For further discussion on the allocation of the allowance for loan losses, see Note 6 Loans and Allowance for Loan Losses to the Corporation's interim condensed consolidated financial statements.

**Loans Past Due and Loans in Nonaccrual Status**

Increases in past due and nonaccrual loans can have a significant impact on the allowance for loan losses. To determine the potential impact, and corresponding estimated losses, management analyzes its historical loss trends on loans past due 30-89 days, 90 days or more, and nonaccrual loans.

The following tables summarize the Corporation's past due and nonaccrual loans as of:

|                             | June 30, 2011           |              |            |                               |
|-----------------------------|-------------------------|--------------|------------|-------------------------------|
|                             | Accruing Loans Past Due |              |            | Total Past Due and Nonaccrual |
|                             | 30-89 Days              | Greater Than |            |                               |
|                             |                         | 90 Days      | Nonaccrual | Nonaccrual                    |
| Commercial and agricultural | \$ 2,467                | \$ 525       | \$ 4,195   | \$ 7,187                      |
| Residential mortgage        | 2,880                   | 139          | 1,845      | 4,864                         |
| Consumer installment        | 192                     | 12           |            | 204                           |
|                             | \$ 5,539                | \$ 676       | \$ 6,040   | \$ 12,255                     |

|                             | December 31, 2010       |              |            |                               |
|-----------------------------|-------------------------|--------------|------------|-------------------------------|
|                             | Accruing Loans Past Due |              |            | Total Past Due and Nonaccrual |
|                             | 30-89 Days              | Greater Than |            |                               |
|                             |                         | 90 Days      | Nonaccrual | Nonaccrual                    |
| Commercial and agricultural | \$ 5,291                | \$ 175       | \$ 4,140   | \$ 9,606                      |
| Residential mortgage        | 6,339                   | 310          | 1,470      | 8,119                         |
| Consumer installment        | 308                     | 1            |            | 309                           |
|                             | \$ 11,938               | \$ 486       | \$ 5,610   | \$ 18,034                     |



**Table of Contents****Troubled Debt Restructurings**

The following table summarizes the Corporation's troubled debt restructurings component of its impaired loans as of:

|   | June 30<br>2011      |               |                  | December 31<br>2010  |               |                 | Total<br>Change |
|---|----------------------|---------------|------------------|----------------------|---------------|-----------------|-----------------|
|   | Accruing<br>Interest | Nonaccrual    | Total            | Accruing<br>Interest | Nonaccrual    | Total           |                 |
| Current                                       | \$ 10,609            | \$ 38         | \$ 10,647        | \$ 4,798             | \$ 499        | \$ 5,297        | \$ 5,350        |
| Past due 30-89 days                           | 137                  | 383           | 520              | 277                  | 26            | 303             | 217             |
| Past due 90 days or<br>more                   |                      | 106           | 106              |                      | 163           | 163             | (57)            |
| <b>Total troubled debt<br/>restructurings</b> | <b>\$ 10,746</b>     | <b>\$ 527</b> | <b>\$ 11,273</b> | <b>\$ 5,075</b>      | <b>\$ 688</b> | <b>\$ 5,763</b> | <b>\$ 5,510</b> |

Since December 31, 2008 the Corporation has taken aggressive actions to avoid foreclosures on borrowers who are willing to work with the Corporation in modifying their loans, thus making them more affordable. These loan modifications have allowed borrowers to develop a payment structure that will allow them to continue making payments in lieu of foreclosure. Troubled debt restructurings that have been placed in nonaccrual status may be placed back on accrual status after six months of continuous resumed performance.

To be classified as a troubled debt restructuring, the concessions granted to a customer who is experiencing financial difficulty must meet one of the following criteria:

1. Reduction of the stated interest rate related to the sole purpose of providing payment relief for the remaining original life of the debt.
2. Extension of the amortization period beyond typical lending guidelines.
3. Forbearance of principal.
4. Forbearance of accrued interest.

The following table displays the results of the Corporation's efforts related to troubled debt restructurings modified since December 31, 2008:

|   | Successful            |                       | Unsuccessful          |                       | Total                 |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|   | Number<br>of<br>Loans | Amount<br>of<br>Loans | Number<br>of<br>Loans | Amount<br>of<br>Loans | Number<br>of<br>Loans | Amount<br>of<br>Loans |
| Reduction in interest rate                                  | 9                     | \$ 275                | 1                     | \$ 132                | 10                    | \$ 407                |
| Extension of amortization                                   | 32                    | 7,152                 | 3                     | 114                   | 35                    | 7,266                 |
| Reduction in interest rate and<br>extension of amortization | 34                    | 6,001                 | 1                     | 93                    | 35                    | 6,094                 |
|   | 75                    | \$ 13,428             | 5                     | \$ 339                | 80                    | \$ 13,767             |

Since December 31, 2008 the Corporation has not restructured any loans as a result of a forbearance of principal or accrued interest. As shown the preceding table, the Corporation has been successful in its efforts to modify loans to prevent foreclosures.

**Table of Contents****Nonperforming Assets**

The following table summarizes the Corporation's nonperforming assets as of:

|  | June 30<br>2011 | December<br>31<br>2010 | Change        |
|--|-----------------|------------------------|---------------|
| Nonaccrual loans                                   | \$ 6,040        | \$ 5,610               | \$ 430        |
| Accruing loans past due 90 days or more            | 676             | 486                    | 190           |
| <b>Total nonperforming loans</b>                   | <b>6,716</b>    | <b>6,096</b>           | <b>620</b>    |
| Other real estate owned (OREO)                     | 2,228           | 2,039                  | 189           |
| Reposessed assets                                  | 2               | 28                     | (26)          |
| <b>Total nonperforming assets</b>                  | <b>\$ 8,946</b> | <b>\$ 8,163</b>        | <b>\$ 783</b> |
| <b>Nonperforming loans as a % of total loans</b>   | <b>0.90%</b>    | <b>0.83%</b>           | <b>0.07%</b>  |
| <b>Nonperforming assets as a % of total assets</b> | <b>0.70%</b>    | <b>0.67%</b>           | <b>0.03%</b>  |

Loans are placed in nonaccrual status when the foreclosure process has begun, generally after a loan is 90 days past due, unless they are well secured and in the process of collection. Upon transferring the loans to nonaccrual status, an evaluation to determine the net realizable value of the underlying collateral is performed. This evaluation is used to help determine if any charge downs are necessary. Loans may be placed back on accrual status after six months of continued performance.

The following table summarizes the Corporation's nonaccrual loan balances by type as of:

|                             | June 30<br>2011 | December<br>31<br>2010 | Change |
|-----------------------------|-----------------|------------------------|--------|
| Commercial and agricultural | \$ 4,195        | \$ 4,140               | \$ 55  |
| Residential mortgage        | 1,845           | 1,470                  | 375    |
|                             | \$ 6,040        | \$ 5,610               | \$ 430 |

Included in nonaccrual commercial and agricultural loans was one credit with a balance of \$2,329 as of June 30, 2011 and \$2,679 as of December 31, 2010. This credit is secured by undeveloped commercial real estate for which there has been a specific allocation established in the amount of \$345 as of December 31, 2010. As of June 30, 2011, there was no specific allocation established for this credit as it has been charged down to reflect the current market value of the real estate. There were no other individually significant credits included in nonaccrual loans as of June 30, 2011 and December 31, 2010.

Included in the nonaccrual loan balances above were credits currently classified as restructured loans as of:

|                             | June 30<br>2011 | December<br>31<br>2010 | Change   |
|-----------------------------|-----------------|------------------------|----------|
| Commercial and agricultural | \$ 527          | \$ 115                 | \$ (412) |
| Residential mortgage        |                 | 573                    | (573)    |

\$ 527      \$ 688      \$ (161)

The Corporation has devoted considerable attention to identifying impaired loans and adjusting the net carrying value of these loans to their current net realizable values through the establishment of a specific reserve or the recording of a charge off. To management's knowledge, all loans that are deemed to be impaired have been recognized. A continued decline in real estate values may require further write downs of loans in foreclosure and other real estate owned and could potentially have an adverse impact on the Corporation's financial performance.

Based on management's analysis, the allowance for loan losses is considered appropriate as of June 30, 2011.

Management will continue to closely monitor its overall credit quality during 2011 to ensure that the allowance for loan losses remains appropriate.

**Table of Contents****NONINTEREST INCOME AND EXPENSES****Noninterest Income**

Noninterest income consists of service charges and fee income, gains from the sale of mortgage loans, gains and losses on trading securities and borrowings measured at fair value, gains from the sale of investment securities, and other. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

|   | Three Months Ended June 30 |                 |               |               |
|---|----------------------------|-----------------|---------------|---------------|
|   | 2011                       | 2010            | Change<br>\$  | %             |
| <b>Service charges and fees</b>                             |                            |                 |               |               |
| NSF and overdraft fees                                      | \$ 651                     | \$ 738          | \$ (87)       | -11.8%        |
| ATM and debit card fees                                     | 441                        | 377             | 64            | 17.0%         |
| Trust fees  | 267                        | 235             | 32            | 13.6%         |
| Freddie Mac servicing fee                                   | 174                        | 179             | (5)           | -2.8%         |
| Service charges on deposit accounts                         | 83                         | 87              | (4)           | -4.6%         |
| Net originated mortgage servicing rights loss               | (36)                       | (159)           | 123           | N/M           |
| All other   | 37                         | 37              |               | 0.0%          |
| <b>Total service charges and fees</b>                       | <b>1,617</b>               | <b>1,494</b>    | <b>123</b>    | <b>8.2%</b>   |
| <b>Gain on sale of mortgage loans</b>                       | <b>53</b>                  | <b>74</b>       | <b>(21)</b>   | <b>-28.4%</b> |
| <b>Net gain (loss) on trading securities</b>                | <b>(8)</b>                 | <b>(37)</b>     | <b>29</b>     | <b>N/M</b>    |
| <b>Net gain (loss) on borrowings measured at fair value</b> | <b>37</b>                  | <b>(3)</b>      | <b>40</b>     | <b>N/M</b>    |
| <b>Other</b>  |                            |                 |               |               |
| Earnings on corporate owned life insurance policies         | 145                        | 144             | 1             | 0.7%          |
| Brokerage and advisory fees                                 | 144                        | 147             | (3)           | -2.0%         |
| All other   | (10)                       | 51              | (61)          | -119.6%       |
| <b>Total other</b>  | <b>279</b>                 | <b>342</b>      | <b>(63)</b>   | <b>-18.4%</b> |
| <b>Total noninterest income</b>                             | <b>\$ 1,978</b>            | <b>\$ 1,870</b> | <b>\$ 108</b> | <b>5.8%</b>   |

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|   | Six Months Ended June 30 |                 |                 |                |
|---|--------------------------|-----------------|-----------------|----------------|
|   | 2011                     | 2010            | Change          |                |
|   |                          |                 | \$              | %              |
| <b>Service charges and fees</b>                                 |                          |                 |                 |                |
| NSF and overdraft fees  | \$ 1,222                 | \$ 1,448        | \$ (226)        | -15.6%         |
| ATM and debit card fees   | 844                      | 722             | 122             | 16.9%          |
| Trust fees  | 488                      | 429             | 59              | 13.8%          |
| Freddie Mac servicing fee                                       | 356                      | 367             | (11)            | -3.0%          |
| Service charges on deposit accounts                             | 158                      | 167             | (9)             | -5.4%          |
| Net originated mortgage servicing rights loss                   | (50)                     | (84)            | 34              | N/M            |
| All other   | 75                       | 73              | 2               | 2.7%           |
| <b>Total service charges and fees</b>                           | <b>3,093</b>             | <b>3,122</b>    | <b>(29)</b>     | <b>-0.9%</b>   |
| <b>Gain on sale of mortgage loans</b>                           | <b>182</b>               | <b>167</b>      | <b>15</b>       | <b>9.0%</b>    |
| <b>Net loss on trading securities</b>                           | <b>(27)</b>              | <b>(38)</b>     | <b>11</b>       | <b>N/M</b>     |
| <b>Net gain on borrowings measured at fair value</b>            | <b>117</b>               | <b>53</b>       | <b>64</b>       | <b>120.8%</b>  |
| <b>Gain on sale of available-for-sale investment securities</b> |                          | <b>56</b>       | <b>(56)</b>     | <b>-100.0%</b> |
| <b>Other</b>  |                          |                 |                 |                |
| Earnings on corporate owned life insurance policies             | 287                      | 313             | (26)            | -8.3%          |
| Brokerage and advisory fees                                     | 283                      | 290             | (7)             | -2.4%          |
| All other   | (9)                      | 74              | (83)            | -112.2%        |
| <b>Total other</b>  | <b>561</b>               | <b>677</b>      | <b>(116)</b>    | <b>-17.1%</b>  |
| <b>Total noninterest income</b>                                 | <b>\$ 3,926</b>          | <b>\$ 4,037</b> | <b>\$ (111)</b> | <b>-2.7%</b>   |

Significant changes in noninterest income are detailed below:

Management continuously analyzes various fees related to deposit accounts including service charges and NSF and overdraft fees. Based on these analyses, the Corporation makes any necessary adjustments to ensure that its fee structure is within the range of its competitors, while at the same time making sure that the fees remain fair to deposit customers. NSF and overdraft fees have been steadily declining over the past two years, with the decline accelerating in the third quarter of 2010 as a result of new regulatory guidance issued by the Federal Reserve Bank being implemented related to NSF and overdraft fees. The Corporation anticipates that NSF and overdraft fees will approximate current levels for the remainder of 2011.

The increases in ATM and debit card fees are primarily the result of the increased usage of debit cards by customers. As management does not anticipate any significant changes to the ATM and debit card fee structures, income is expected to continue to increase as the usage of debit cards increases.

Trust fees have increased primarily due to increases in the size of the managed portfolio. As management anticipates continued growth in trust services it anticipates Trust fees to continue to increase as well.

Fluctuations in the gains and losses related to trading securities and borrowings carried at fair value are caused by interest rate variances. Management does not anticipate any significant fluctuations in net trading activities for the remainder of the year as significant interest rate changes are not expected.

The Corporation is continuously analyzing its available-for-sale investment portfolio to take advantage of selling opportunities that would generate gains. Currently, management does not anticipate any significant

sales during the remainder of 2011.

The fluctuation in all other income is spread throughout various categories, none of which are individually significant.

**Table of Contents****Noninterest Expenses**

Noninterest expenses include compensation and benefits, occupancy, furniture and equipment, FDIC insurance premiums, and other expenses. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations:

|  | Three Months Ended June 30 |              |            |              |
|--|----------------------------|--------------|------------|--------------|
|  | 2011                       | 2010         | Change     |              |
|  |                            |              | \$         | %            |
| <b>Compensation and benefits</b>       |                            |              |            |              |
| Leased employee salaries               | \$ 3,513                   | \$ 3,380     | \$ 133     | 3.9%         |
| Leased employee benefits               | 1,227                      | 1,183        | 44         | 3.7%         |
| All other                              | 6                          | 2            | 4          | 200.0%       |
| <b>Total compensation and benefits</b> | <b>4,746</b>               | <b>4,565</b> | <b>181</b> | <b>4.0%</b>  |
| <b>Occupancy</b>                       |                            |              |            |              |
| Depreciation                           | 150                        | 147          | 3          | 2.0%         |
| Outside services                       | 145                        | 131          | 14         | 10.7%        |
| Utilities                              | 106                        | 93           | 13         | 14.0%        |
| Property taxes                         | 130                        | 114          | 16         | 14.0%        |
| Building repairs                       | 59                         | 53           | 6          | 11.3%        |
| All other                              | 23                         | 19           | 4          | 21.1%        |
| <b>Total occupancy</b>                 | <b>613</b>                 | <b>557</b>   | <b>56</b>  | <b>10.1%</b> |
| <b>Furniture and equipment</b>         |                            |              |            |              |
| Depreciation                           | 485                        | 490          | (5)        | -1.0%        |
| Computer / service contracts           | 465                        | 438          | 27         | 6.2%         |
| ATM and debit card expenses            | 157                        | 146          | 11         | 7.5%         |
| All other                              | 20                         | 8            | 12         | 150.0%       |
| <b>Total furniture and equipment</b>   | <b>1,127</b>               | <b>1,082</b> | <b>45</b>  | <b>4.2%</b>  |
| <b>FDIC insurance premiums</b>         | <b>331</b>                 | <b>313</b>   | <b>18</b>  | <b>5.8%</b>  |
| <b>Other</b>                           |                            |              |            |              |
| Marketing and community relations      | 527                        | 272          | 255        | 93.8%        |
| Directors fees                         | 206                        | 236          | (30)       | -12.7%       |
| Audit and SOX compliance fees          | 167                        | 101          | 66         | 65.3%        |
| Foreclosed asset and collection        | 177                        | 155          | 22         | 14.2%        |
| Education and travel                   | 99                         | 98           | 1          | 1.0%         |
| Postage and freight                    | 96                         | 100          | (4)        | -4.0%        |
| Printing and supplies                  | 89                         | 101          | (12)       | -11.9%       |
| Amortization of deposit premium        | 76                         | 86           | (10)       | -11.6%       |
| Legal fees                             | 54                         | 115          | (61)       | -53.0%       |
| Consulting fees                        | 67                         | 54           | 13         | 24.1%        |
| All other                              | 404                        | 440          | (36)       | -8.2%        |

|                                   |                 |                 |               |              |
|-----------------------------------|-----------------|-----------------|---------------|--------------|
| <b>Total other</b>                | <b>1,962</b>    | <b>1,758</b>    | <b>204</b>    | <b>11.6%</b> |
| <b>Total noninterest expenses</b> | <b>\$ 8,779</b> | <b>\$ 8,275</b> | <b>\$ 504</b> | <b>6.1%</b>  |



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|  | Six Months Ended June 30 |                  |               |              |
|--|--------------------------|------------------|---------------|--------------|
|  | 2011                     | 2010             | Change        | %            |
| <b>Compensation and benefits</b>       |                          |                  |               |              |
| Leased employee salaries               | \$ 7,069                 | \$ 6,757         | \$ 312        | 4.6%         |
| Leased employee benefits               | 2,670                    | 2,396            | 274           | 11.4%        |
| All other                              | 12                       | 7                | 5             | 71.4%        |
| <b>Total compensation and benefits</b> | <b>9,751</b>             | <b>9,160</b>     | <b>591</b>    | <b>6.5%</b>  |
| <b>Occupancy</b>                       |                          |                  |               |              |
| Depreciation                           | 298                      | 292              | 6             | 2.1%         |
| Outside services                       | 307                      | 255              | 52            | 20.4%        |
| Property taxes                         | 258                      | 228              | 30            | 13.2%        |
| Utilities                              | 233                      | 216              | 17            | 7.9%         |
| Building repairs                       | 119                      | 92               | 27            | 29.3%        |
| All other                              | 44                       | 36               | 8             | 22.2%        |
| <b>Total occupancy</b>                 | <b>1,259</b>             | <b>1,119</b>     | <b>140</b>    | <b>12.5%</b> |
| <b>Furniture and equipment</b>         |                          |                  |               |              |
| Depreciation                           | 984                      | 943              | 41            | 4.3%         |
| Computer / service contracts           | 925                      | 867              | 58            | 6.7%         |
| ATM and debit card fees                | 296                      | 288              | 8             | 2.8%         |
| All other                              | 28                       | 15               | 13            | 86.7%        |
| <b>Total furniture and equipment</b>   | <b>2,233</b>             | <b>2,113</b>     | <b>120</b>    | <b>5.7%</b>  |
| <b>FDIC insurance premiums</b>         | <b>665</b>               | <b>619</b>       | <b>46</b>     | <b>7.4%</b>  |
| <b>Other</b>                           |                          |                  |               |              |
| Marketing and community relations      | 750                      | 660              | 90            | 13.6%        |
| Directors fees                         | 417                      | 445              | (28)          | -6.3%        |
| Audit and SOX compliance fees          | 323                      | 346              | (23)          | -6.6%        |
| Foreclosed asset and collection        | 277                      | 354              | (77)          | -21.8%       |
| Education and travel                   | 204                      | 212              | (8)           | -3.8%        |
| Postage and freight                    | 196                      | 183              | 13            | 7.1%         |
| Printing and supplies                  | 189                      | 197              | (8)           | -4.1%        |
| Amortization of deposit premium        | 152                      | 172              | (20)          | -11.6%       |
| Legal fees                             | 116                      | 198              | (82)          | -41.4%       |
| Consulting fees                        | 100                      | 100              |               | 0.0%         |
| All other                              | 734                      | 751              | (17)          | -2.3%        |
| <b>Total other</b>                     | <b>3,458</b>             | <b>3,618</b>     | <b>(160)</b>  | <b>-4.4%</b> |
| <b>Total noninterest expenses</b>      | <b>\$ 17,366</b>         | <b>\$ 16,629</b> | <b>\$ 737</b> | <b>4.4%</b>  |



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Significant changes in noninterest expenses are detailed below:

Leased employee salaries have increased due to annual merit increases and the continued growth of the Corporation.

The increase in Leased employee benefits is primarily related to an increase in medical costs.

Foreclosed asset and collection expenses have declined from 2010 however; they continue to be at historically high levels. Management anticipates that these expenses will approximate current levels throughout the remainder of 2011.

Marketing and community relations expenses have increased primarily as a result of increased charitable contributions.

The change in Audit and SOX compliance fees is primarily due to the timing of performance of recurring audit procedures. Management does not anticipate any significant changes for the remainder of 2011.

The Corporation's legal expenses can fluctuate from period to period based on the volume of foreclosures as well as expenses related to the Corporation's ongoing operations. At this time, the Corporation is not aware of any significant legal matters for 2011.

The fluctuations in all other expenses are spread throughout various categories, none of which are individually significant.

**ANALYSIS OF CHANGES IN FINANCIAL CONDITION**

|  | June 30             | December            |                      | %            |
|--|---------------------|---------------------|----------------------|--------------|
|  | 2011                | 31                  | \$                   | Change       |
|  |                     | 2010                | Change(unannualized) |              |
| <b>ASSETS</b>  |                     |                     |                      |              |
| Cash and cash equivalents                                    | \$ 21,792           | \$ 18,109           | \$ 3,683             | 20.34%       |
| Certificates of deposit held in other financial institutions | 10,874              | 15,808              | (4,934)              | -31.21%      |
| Trading securities   | 4,910               | 5,837               | (927)                | -15.88%      |
| Available-for-sale securities                                | 380,225             | 330,724             | 49,501               | 14.97%       |
| Mortgage loans available-for-sale                            | 764                 | 1,182               | (418)                | -35.36%      |
| Loans  | 746,294             | 735,304             | 10,990               | 1.49%        |
| Allowance for loan losses                                    | (12,378)            | (12,373)            | (5)                  | 0.04%        |
| Premises and equipment                                       | 24,229              | 24,627              | (398)                | -1.62%       |
| Goodwill and other intangible assets                         | 46,939              | 47,091              | (152)                | -0.32%       |
| Equity securities without readily determinable fair values   | 17,061              | 17,564              | (503)                | -2.86%       |
| Other assets   | 40,560              | 41,937              | (1,377)              | -3.28%       |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,281,270</b> | <b>\$ 1,225,810</b> | <b>\$ 55,460</b>     | <b>4.52%</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                  |                     |                     |                      |              |
| <b>Liabilities</b>   |                     |                     |                      |              |
| Deposits   | \$ 924,199          | \$ 877,339          | \$ 46,860            | 5.34%        |
| Borrowed funds   | 196,480             | 194,917             | 1,563                | 0.80%        |
| Accrued interest payable and other liabilities               | 9,077               | 8,393               | 684                  | 8.15%        |

|  |                     |                     |                  |              |
|--|---------------------|---------------------|------------------|--------------|
| <b>Total liabilities</b>                         | <b>1,129,756</b>    | <b>1,080,649</b>    | <b>49,107</b>    | <b>4.54%</b> |
| <b>Shareholders equity</b>                       | <b>151,514</b>      | <b>145,161</b>      | <b>6,353</b>     | <b>4.38%</b> |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b> | <b>\$ 1,281,270</b> | <b>\$ 1,225,810</b> | <b>\$ 55,460</b> | <b>4.52%</b> |

As shown above, the Corporation has had strong deposit growth since year end. However, as loans have remained essentially unchanged, the Corporation increased cash and cash equivalents (which includes interest bearing balances due from banks) and available-for-sale investment securities. As deposits are anticipated to continue to grow throughout the remainder of 2011, the Corporation's holdings of available-for-sale investment securities are expected to increase as well.

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The following table outlines the changes in the loan portfolio:

|                                  | June 30<br>2011 | December<br>31<br>2010 | \$ Change | % Change<br>(unannualized) |
|----------------------------------|-----------------|------------------------|-----------|----------------------------|
| Commercial                       | \$ 358,943      | \$ 348,852             | \$ 10,091 | 2.89%                      |
| Agricultural                     | 72,126          | 71,446                 | 680       | 0.95%                      |
| Residential real estate mortgage | 284,190         | 284,029                | 161       | 0.06%                      |
| Installment                      | 31,035          | 30,977                 | 58        | 0.19%                      |
|                                  | \$ 746,294      | \$ 735,304             | \$ 10,990 | 1.49%                      |

The following table outlines the changes in the deposit portfolio:

|                                     | June 30<br>2011   | December<br>31<br>2010 | \$ Change        | % Change<br>(unannualized) |
|-------------------------------------|-------------------|------------------------|------------------|----------------------------|
| Noninterest bearing demand deposits | \$ 113,635        | \$ 104,902             | \$ 8,733         | 8.32%                      |
| Interest bearing demand deposits    | 148,176           | 142,259                | 5,917            | 4.16%                      |
| Savings deposits                    | 195,541           | 177,817                | 17,724           | 9.97%                      |
| Certificates of deposit             | 415,839           | 398,613                | 17,226           | 4.32%                      |
| Brokered certificates of deposit    | 51,008            | 53,748                 | (2,740)          | -5.10%                     |
| <b>Total</b>                        | <b>\$ 924,199</b> | <b>\$ 877,339</b>      | <b>\$ 46,860</b> | <b>5.34%</b>               |

As shown in the preceding table, a significant amount of the growth in deposits since December 31, 2010 has been spread across the various deposit categories which is comprised of market deposits. This growth was the result of focused marketing efforts to increase deposit market share in the communities served. Management anticipates that deposits will continue to grow in 2011.

Borrowed funds consist of the following obligations as of:

|  | June 30, 2011     |              | December 31,<br>2010 |              |
|--|-------------------|--------------|----------------------|--------------|
|  | Amount            | Rate         | Amount               | Rate         |
| Federal Home Loan Bank advances  | \$ 132,306        | 3.44%        | \$ 113,423           | 3.64%        |
| Securities sold under agreements to repurchase without stated maturity dates | 40,110            | 0.25%        | 45,871               | 0.25%        |
| Securities sold under agreements to repurchase with stated maturity dates    | 16,864            | 3.32%        | 19,623               | 3.01%        |
| Federal funds purchased  | 7,200             | 0.50%        | 16,000               | 0.60%        |
| <b>Total</b>   | <b>\$ 196,480</b> | <b>2.67%</b> | <b>\$ 194,917</b>    | <b>2.53%</b> |

**Capital**

The capital of the Corporation consists solely of common stock, retained earnings, and accumulated other comprehensive income. The Corporation offers dividend reinvestment and employee and director stock purchase plans. Under the provisions of these plans, the Corporation issued 61,057 shares or \$1,090 of common stock during the first six months of 2011, as compared to 59,186 shares or \$1,078 of common stock during the same period in 2010. The Corporation also offers a deferred compensation plan for its directors, which allows participants to purchase stock units, in lieu of cash payments. Pursuant to this plan, the Corporation increased shareholders' equity by \$307 and \$332 during the six month periods ended June 30, 2011 and 2010, respectively.

The Board of Directors has approved a publically announced common stock repurchase plan to enable the Corporation to repurchase its common stock. During the first six months of 2011 and 2010, pursuant to this plan, the Corporation repurchased 50,458 shares of common stock at an average price of \$18.11 and 76,097 shares of common stock at an average price of \$18.74, respectively. As of June 30, 2011, the Corporation was authorized to repurchase up to an additional 88,979 shares of common stock.

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Accumulated other comprehensive income increased \$2,364 for the six month period ended June 30, 2011, net of tax. The increase is a result of unrealized gains on available-for-sale investment securities. Management has reviewed the credit quality of its investment portfolio and believes that there are no losses that are other-than-temporary.

There are no significant regulatory constraints placed on the Corporation's capital. The Federal Reserve Board's current recommended minimum primary capital to assets requirement is 6.0%. The Corporation's primary capital to adjusted average assets, which consists of shareholders' equity plus the allowance for loan losses less acquisition intangibles, was 8.16% as of June 30, 2011.

There are no commitments for significant capital expenditures for the remainder of 2011.

The Federal Reserve Board has established a minimum risk based capital standard. Under this standard, a framework has been established that assigns risk weights to each category of on and off balance sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. The minimum standard is 8%, of which at least 4% must consist of equity capital net of goodwill. The following table sets forth the percentages required under the Risk Based Capital guidelines and the Corporation's values as of:

|                   | June 30<br>2011 | December<br>31<br>2010 | Required |
|-------------------|-----------------|------------------------|----------|
| Equity Capital    | 12.52%          | 12.44%                 | 4.00%    |
| Secondary Capital | 1.25%           | 1.25%                  | 4.00%    |
| Total Capital     | 13.77%          | 13.69%                 | 8.00%    |

Isabella Bank Corporation's secondary capital includes only the allowance for loan losses. The percentage for the secondary capital under the required column is the maximum amount allowed from all sources.

The Federal Reserve and FDIC also prescribe minimum capital requirements for the Bank. At June 30, 2011, the Bank exceeded these minimum capital requirements. Recently passed legislation may increase the required level of capital for banks. This increase in capital levels may have an adverse impact on the Corporation's ability to grow and pay dividends.

**Liquidity**

The primary sources of the Corporation's liquidity are cash and demand deposits due from banks, certificates of deposit held in other financial institutions, trading securities, and available-for-sale securities, excluding money market preferred securities and preferred stocks due to their illiquidity. These categories totaled \$407,397 or 31.8% of assets as of June 30, 2011 as compared to \$360,677 or 29.4% as of December 31, 2010. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests, and various other commitments including expansion of operations, investment opportunities, and payment of cash dividends. Liquidity varies on a daily basis as a result of customer activity.

Historically, the primary source of funds for the Corporation has been deposits. The Corporation emphasizes interest bearing time deposits as part of its funding strategy. The Corporation also seeks noninterest bearing deposits, or checking accounts, which reduce the Corporation's cost of funds in an effort to expand the customer base.

In addition to these primary sources of liquidity, the Corporation has the ability to borrow in the federal funds market at the Federal Reserve Bank, the Federal Home Loan Bank, as well as other correspondent banks. The Corporation's liquidity is considered adequate by the management of the Corporation.

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The following table summarizes the Corporation's sources and uses of cash for the six month periods ended June 30:

|   | 2011      | 2010      | \$ Variance |
|---|-----------|-----------|-------------|
| Net cash provided by operating activities | \$ 11,225 | \$ 16,624 | \$ (5,399)  |
| Net cash used in investing activities     | (53,418)  | (18,447)  | (34,971)    |
| Net cash provided by financing activities | 45,876    | 10,229    | 35,647      |
| Increase in cash and cash equivalents     | 3,683     | 8,406     | (4,723)     |
| Cash and cash equivalents January 1       | 18,109    | 22,706    | (4,597)     |
| Cash and cash equivalents June 30         | \$ 21,792 | \$ 31,112 | \$ (9,320)  |

The decrease in cash and cash equivalents from 2010 is the result of increased purchases of available-for-sale securities.

**FINANCIAL INSTRUMENTS WITH OFF BALANCE SHEET ARRANGEMENTS**

The Corporation is party to credit related financial instruments with off-balance-sheet risk. These financial instruments are entered into in the normal course of business to meet the financing needs of its customers. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Corporation has in a particular class of financial instrument.

|  | Contract Amount |                     |
|--|-----------------|---------------------|
|  | June 30<br>2011 | December 31<br>2010 |
| Unfunded commitments under lines of credit | \$100,155       | \$110,201           |
| Commercial and standby letters of credit   | 4,324           | 4,881               |
| Commitments to grant loans                 | 26,075          | 13,382              |

Unfunded commitments under commercial lines of credit, revolving credit home equity lines of credit, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These commitments may expire without being drawn upon and may not be drawn upon to the total extent to which the Corporation is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured. Commercial and standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements, including commercial paper, bond financing, and similar transactions. These commitments to extend credit and letters of credit mature within one year. The credit risk involved in these transactions is essentially the same as that involved in extending loans to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon the extension of credit, is based on management's credit evaluation of the borrower. While the Corporation considers standby letters of credit to be guarantees, the amount of the liability related to such guarantees on the commitment date is not significant and a liability related to such guarantees is not recorded on the consolidated balance sheets.

Commitments to extend credit are 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 may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management's credit evaluation of the customer.

The Corporation's exposure to credit-related loss in the event of nonperformance by the counter 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. The Corporation uses the same credit policies in deciding to make these commitments as



it does for extending loans to customers. No significant losses are anticipated as a result of these commitments.

**Forward Looking Statements**

This report contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Corporation intends such forward looking statements to be covered by the safe harbor provisions for forward looking statements contained in the Private Securities Litigation Reform Act of

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1995, and is including this statement for purposes of these safe harbor provisions. Forward looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Corporation, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Corporation's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Corporation and its subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, fluctuation in the value of collateral securing our loan portfolio, deposit flows, competition, demand for financial services in the Corporation's market area, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward looking statements and undue reliance should not be placed on such statements. Further information concerning the Corporation and its business, including additional factors that could materially affect the Corporation's financial results, is included in the Corporation's filings with the Securities and Exchange Commission.

**Item 3 Quantitative and Qualitative Disclosures about Market Risk**

The Corporation's primary market risks are interest rate risk and liquidity risk. The Corporation has no significant foreign exchange risk and does not utilize interest rate swaps or derivatives, except for interest rate locks and forward loan commitments, in the management of its interest rate risk. Any changes in foreign exchange rates or commodity prices would have an insignificant impact on the Corporation's interest income and cash flows. The Corporation does have a significant amount of loans extended to borrowers in agricultural production. The cash flow of such borrowers and ability to service debt is largely dependent on commodity prices. The Corporation mitigates these risks by using conservative price and production yields when calculating a borrower's available cash flow to service their debt. Interest rate risk (IRR) is the exposure of the Corporation's net interest income, its primary source of income, to changes in interest rates. IRR results from the difference in the maturity or repricing frequency of a financial institution's interest earning assets and its interest bearing liabilities. IRR is the fundamental method in which financial institutions earn income and create shareholder value. Excessive exposure to IRR could pose a significant risk to the Corporation's earnings and capital.

The Federal Reserve Board, the Corporation's primary Federal regulator, has adopted a policy requiring the Board of Directors and senior management to effectively manage the various risks that can have a material impact on the safety and soundness of the Corporation. The risks include credit, interest rate, liquidity, operational, and reputational. The Corporation has policies, procedures and internal controls for measuring and managing these risks. Specifically, the IRR policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to the Board of Directors.

The Corporation uses several techniques to manage IRR. The first method is gap analysis. Gap analysis measures the cash flows and/or the earliest repricing of the Corporation's interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the imbedded repricing options contained in assets and liabilities. A substantial portion of the Corporation's assets are invested in loans and investment securities with issuer call options. Residential real estate and other consumer loans have imbedded options that allow the borrower to repay the balance prior to maturity without penalty, while commercial and agricultural loans have prepayment penalties. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current interest rate for residential mortgages, the level of sales of used homes, and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in the Corporation's cash flows from these assets. A significant portion of the Corporation's securities are callable or subject to prepayment. The call option is more likely to be exercised in a period of decreasing interest rates. Investment securities, other than those that are callable, do not have any significant imbedded options. Savings and checking deposits may generally be withdrawn on request without prior notice. The timing of cash flows from these deposits is estimated based on historical experience. Time deposits have penalties that discourage early withdrawals.

The second technique used in the management of IRR is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows to project future interest income. By changing the amount and timing of the cash flows and the repricing interest rates of those cash flows, the Corporation can project the effect of changing interest rates on its interest income. Based on the projections prepared for the year ending December 31, 2011, the Corporation's net interest income would decrease slightly during a period of increasing interest rates.

The following tables provide information about the Corporation's assets and liabilities that are sensitive to changes in interest rates as of June 30, 2011 and December 31, 2010. The Corporation has no interest rate swaps, futures contracts, or other derivative financial

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options. The principal amounts of assets and time deposits maturing were calculated based on the contractual maturity dates. Savings and NOW accounts are based on management's estimate of their future cash flows.

| (dollars in thousands)            | June 30, 2011 |           |           |          |          |            | Total     | Fair Value<br>06/30/11 |
|-----------------------------------|---------------|-----------|-----------|----------|----------|------------|-----------|------------------------|
|                                   | 2012          | 2013      | 2014      | 2015     | 2016     | Thereafter |           |                        |
| Rate sensitive assets             |               |           |           |          |          |            |           |                        |
| Other interest bearing assets     | \$ 4,829      | \$ 5,805  | \$ 1,325  | \$       | \$       | \$         | \$ 11,959 | \$ 12,020              |
| Average interest rates            | 1.17%         | 1.69%     | 1.14%     |          |          |            | 1.42%     |                        |
| Trading securities                | \$ 2,943      | \$ 1,027  | \$ 940    | \$       | \$       | \$         | \$ 4,910  | \$ 4,910               |
| Average interest rates            | 2.92%         | 2.35%     | 2.59%     |          |          |            | 2.74%     |                        |
| Fixed interest rate securities    | \$ 78,530     | \$ 43,409 | \$ 37,042 | \$33,825 | \$28,773 | \$158,646  | \$380,225 | \$380,225              |
| Average interest rates            | 3.32%         | 3.30%     | 3.38%     | 3.35%    | 3.51%    | 3.28%      | 3.33%     |                        |
| Fixed interest rate loans         | \$137,014     | \$118,783 | \$125,877 | \$76,556 | \$65,923 | \$ 61,324  | \$585,477 | \$599,452              |
| Average interest rates            | 6.48%         | 6.41%     | 5.96%     | 6.29%    | 5.62%    | 5.31%      | 6.11%     |                        |
| Variable interest rate loans      | \$ 76,155     | \$ 19,825 | \$ 23,115 | \$19,254 | \$11,361 | \$ 11,107  | \$160,817 | \$160,817              |
| Average interest rates            | 5.57%         | 3.51%     | 4.19%     | 3.79%    | 3.61%    | 4.98%      | 4.73%     |                        |
| Rate sensitive liabilities        |               |           |           |          |          |            |           |                        |
| Borrowed funds                    | \$ 82,793     | \$ 17,426 | \$ 20,102 | \$26,159 | \$30,000 | \$ 20,000  | \$196,480 | \$208,717              |
| Average interest rates            | 2.02%         | 3.70%     | 3.45%     | 2.98%    | 4.17%    | 2.56%      | 2.83%     |                        |
| Savings and NOW accounts          | \$ 76,505     | \$ 78,356 | \$ 60,459 | \$40,685 | \$27,312 | \$ 60,400  | \$343,717 | \$343,717              |
| Average interest rates            | 0.20%         | 0.20%     | 0.20%     | 0.19%    | 0.18%    | 0.16%      | 0.19%     |                        |
| Fixed interest rate time deposits | \$242,022     | \$ 94,594 | \$ 42,918 | \$36,667 | \$43,148 | \$ 5,859   | \$465,208 | \$473,925              |
| Average interest rates            | 1.73%         | 2.77%     | 2.62%     | 2.81%    | 2.74%    | 1.71%      | 2.20%     |                        |
| Variable interest rate            | \$ 1,181      | \$ 458    | \$        | \$       | \$       | \$         | \$ 1,639  | \$ 1,639               |

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|                                      | December 31, 2010 |           |           |          |          |            |           | Fair Value |
|--------------------------------------|-------------------|-----------|-----------|----------|----------|------------|-----------|------------|
|                                      | 2011              | 2012      | 2013      | 2014     | 2015     | Thereafter | Total     | 12/31/10   |
| time deposits                        |                   |           |           |          |          |            |           |            |
| Average interest rates               | 0.90%             | 0.89%     |           |          |          |            | 0.90%     |            |
| Rate sensitive assets                |                   |           |           |          |          |            |           |            |
| Other interest bearing assets        | \$ 10,550         | \$ 5,429  | \$ 960    | \$       | \$       | \$         | \$ 16,939 | \$ 17,039  |
| Average interest rates               | 0.96%             | 1.82%     | 2.16%     |          |          |            | 1.30%     |            |
| Trading securities                   | \$ 1,918          | \$ 2,366  | \$ 1,031  | \$ 522   | \$       | \$         | \$ 5,837  | \$ 5,837   |
| Average interest rates               | 3.46%             | 2.31%     | 2.42%     | 2.47%    |          |            | 2.72%     |            |
| Fixed interest rate securities       | \$ 64,652         | \$ 42,984 | \$ 32,871 | \$29,395 | \$24,438 | \$136,384  | \$330,724 | \$330,724  |
| Average interest rates               | 3.68%             | 3.42%     | 3.30%     | 3.33%    | 3.28%    | 3.13%      | 3.32%     |            |
| Fixed interest rate loans            | \$128,277         | \$121,434 | \$140,019 | \$67,423 | \$68,569 | \$ 66,010  | \$591,732 | \$603,435  |
| Average interest rates               | 6.80%             | 6.63%     | 6.26%     | 6.47%    | 6.08%    | 5.83%      | 6.41%     |            |
| Variable interest rate loans         | \$ 59,536         | \$ 17,306 | \$ 22,523 | \$15,118 | \$18,830 | \$ 10,259  | \$143,572 | \$143,572  |
| Average interest rates               | 4.94%             | 4.76%     | 4.27%     | 3.78%    | 3.69%    | 5.21%      | 4.55%     |            |
| Rate sensitive liabilities           |                   |           |           |          |          |            |           |            |
| Borrowed funds                       | \$ 74,151         | \$ 33,013 | \$ 15,127 | \$37,087 | \$25,539 | \$ 10,000  | \$194,917 | \$200,603  |
| Average interest rates               | 0.62%             | 3.46%     | 2.55%     | 3.11%    | 4.60%    | 2.35%      | 2.33%     |            |
| Savings and NOW accounts             | \$ 74,278         | \$ 73,818 | \$ 53,174 | \$35,872 | \$24,520 | \$ 58,414  | \$320,076 | \$320,076  |
| Average interest rates               | 0.21%             | 0.21%     | 0.20%     | 0.19%    | 0.18%    | 0.15%      | 0.19%     |            |
| Fixed interest rate time deposits    | \$215,648         | \$113,338 | \$ 44,269 | \$31,414 | \$39,474 | \$ 6,278   | \$450,421 | \$452,392  |
| Average interest rates               | 1.79%             | 2.67%     | 3.35%     | 2.86%    | 2.97%    | 3.26%      | 2.36%     |            |
| Variable interest rate time deposits | \$ 1,279          | \$ 661    | \$        | \$       | \$       | \$         | \$ 1,940  | \$ 1,940   |
|                                      | 1.21%             | 1.06%     |           |          |          |            | 1.16%     |            |

Average  
interest rates

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**Item 4 Controls and Procedures**

**DISCLOSURE CONTROLS AND PROCEDURES**

The Corporation's management carried out an evaluation, under the supervision and with the participation of the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of June 30, 2011, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Corporation's disclosure controls and procedures as of June 30, 2011, were effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

During the most recent fiscal quarter, no change occurred in the Corporation's internal control over financial reporting that materially affected, or is likely to materially effect, the Corporation's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1 Legal Proceedings**

The Corporation is not involved in any material legal proceedings. The Corporation is involved in ordinary, routine litigation incidental to its business; however, no such routine proceedings are expected to result in any material adverse effect on operations, earnings, or financial condition.

**Item 1A Risk Factors**

There have been no material changes to the risk factors disclosed in Item 1A in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds****(A) None****(B) None****(C) Repurchases of Common Stock**

The Board of Directors has adopted a common stock repurchase plan. On April 27, 2011, the Board of Directors amended the plan to allow for the repurchase of an additional 100,000 shares of the Corporation's common stock. These authorizations do not have expiration dates. As shares are repurchased under this plan, they are retired and revert back to the status of authorized, but unissued shares.

The following table provides information for the three month period ended June 30, 2011, with respect to this plan:

|   | Shares Repurchased |                               | Total Number<br>of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plan<br>or Program | Maximum Number<br>of<br>Shares That May<br>Yet Be<br>Purchased Under<br>the<br>Plans or Programs |
|---|--------------------|-------------------------------|--|--|
|   | Number             | Average<br>Price<br>Per Share |  |  |
| Balance, March 31, 2011                   |                    |                               |  | 7,698  |
| April 1 - 27, 2011                        | 4,940              | \$ 17.81                      | 4,940  | 2,758  |
| Additional Authorization (100,000 shares) |                    |                               |  | 102,758  |
| April 28 - 30, 2011                       | 600                | 18.33                         | 600  | 102,158  |
| May 1 - 31, 2011                          | 3,496              | 18.02                         | 3,496  | 98,662   |
| June 1 - 30, 2011                         | 9,683              | 18.07                         | 9,683  | 88,979   |
| Balance, June 30, 2011                    | 18,719             | \$ 18.00                      | 18,719   | 88,979   |



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**Item 6 Exhibits**

(a) Exhibits

- 31(a) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Executive Officer
- 31(b) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Financial Officer
- 32 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer
- 101.1\* 101.INS (XBRL Instance Document)
- 101.SCH (XBRL Taxonomy Extension Schema Document)
- 101.CAL (XBRL Calculation Linkbase Document)
- 101.LAB (XBRL Taxonomy Label Linkbase Document)
- 101.DEF (XBRL Taxonomy Linkbase Document)
- 101.PRE (XBRL Taxonomy Presentation Linkbase Document)

In accordance with Rule 406T of Regulations S-T, the XBRL related information shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Isabella Bank Corporation

Date: August 1, 2011

/s/ Richard J. Barz

Richard J. Barz  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 1, 2011

/s/ Dennis P. Angner

Dennis P. Angner  
President, Chief Financial Officer  
(Principal Financial Officer, Principal Accounting Officer)

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