FRIENDSHIP BANCORP

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

FRIENDSHIP BANCORP
Friendship, Indiana

CONSOLIDATED FINANCIAL STATEMENTS
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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Friendship BanCorp
Friendship, Indiana

We have audited the accompanying consolidated financial statements of Friendship BanCorp, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Friendship BanCorp as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Indianapolis, Indiana
April 2, 2013

FRIENDSHIP BANCORP
CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011

	2012	2011
ASSETS		
Cash and due from banks	$ 12,743,193	$ 10,536,429
Federal funds sold	1,732,019	9,053,181
Total cash and cash equivalents	14,475,212	19,589,610
Interest bearing deposits in other financial institutions	200,000	500,000
Available-for-sale securities	42,235,642	33,555,153
Held to maturity securities (fair value of $15,305,227 and $13,849,639)	14,582,519	13,247,393
Loans held for sale	768,167	312,000
Total loans	227,929,221	217,616,379
Allowance for loan losses	(2,309,465)	(2,191,188)
Loans, net	225,619,756	215,425,191
Premises and equipment, net	6,881,992	7,075,375
Restricted equity investments, at cost	2,352,450	2,352,450
Bank owned life insurance	3,136,309	2,053,523
Goodwill	1,457,953	1,457,953
Other real estate	575,027	723,546
Accrued interest receivable and other assets	3,047,674	3,480,148
Total assets	$ 315,332,701	$ 299,772,342
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Noninterest-bearing deposits	$ 15,313,720	$ 12,359,343
Interest-bearing deposits	265,935,724	246,350,673
	281,249,444	258,710,016
Federal Home Loan Bank advances	3,000,000	12,000,000
Notes payable	1,555,375	2,155,375
Accrued interest payable and other liabilities	2,441,519	2,466,979
Total liabilities	288,246,338	275,332,370
Shareholders' equity		
Common stock, No par value; 2,000,000 shares authorized; 870,655 (2012) and 866,155 (2011) shares issued and outstanding	3,276,936	3,171,936
Additional paid-in capital	510,962	496,777
Retained earnings	23,171,513	20,866,405
Accumulated other comprehensive income	260,827	217,229
Unearned ESOP	(133,875)	(312,375)
Total shareholders' equity	27,086,363	24,439,972
Total liabilities and shareholders' equity	$ 315,332,701	$ 299,772,342

See accompanying notes.

FRIENDSHIP BANCORP
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2012 and 2011

	2012	2011
Interest income		
Interest and dividend income		
Loans, including fees	$ 14,327,470	$ 14,529,424
Taxable securities	601,881	855,828
Tax exempt securities	424,383	431,415
Other	107,808	106,420
	15,461,542	15,923,087
Interest expense		
Interest expense		
Deposits	2,879,244	3,655,201
Federal Home Loan Bank advances and other debt	237,009	715,781
	3,116,253	4,370,982
Net interest income	12,345,289	11,552,105
Provision for loan losses	600,000	1,040,000
Net interest income after provision for loan losses	11,745,289	10,512,105
Non-interest income		
Service charges on deposit accounts	1,071,114	1,110,184
Insurance revenues	1,271,101	1,289,601
Net gain on sale of loans	489,731	279,432
Net gain on sales and calls of securities	7,961	39,857
Trust and investment product fees	138,843	143,066
Other	557,950	85,164
	3,536,700	2,947,304
Non-interest expense		
Salaries and employee benefits	5,962,615	5,632,981
Occupancy and equipment	1,290,123	1,331,457
Data processing	290,935	302,667
Advertising	225,683	167,308
Professional services	184,203	148,725
Supplies	99,125	77,784
Postage	96,589	96,220
Telephone	74,331	76,104
FDIC insurance	173,200	326,122
Loss of extinguishment of debt	531,140	-
Other	1,499,331	1,388,326
	10,427,275	9,547,694
Income before income taxes	4,854,714	3,911,715
Income tax expense	1,679,701	1,279,996
Net income	$ 3,175,013	$ 2,631,719

See accompanying notes.

FRIENDSHIP BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2012 and 2011

	2012	2011
Net income	$ 3,175,013	$ 2,631,719
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gain/(loss) arising during the period	79,106	468,639
Reclassification adjustment for losses (gains) included in net income	(6,911)	(39,857)
Net unrealized gains (losses)	72,195	428,782
Tax effect	(28,597)	(169,840)
Total other comprehensive income	43,598	258,942
Comprehensive income	$ 3,218,611	$ 2,890,661

See accompanying notes.

FRIENDSHIP BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years ended December 31, 2012 and 2011

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP	Total Shareholders' Equity
Balance at January 1, 2011	$ 3,438,818	$ 483,287	$ 18,932,454	$ (41,713)	$ -	$ 22,812,846
Net income			2,631,719			2,631,719
Other comprehensive income				258,942		258,942
Stock based compensation expense		13,490				13,490
Exercise of stock options (5,400 shares)	75,600					75,600
Purchase of shares by ESOP					(357,000)	(357,000)
Compensation expense related to release of ESOP shares					44,625	44,625
Purchase of shares	(342,482)					(342,482)
Cash dividends declared ($.80 per share)			(697,768)			(697,768)
Balance at December 31, 2011	3,171,936	496,777	20,866,405	217,229	(312,375)	24,439,972
Net income			3,175,013			3,175,013
Other comprehensive income				43,598		43,598
Stock based compensation expense		14,185				14,185
Exercise of stock options (4,500 shares)	105,000					105,000
Compensation expense related to release of ESOP shares					178,500	178,500
Cash dividends declared ($1.00 per share)			(869,905)			(869,905)
Balance at December 31, 2012	$ 3,276,936	$ 510,962	$ 23,171,513	$ 260,827	$ (133,875)	$ 27,086,363

See accompanying notes.

FRIENDSHIP BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Net income	$ 3,175,013	$ 2,631,719
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	600,000	1,040,000
Depreciation and amortization	588,496	541,145
Net amortization and accretion of securities	362,428	466,440
Net realized (gain) loss on AFS securities	(6,911)	(39,857)
Net realized (gain) loss on HTM securities	(1,050)	-
Net realized (gain) loss on sale of ORE	17,898	399,274
Earnings on life insurance	(82,786)	(46,883)
Gain on sale of loans	(489,731)	(279,432)
(Gain) loss on sales and disposals of fixed assets	(8,427)	15,996
Loss on retirement of debt	531,140	-
Stock-based compensation	14,185	13,490
ESOP compensation expense	178,500	44,625
Net change in:		
Loans held for sale	33,564	2,394,932
Accrued interest and other assets	403,877	172,138
Accrued expenses and other liabilities	(25,460)	724,577
Net cash from operating activities	5,290,736	8,078,164
Cash flows from investing activities		
Available-for-sale (AFS) securities:		
Maturities, prepayments and calls	23,387,990	16,549,490
Purchases	(32,326,989)	(24,266,783)
Held to maturity (HTM) securities:		
Maturities, prepayments, and calls	995,505	619,631
Purchases	(2,354,393)	(518,730)
Loan originations and payments, net	(11,945,439)	(10,220,777)
Net change in interest bearing deposits	300,000	-
Additions to premises and equipment, net	(386,686)	(286,338)
Proceeds from sale of ORE	1,281,495	2,843,861
Purchase of bank owned life insurance	(1,000,000)	(1,000,000)
Purchase of restricted stock	-	(145,000)
Redemption of restricted stock	-	116,100
Net cash from investing activities	(22,048,517)	(16,308,546)
Cash flows from financing activities		
Net change in deposits	22,539,428	21,568,895
Repayments on Federal Home Loan Bank advances	(9,531,140)	(4,000,000)
Proceeds from note payable	-	700,000
Repayments of note payable	(600,000)	(44,625)
Cash dividends paid	(869,905)	(697,768)
Purchase of shares	-	(342,482)
Purchase of shares by ESOP	-	(357,000)
Proceeds from exercise of stock options	105,000	75,600
Net cash from financing activities	11,643,383	16,902,620
Net change in cash and cash equivalents	(5,114,398)	8,672,238
Beginning cash and cash equivalents	19,589,610	10,917,372
Ending cash and cash equivalents	$ 14,475,212	$ 19,589,610

See accompanying notes.

FRIENDSHIP BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2012 and 2011

	2012	2011
Supplemental cash flow information:		
Interest paid	$ 3,129,581	$ 4,731,639
Income taxes paid	2,035,000	1,075,000
Supplemental noncash disclosure:		
Transfers from loans to other real estate	1,150,874	1,783,036

See accompanying notes.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include Friendship BanCorp ("Company") and its wholly owned subsidiary, The Friendship State Bank, with its wholly owned subsidiary, Friendship Financial Services, LLC, together referred to as "the Bank." Intercompany transactions and balances are eliminated upon consolidation.

Nature of Operations: The Bank provides financial services through its offices in southeastern Indiana. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Real estate loans are secured by both residential and commercial real estate. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area. Friendship Financial Services is a full service insurance agency and sells those products, as agent, to its customers.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through April 2, 2013, which is the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, carrying value of goodwill, and fair values of financial instruments are particularly subject to change.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions under 90 days, and federal funds sold. Net cash flows are reported for loan and deposit transactions.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within five years and are carried at cost.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and are based on the amortized cost of the individual security sold.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans Held for Sale: Loans originated and intended for sale are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right.

Gains and losses on sales of loans are based on the difference between the selling price and the carrying value of the related loans sold.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, net deferred loan fees, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance.

Interest income is reported on the interest method and includes amortization of net deferred loan fees over the loan term. Interest income on mortgage and commercial real estate loans is discontinued at the time the loan is 180 days delinquent. Interest income on consumer loans is discontinued at the time the loan is 90 days delinquent if it is in process of collection; otherwise, it is charged off at this time. Past due status is based on the 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.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Non-accrual and collection policies are consistent for all loan classes.

Concentration of Credit Risk: Most of the Company's business activity is with customers located within Ripley, Dearborn, Ohio, and Switzerland Counties. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in the area.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties and the Company has granted concessions, are considered troubled debt restructurings and classified as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception.

The general component covers non-impaired loans and is based on the historical loss experience is determined based on the actual loss history experienced by the Company over the most recent twelve quarters. These actual loss experiences are supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are consistent within each of the portfolio segments, which have been identified as: Commercial, Agricultural, Real Estate, Municipal, and Consumer.

The risk characteristics of each of the identified portfolio segments are as follows:

Commercial: Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Borrowers may be subject to adverse economic conditions that can lead to decreases in product demand; increasing material or other production costs; interest rate increases that could have an adverse impact on profitability; non-payment of credit that has been extended under normal vendor terms for goods sold or services extended; interruption related to the importing or exporting of production materials or sold products.

Agricultural: Agricultural loans are typically secured by crops or other farm equipment. These loans are subject to risks which could cause poor operating performance of the borrower, such as adverse weather conditions; fluctuation of the price of agricultural commodities; and the general economy.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate: Real estate loans are generally secured by 1-4 family residences, multifamily residences, or farm real estate, and are generally owner occupied. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. These loans are subject to adverse employment conditions in the local economy leading to increased default rate; decreased market values from oversupply in a geographic area; impact to borrowers' ability to maintain payments in the event of incremental rate increases on adjustable rate mortgages.

Municipal: Municipal obligations are generally secured by specific assets or the taxing power of the municipality. These loans are subject to adverse employment conditions in the local economy and lower real estate values which can reduce the municipality's tax base.

Consumer: Consumer loans generally consist of loans secured by personal property or unsecured loans such as credit cards. Repayment of these loans is primarily dependent on the personal income of the borrowers, who are subject to adverse employment conditions in the local economy which may lead to higher unemployment.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line or declining-balance methods, with useful lives ranging from 7 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line or declining-balance method, with useful lives ranging from 3 to 25 years.

Restricted Stock: Restricted stock includes Federal Home Loan Bank (FHLB) of Indianapolis stock, Federal Reserve Bank (FRB) stock, and Bankers' Bank of Kentucky stock. This restricted stock is carried at cost and periodically evaluated for impairment. Because this stock is viewed as a long-term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Goodwill and Other Intangible Assets: Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the balance sheet.

In 2010, the Company paid $325,000 to acquire an insurance agency. The only identifiable assets purchased were a non-compete intangible of $80,000 and a customer list intangible of $245,000. These assets are amortized on an accelerated method over their estimated useful lives, which range from 2 to 7 years. The current balance of intangible assets is $154,583 and $227,875 at December 31, 2012 and 2011. Amortization expense is $73,298 for 2012 and 2011.

Other Real Estate: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing Assets: Servicing assets are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing assets are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on market prices for comparable mortgage servicing contracts. The Company uses the amortization method, which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing assets are included in other assets.

Servicing assets are evaluated for impairment based upon the fair value of the assets as compared to carrying amount. Impairment is determined by stratifying assets into groupings based on predominant risk characteristics, such as loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with other income on the income statement. The fair values of servicing assets are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income which is reported on the income statement as other income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of servicing assets is netted against loan servicing fee income. Servicing fees, net of amortization, totaled $108,402 and $98,004 for the years ended December 31, 2012 and 2011. Late fees and ancillary fees related to loan servicing are not material.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Stock-Based Compensation: Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. The differences relate principally to premises and equipment, unrealized gains and losses on available-for-sale securities, allowance for loan losses, deferred compensation, goodwill and loan servicing rights. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee Stock Ownership Plan: The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of shareholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Off Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale which is recognized as a separate component of equity.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassification: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

(Continued)

NOTE 2 - SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at December 31, 2012 and 2011 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2012				
U.S. Treasury and government agency	$ 29,640,790	$ 139,077	$ (21,081)	$ 29,758,786
Mortgage-backed securities - residential	9,163,207	163,938	-	9,327,145
Corporate debt	2,999,741	154,135	(4,165)	3,149,711
	$ 41,803,738	$ 457,150	$ (25,246)	$ 42,235,642

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2011				
U.S. Treasury and government agency	$ 19,378,366	$ 207,362	$ (8,474)	$ 19,577,254
Mortgage-backed securities - residential	11,067,646	147,751	-	11,215,397
Corporate debt	2,749,432	50,545	(37,475)	2,762,502
	$ 33,195,444	$ 405,658	$ (45,949)	$ 33,555,153

(Continued)

NOTE 2 - SECURITIES (Continued)

The carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

	2012			
	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
States and political subdivisions	$ 14,582,519	$ 807,149	$ (84,441)	$ 15,305,227

	2011			
	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
States and political subdivisions	$ 13,247,393	$ 736,178	$ (133,932)	$ 13,849,639

The amortized cost and fair value of the investment securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	December 31, 2012	
	Amortized Cost	Fair Value
Available-for-sale		
Within one year	$ 2,755,675	$ 2,765,552
One to five years	29,732,970	29,942,546
Five to ten years	9,065,093	9,264,699
Over ten years	250,000	262,845
Total	$ 41,803,738	$ 42,235,642
Held-to-maturity		
Within one year	$ 875,135	$ 878,037
One to five years	5,515,902	5,761,613
Five to ten years	5,917,257	6,245,291
Over ten years	2,274,225	2,420,286
Total	$ 14,582,519	$ 15,305,227

(Continued)

NOTE 2 - SECURITIES (Continued)

There were no sales of securities in 2012 or 2011. All gains were due to calls.

Securities with unrealized losses at year-end 2012 and 2011, presented by length of time in an unrealized loss position, are as follows:

2012	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
Available for sale:						
U.S. Treasury and government agency	$ -	$ -	$ 8,242,994	$ (21,081)	$ 8,242,994	$ (21,081)
Corporate debt	-	-	495,835	(4,165)	495,835	(4,165)
Held to maturity:						
States and political subdivisions	134,886	(114)	2,610,488	(84,327)	2,745,374	(84,441)
Total temporarily impaired	$ 134,886	$ (114)	$15,813,317	$ (109,573)	$15,948,203	$ (109,687)

2011	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
Available for sale:						
U.S. Treasury and government agency	$ 991,420	$ (7,134)	$ 1,995,730	$ (1,340)	$ 2,987,150	$ (8,474)
Corporate debt	735,398	(13,755)	225,693	(23,720)	961,091	(37,475)
Held to maturity:						
States and political subdivisions	-	-	1,276,068	(133,932)	1,276,068	(133,932)
Total temporarily impaired	$ 1,726,818	$ (20,889)	$ 3,497,491	$ (158,992)	$ 5,224,309	$ (179,881)

Unrealized losses on debt securities have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates and other market conditions. The fair value is expected to recover as the securities approach their maturity date and/or market rates change.

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

Total loans are comprised of the following as of year-end:

	2012	2011
Commercial	$ 7,222,399	$ 7,204,372
Agricultural	16,318,199	16,969,271
Real estate	192,916,549	182,157,009
Municipal	709,608	1,056,877
Consumer	10,762,466	10,228,850
	$ 227,929,221	$ 217,616,379

Certain directors and executive officers of the Bank, including their families and companies in which they are the principal owners, were customers of and had other transactions with the Bank. Total loans to these persons were $6,849,793 and $7,132,025 at December 31, 2012 and 2011.

Mortgage loans serviced for others are not included in the accompanying balance sheet. The unpaid principal balances of these loans at December 31, 2012 and 2011 were $46,126,443 and $40,767,931.

Activity for capitalized mortgage servicing rights was as follows. There was no valuation allowance as of December 31, 2012 or 2011.

	2012	2011
Beginning of year	$ 216,553	$ 219,028
Additions	138,955	86,617
Amortized to expense	(106,022)	(89,092)
End of year	$ 249,486	$ 216,553

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2012:

December 31, 2012	Commercial	Agricultural	Real Estate	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 115,544	$ 42,420	$ 1,698,051	$ 2,642	$ 188,029	$ 144,502	$ 2,191,188
Provision for loan losses	(42,917)	(1,625)	424,510	(868)	76,436	144,464	600,000
Loans charged-off	-	-	(439,781)	-	(70,533)	-	(510,314)
Recoveries	4,533	-	3,163	-	20,895	-	28,591
Total ending allowance balance	$ 77,160	$ 40,795	$ 1,685,943	$ 1,774	$ 214,827	$ 288,966	$ 2,309,465

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2012:

December 31, 2012	Commercial	Agricultural	Real Estate	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ 240,183	$ -	$ -	$ -	$ 240,183
Collectively evaluated for impairment	77,160	40,795	1,445,760	1,774	214,827	288,966	2,069,282
Total ending allowance balance	$ 77,160	$ 40,795	$ 1,685,943	$ 1,774	$ 214,827	$ 288,966	$ 2,309,465
Loans individually evaluated for impairment	$ 340,928	$ -	$ 2,235,539	$ -	$ -	-	$ 2,576,467
Loans collectively evaluated for impairment	6,881,471	16,318,199	190,681,010	709,608	10,762,466	-	225,352,754
Total ending loans balance	$ 7,222,399	$ 16,318,199	$ 192,916,549	$ 709,608	$ 10,762,466	$ -	$ 227,929,221

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2011:

December 31, 2011	Commercial	Agricultural	Real Estate	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 136,613	$ 41,189	$ 1,484,468	$ 3,522	$ 219,661	$ 313,060	$ 2,198,513
Provision for loan losses	(22,922)	1,231	1,218,009	(880)	13,120	(168,558)	1,040,000
Loans charged-off	(7,041)	-	(1,005,865)	-	(70,477)	-	(1,083,383)
Recoveries	8,894	-	1,439	-	25,725	-	36,058
Total ending allowance balance	$ 115,544	$ 42,420	$ 1,698,051	$ 2,642	$ 188,029	$ 144,502	$ 2,191,188

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2011:

December 31, 2011	Commercial	Agricultural	Real Estate	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 5,739	$ 4,650	$ 173,576	$ -	$ -	$ -	$ 183,965
Collectively evaluated for impairment	109,805	37,770	1,524,475	2,642	188,029	144,502	2,007,223
Total ending allowance balance	$ 115,544	$ 42,420	$ 1,698,051	$ 2,642	$ 188,029	$ 144,502	$ 2,191,188
Loans individually evaluated for impairment	$ 458,863	$ 12,632	$ 1,271,237	$ -	$ -	$ -	$ 1,742,732
Loans collectively evaluated for impairment	6,745,509	16,956,639	180,885,772	1,056,877	10,228,850	-	215,873,647
Total ending loans balance	$ 7,204,372	$ 16,969,271	$ 182,157,009	$ 1,056,877	$ 10,228,850	$ -	$ 217,616,379

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2012 and 2011:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
December 31, 2012						
With no related allowance recorded:						
Commercial	$ 340,928	$ 340,928	$ -	$ 424,913	$ 27,700	$ 27,324
Agricultural	-	-	-	5,114	-	694
Real estate						
Commercial	608,916	608,916	-	713,475	46,772	46,252
Residential	-	-	-	68,894	-	-
Subtotal	949,844	949,844	-	1,212,396	74,472	74,270
With an allowance recorded:						
Real estate						
Commercial	25,084	25,084	25,084	26,081	1,759	809
Residential	1,601,539	1,601,539	215,099	1,582,405	60,938	2,992
Total	$ 2,576,467	$ 2,576,467	$ 240,183	$ 2,820,882	$ 137,169	$ 77,071
December 31, 2011						
With an allowance recorded:						
Commercial	$ 458,863	$ 458,863	$ 5,739	$ 621,689	$ 42,158	$ 43,133
Agricultural	12,632	12,632	4,650	21,454	1,571	1,601
Real estate						
Construction	187,140	187,140	2,330	192,401	1,671	2,132
Commercial	918,119	918,119	142,007	823,262	67,483	71,112
Residential	165,978	165,978	29,239	148,942	5,647	7,071
Total	$ 1,742,732	$ 1,742,732	$ 183,965	$ 1,807,748	$ 118,530	$ 125,049

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present the recorded investment in nonaccrual by class of loans as of December 31, 2012 and 2011. As of December 31, 2012 and 2011, there were $0 in loans past due over 90 days still on accrual.

	2012	2011
Real Estate		
Commercial	$ 25,084	$ 279,660
Residential	1,601,539	818,647
Consumer	-	993
Total	$ 1,626,623	$ 1,099,300

Nonperforming loans includes both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2012 by class of loans:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
December 31, 2012						
Commercial	$ 147,431	$ -	$ -	$ 147,431	$ 7,074,968	$ 7,222,399
Agricultural	2,040	-	-	2,040	16,316,159	16,318,199
Real estate						
Construction	-	-	-	-	10,281,398	10,281,398
Commercial	255,841	201,433	25,084	482,358	29,546,750	30,029,108
Residential	3,778,531	1,013,139	1,601,539	6,393,209	146,212,834	152,606,043
Municipal	-	-	-	-	709,608	709,608
Consumer	144,822	4,573	-	149,395	10,613,071	10,762,466
Total	$ 4,328,665	$ 1,219,145	$ 1,626,623	$ 7,174,433	$ 220,754,788	$ 227,929,221

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
December 31, 2011						
Commercial	$ 68,931	$ -	$ -	$ 68,931	$ 7,135,441	$ 7,204,372
Agricultural	40,069	1,510	-	41,579	16,927,692	16,969,271
Real estate						
Construction	-	-	-	-	1,811,981	1,811,981
Commercial	571,705	92,828	279,660	944,193	37,865,752	38,809,945
Residential	4,827,757	1,215,983	818,647	6,862,387	134,672,696	141,535,083
Municipal	-	-	-	-	1,056,877	1,056,877
Consumer	294,584	11,553	993	307,131	9,921,719	10,228,850
Total	$ 5,803,046	$ 1,321,874	$ 1,099,300	$ 8,224,221	$ 209,392,158	$ 217,616,379

Troubled Debt Restructurings:

During the year ending December 31, 2012, no loans were modified as troubled debt restructurings. No loans were classified as troubled debt restructurings at December 31, 2012 or 2011.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

(Continued)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Doubtful	Not Rated
December 31, 2012					
Commercial	$ 6,217,298	$ 342,829	$ 662,272	$ -	$ -
Agricultural	16,234,152	-	84,047	-	-
Real estate					
Construction	10,091,483	-	189,915	-	-
Commercial	29,446,357	50,744	532,007	-	-
Residential	151,004,084	-	1,601,959	-	-
Municipal	-	-	-	-	709,608
Consumer	-	-	-	-	10,762,466
Total	$ 212,993,374	$ 393,573	$ 3,070,200	$ -	$ 11,472,074
December 31, 2011					
Commercial	$ 6,219,866	$ -	$ 984,506	$ -	$ -
Agricultural	16,774,580	122,380	72,310	-	-
Real estate					
Construction	1,612,672	9,791	189,518	-	-
Commercial	37,355,765	253,569	1,200,611	-	-
Residential	139,609,748	626,742	1,298,593	-	-
Municipal	-	-	-	-	1,056,877
Consumer	-	-	-	-	10,228,850
Total	$ 201,572,631	$ 1,012,482	$ 3,745,538	$ -	$ 11,285,727

(Continued)

NOTE 4 - PREMISES AND EQUIPMENT

Premises and equipment consist of the following as of year-end:

	2012	2011
Land	$ 1,913,220	$ 1,913,220
Buildings and improvements	6,021,639	5,685,270
Furniture and equipment	3,965,354	3,858,397
Construction in process	25,001	1,275
Total	11,925,214	11,458,162
Accumulated depreciation	(5,043,222)	(4,382,787)
	$ 6,881,992	$ 7,075,375

NOTE 5 - INCOME TAXES

Income taxes consist of the following as of December 31, 2012 and 2011:

	2012	2011
Current payable	$ 1,717,603	$ 1,302,590
Deferred income taxes (benefit)	(37,902)	(24,321)
Change in valuation allowance	-	1,727
Total income taxes	$ 1,679,701	$ 1,279,996

The following is a reconciliation of income taxes and the amount computed by applying the statutory federal income tax rate of 34% to income before income taxes:

	2012	2011
Statutory rate applied to income before income taxes	$ 1,650,603	$ 1,329,983
Add (deduct):		
Tax exempt interest income	(142,646)	(136,310)
State income tax, net	261,600	211,144
Income tax credits	(55,810)	(57,810)
Change in valuation allowance	-	1,727
Other	(34,046)	(68,738)
	$ 1,679,701	$ 1,279,996

(Continued)

NOTE 6 - INCOME TAXES (Continued)

The net deferred tax liability, as of December 31, 2012 and 2011, reflected in other liabilities in the accompanying consolidated balance sheets is comprised of the following components:

	2012	2011
Deferred tax assets:		
Allowance for loan losses	$ 676,842	$ 634,393
Deferred compensation	394,040	341,866
Other real estate owned write-downs	55,883	59,503
State capital loss carryforward	48,654	48,654
Other	47,472	35,706
	1,222,891	1,120,122
Deferred tax liabilities:		
Depreciation	(278,455)	(325,897)
Goodwill	(474,021)	(429,772)
Net unrealized gain on securities available for sale	(171,077)	(142,480)
Mortgage servicing rights	(97,525)	(84,652)
Prepaid expenses	(73,216)	(51,997)
Deferred FHLB stock dividends	(39,050)	(39,050)
Other	(184,438)	(150,470)
	(1,317,782)	(1,224,318)
Valuation allowance	(48,654)	(48,654)
Net deferred tax asset/(liability)	$ (143,545)	$ (152,850)

The Company has an Indiana state tax capital loss carryforward of $955,733, which expires in 2014. The Company maintains a valuation allowance as it does not anticipate generating capital gains in Indiana to utilize this carryforward prior to its expiration.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of Indiana. The Company is no longer subject to examination by taxing authorities for years before 2009. The Company does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company did not have any amounts accrued for interest and penalties at December 31, 2012.

(Continued)

NOTE 6 - DEPOSITS

Time deposits of $100,000 or more were $46,670,503 and $25,797,628 at December 31, 2012 and 2011.

Scheduled maturities of time deposits for the next five years were as follows:

2013	$ 49,079,095
2014	16,318,783
2015	10,374,638
2016	11,568,722
2017	8,087,952
	$ 95,429,190

NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

Advances at year end are as follows:

	2012	2011
Maturities January 2011 through August 2018, fixed rates from 2.39% to 5.22%, averaging 3.94%.	$ 3,000,000	$ 12,000,000
	$ 3,000,000	$ 12,000,000

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. During the year ended December 31, 2012, the Bank paid off a portion of its FHLB advances early which resulted in prepayment penalty fees of $531,140. This is separately disclosed on the income statement as loss on extinguishment of debt. Advances from the Federal Home Loan Bank require monthly interest payments and are secured by a blanket pledge of the Bank's mortgage loans and certain other loans. Based on this collateral and the Bank's holdings of FHLB stock, the Bank is eligible to borrow up to $26,236,000 at year-end 2012.

Payment Information

Required payments over the next five years are:

2013	$ -
2014	-
2015	2,000,000
2016	-
2017	1,000,000

NOTE 8 - NOTES PAYABLE

Notes payable at December 31, 2012 consists of a line of credit with Bankers Bank of Kentucky with an interest rate of prime rate less 0.25%; however the interest rate shall not drop below 4.50%. Interest is due quarterly with principal due at maturity, March 3, 2013. The line is collateralized by 100% of the common stock of The Friendship State Bank.

(Continued)

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Some financial instruments are used to meet customer financing needs and to reduce exposure in interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to varying degrees, credit and interest-rate risk in excess of the amount reported in the balance sheet.

Commitments at year-end are as follows:

	2012	2011
Unused lines of credit	$ 5,965,564	$ 5,550,820
Standby letters of credit	230,000	250,000

Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party. Exposure to credit loss if the other party does not perform is represented by the contractual amount of these items. Collateral or other security is normally obtained for these financial instruments prior to their use, and many of the commitments are expected to expire without being used.

At December 31, 2012 and 2011, the Bank was required to have $7,483,000 and $7,894,000 on deposit with the Federal Reserve or as cash on hand.

The Bank is involved in various legal actions arising in the normal course of business. In the opinion of management, the Bank has adequate legal defenses or insurance coverage such that resolution of these matters will not have a material effect on the balance sheet.

NOTE 10 - BENEFIT PLANS

The Bank sponsors a defined contribution 401(k) plan with ESOP provisions which covers substantially all employees. Eligible employees can elect to defer up to 15 percent of their salary, not to exceed $17,000. The Bank matches one half of employee contributions, up to six percent of their salaries. Employer's contributions are 100% vested after five years of service. The Plan includes an employee stock ownership option. Employees can direct all or a portion of their contributions to purchase stock of the Company. The Bank's total 401(k) contributions charged to expense in 2012 and 2011 were $169,029 and $79,385.

Participants receive distributions from the plan of their vested shares of Company common stock subsequent to the end of their employment. The Company is required to redeem the shares of Company common stock that have been distributed from the plan at current market value, upon request of the participants receiving such distributions. An independent appraisal is obtained annually to determine the market value of Company stock. As of December 31, 2012 and 2011, there were 22,506 and 25,112 allocated shares with a fair value of $810,212 and $860,076 subject to repurchase obligation.

(Continued)

NOTE 10 - BENEFIT PLANS (Continued)

During 2011, under the ESOP provisions of the Plan, the Plan entered into a loan with the Company in connection with the repurchase of 10,500 shares from an unrelated shareholder. The amount of the loan at inception was $357,000, and accordingly, this amount was shown as a reduction of shareholders' equity. These unallocated shares are released to participants proportionately as the loan is repaid. Dividends on allocated shares are recorded as dividends and charged to retained earnings. Dividends on unallocated shares are used to repay the loan and are treated as compensation expense. Compensation expense recorded is equal to the fair market value of the shares released for allocation.

The ESOP shares as of December 31, 2012 and 2011 were as follows:

	2012	2011
Allocated shares, beginning of year	$ 129,914	$ 128,601
Shares released during the year for allocation	5,250	1,313
Unreleased shares, end of year	3,938	9,188
Total ESOP shares	139,102	139,102
Fair value of unreleased shares	$ 141,750	$ 314,672

In addition, the Bank has entered into deferred compensation, salary continuation agreements that provide benefits to certain directors and officers or their beneficiaries. The benefits expected to be paid are being accrued to date of full eligibility. Benefit payments under the agreements may be accelerated upon death, disability or termination by the Bank prior to full eligibility. The salary continuation plan was frozen in 2007. The expense incurred for the deferred compensation plan in 2012 and 2011 was $148,189 and $76,975. The Company purchased life insurance on the participants. The net realizable value of such insurance in 2012 and 2011 was $3,136,309 and $2,053,523.

NOTE 11 - STOCK OPTIONS

Options to buy stock are granted to directors, officers and employees under the Employee Stock Option Plan, which provides for issue of up to 100,000 options. The maximum option term is ten years. At December 31, 2012, options to purchase 85,738 shares of stock remain for future grant under this plan.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding. The risk-free rate of interest for the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. There were no grants in 2012 or 2011.

(Continued)

NOTE 11 - STOCK OPTIONS (Continued)

A summary of the activity in the plan is as follows.

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	16,772	$ 31.02	9.01	$ 61,129
Granted	-	-		
Exercised	(4,500)	23.33		
Forfeited or expired	(100)	14.00		
Outstanding at end of year	12,172	$ 34.00	8.03	$ 24,344
Exercisable at end of year	12,172	$ 34.00	8.03	$ 24,344

The total intrinsic value of options exercised during the years ending December 31, 2012 and 2011 was $22,415 and $109,350, respectively. Cash received from option exercises for the years ended December 31, 2012 and 2011 was $105,000 and $75,600. The actual tax benefit realized for the tax deductions from stock option exercises totaled $14,423 and $31,272 for the years ending December 31, 2012 and 2011.

NOTE 12 - CAPITAL REQUIREMENTS

Banks are subject to regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative and qualitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes the Bank, as of December 31, 2012, meets all of the capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of December 31, 2012 and 2011, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank’s category.

(Continued)

NOTE 12 - CAPITAL REQUIREMENTS (Continued)

The Bank's actual and required capital amounts (in thousands) and ratios at year-end are presented below.

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2012						
Total Capital (to Risk Weighted Assets)	$ 28,919	15.4%	$ 15,044	8.0%	$ 18,804	10.0%
Tier I Capital (to Risk Weighted Assets)	$ 26,610	14.2%	$ 7,522	4.0%	$ 11,283	6.0%
Tier I Capital (to Average Assets)	$ 26,610	8.4%	$ 12,653	4.0%	$ 15,816	5.0%

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2011						
Total Capital (to Risk Weighted Assets)	$ 27,148	15.3%	$ 14,187	8.0%	$ 17,733	10.0%
Tier I Capital (to Risk Weighted Assets)	$ 24,957	14.1%	$ 7,093	4.0%	$ 10,640	6.0%
Tier I Capital (to Average Assets)	$ 24,957	8.1%	$ 12,289	4.0%	$ 15,361	5.0%

(Continued)

NOTE 13 - DISCLOSURE ABOUT FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing and asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for securities available for sale are determined by matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). One U.S. Treasury security is valued using Level 1 inputs as there are available quoted market prices.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate (ORE) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

(Continued)

NOTE 13 - DISCLOSURE ABOUT FAIR VALUE (Continued)

Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at December 31, 2012 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:				
Available-for-sale securities				
U.S. Treasury	$ 9,113,729	$ 9,241,408	$ -	$ -
U.S. government agency	20,527,061	-	20,517,378	-
Mortgage-backed - residential	9,163,207	-	9,327,144	-
Corporate debt	2,999,741	-	3,349,712	-
Total investment securities available-for-sale	$41,803,738	$ 9,241,408	$33,194,234	$ -

	Fair Value Measurements at December 31, 2011 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities				
U.S. Treasury	$ 6,182,470	$ 6,182,470	$ -	$ -
U.S. government agency	13,394,784	-	13,394,784	-
Mortgage-backed - residential	11,215,397	-	11,215,397	-
Corporate debt	2,762,502	-	2,762,502	-
Total investment securities available-for-sale	$33,555,153	$ 6,182,470	$27,372,683	$ -

There were no transfers between Level 1 and Level 2 in 2012 and 2011.

(Continued)

NOTE 13 - DISCLOSURE ABOUT FAIR VALUE (Continued)

Assets Measured on a Non-Recurring Basis

Assets measured at fair value on a non-recurring basis are summarized below

	Fair Value Measurements at December 31, 2012 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Real Estate				
Residential	$ 1,386,440	$ -	$ -	$ 1,386,440
	$ 1,386,440	$ -	$ -	$ 1,386,440
Other real estate:				
Commercial	$ 288,922	$ -	$ -	$ 288,922
Residential	286,105	-	-	286,105
	$ 575,027	$ -	$ -	$ 575,027

	Fair Value Measurements at December 31, 2011 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial	$ 458,863	$ -	$ -	$ 458,863
Agriculture	12,632	-	-	12,632
Real Estate				
Residential	165,978	-	-	165,978
Commercial	918,119	-	-	918,119
Construction	187,140	-	-	187,140
	$ 1,742,732	$ -	$ -	$ 1,742,732
Other real estate:				
Commercial	$ 529,293	$ -	$ -	$ 529,293
Residential	194,504	-	-	194,504
	$ 723,797	$ -	$ -	$ 723,797

(Continued)

NOTE 13 - DISCLOSURE ABOUT FAIR VALUE (Continued)

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

	Fair value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans – residential real estate	$ 1,386,440	Sales comparison approach	Adjustment for differences between the comparable sales and age of valuations	10-35%
Other real estate	$ 575,027	Sales comparison approach	Adjustment for differences between the comparable sales and age of valuations	10-20%

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $1,626,623, with a valuation allowance of $240,183 at December 31, 2012, resulting in an additional provision for loan losses of $56,218 for the year ending December 31, 2012. At December 31, 2011, impaired loans had a carrying amount of $1,742,732, with a valuation allowance of $183,965 at December 31, 2011, resulting in an additional provision for loan losses of $51,363 for the year ending December 31, 2011.

The following table shows the estimated fair values and the related carrying amount of the Company's financial instruments (dollar amounts in thousands).

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and due from banks	$ 12,743	$ 12,743	$ 10,536	$ 10,536
Federal funds sold	1,732	1,732	9,053	9,053
Interest bearing deposits	200	200	500	500
Securities available-for-sale	42,236	42,236	33,555	33,555
Securities held to maturity	14,583	15,305	13,247	13,850
Loans held for sale	768	768	312	312
Net loans	225,620	239,398	215,425	218,668
Restricted equity investments	2,352	N/A	2,352	N/A
Accrued interest receivable	1,374	1,374	1,538	1,538
Financial liabilities				
Deposits	(281,249)	(283,514)	(258,710)	(262,456)
Federal Home Loan Bank advances	(3,000)	(3,193)	(12,000)	(12,761)
Notes payable	1,555	1,555	2,155	2,155
Accrued interest payable	(112)	(112)	(125)	(125)

(Continued)

NOTE 13 - DISCLOSURE ABOUT FAIR VALUE (Continued)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest-bearing deposits, short-term borrowings, notes payable, accrued interest receivable and payable, demand deposits, and variable rate loans, deposits, or borrowings that reprice frequently and fully. The estimated fair value for all securities is determined as previously described for securities available for sale. Estimated fair value for loans is based on the rates charged at December 31, 2012 and 2011 for new loans with similar maturities and credit risk, applied until the loan is assumed to reprice or be paid. Estimated fair values for time deposits and other debt are based on the rates paid at December 31, 2012 and 2011 for new deposits or borrowings, applied until maturity. It was not practicable to determine the fair value of restricted equity investments due to restrictions placed on its transferability. Estimated fair value for other financial instruments and off-balance-sheet loan commitments are considered nominal.