



STATE BANK *of* DAVIS

northwestbank



financial group, inc.



German American
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LENA STATE BANK

State Bank
Freeport, IL



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LENA STATE BANK



German American

S·T·A·T·E B·A·N·K

Traditional Banking ... Lifetime Solutions



STATE BANK *of* DAVIS

We are a market driven,
people oriented
community banking organization
dedicated to enhancing
shareholder value by
providing our customers with
diversified financial services
that help them achieve
economic success
and financial security.



We will pursue these goals
while balancing shareholder
and customer interests
with the ongoing welfare
of our employees
and local communities.
The member banks
of our group maintain
a high degree
of independence
and sensitivity to the concerns
of the local communities
and markets that we
choose to serve.



We will seek to
expand sensibly into
new markets when we believe
that our business model and
community banking philosophy
can be successfully extended.



In summary:

“Community Building through Community Banking”

Dear Stockholders,

It would be accurate to say that 2012 was one of the most challenging in your Company's 26 year history. Upon reflection, I am proud of the compassionate efforts put forth by our bank group, which worked closely for the past few years with many long term customers whose businesses were severely impacted by the Great Recession; unfortunately, several of those customers ran out of reserves and/or the will to keep operating in 2012. Circumstances varied, but all were operating in a local business climate that continued to fare poorly compared to the slowly improving national economy, against stubbornly high (12% average) unemployment, and a state political culture and tax burden that have combined to present major obstacles to business recovery. When the banks' loan customers who had struggled for years ceased making payments on previously performing loans, the banks were faced with liquidating various types of real estate collateral at significant losses in an adverse market. Accounting for these circumstances forced recognition of credit costs of over \$14 million in 2012, and a resultant 47.5% decline in net income for the year 2012 to \$3,446,000 from the near record \$6,568,000 recorded in 2011. For the first time since the start of the Great Recession in 2008, Foresight's profitability as measured by return on assets of .39% was less than peer average of .73%. However, for the five year period since 2008 in working through adversity with customers, Foresight's average return on assets of .65% far exceeds the peer average of .32%.

Continued progress was made in 2012 in reducing the relative burden of non-performing assets, which declined by 15% to a year-end total of \$17 million. Reserves for loan losses were increased to \$14.9 million, or 2.4% of total loans. Reserve coverage of non-performing assets is well above peer average as a result of these strategic decisions. Asset quality improvement remains the most important goal for future performance improvement in an economy that remains challenging.

For the year, net interest income declined by 1.3%, as loan volumes were lower due to increased competition and lack of credit worthy loan demand, along with the loss of customers that went out of business due to regulatory burdens and/or the recession. Non-interest operating expenses excluding the costs of foreclosed real estate increased by 4.3%, reflective of increased personnel and infrastructure costs incurred to meet regulatory requirements in compliance with the barrage of new banking regulations, as well as new internet security directives. On a more positive note, non-interest income increased 8.9% driven by mortgage banking revenues growth from the low interest rate environment and addition of experienced and talented key personnel in the fourth quarter from a local mortgage banking company that found our company to be the best partner they could find to deploy their mortgage lending skills.

The most encouraging set of events in 2012 was the sale of \$10 million in capital debentures in September which facilitated full redemption of \$15.75 million of TARP preferred stock held by the U.S. Treasury in December. The support of the 84 local customers who purchased the debenture offering, most of whom are existing Foresight shareholders, was very encouraging, and positions the company to improve future performance from a position of strength, as evidenced by a maintaining regulatory capital at about 45% above regulatory requirements, continued payment of common stock dividends, and a strong cash position providing the parent company with flexibility to support the bank group.

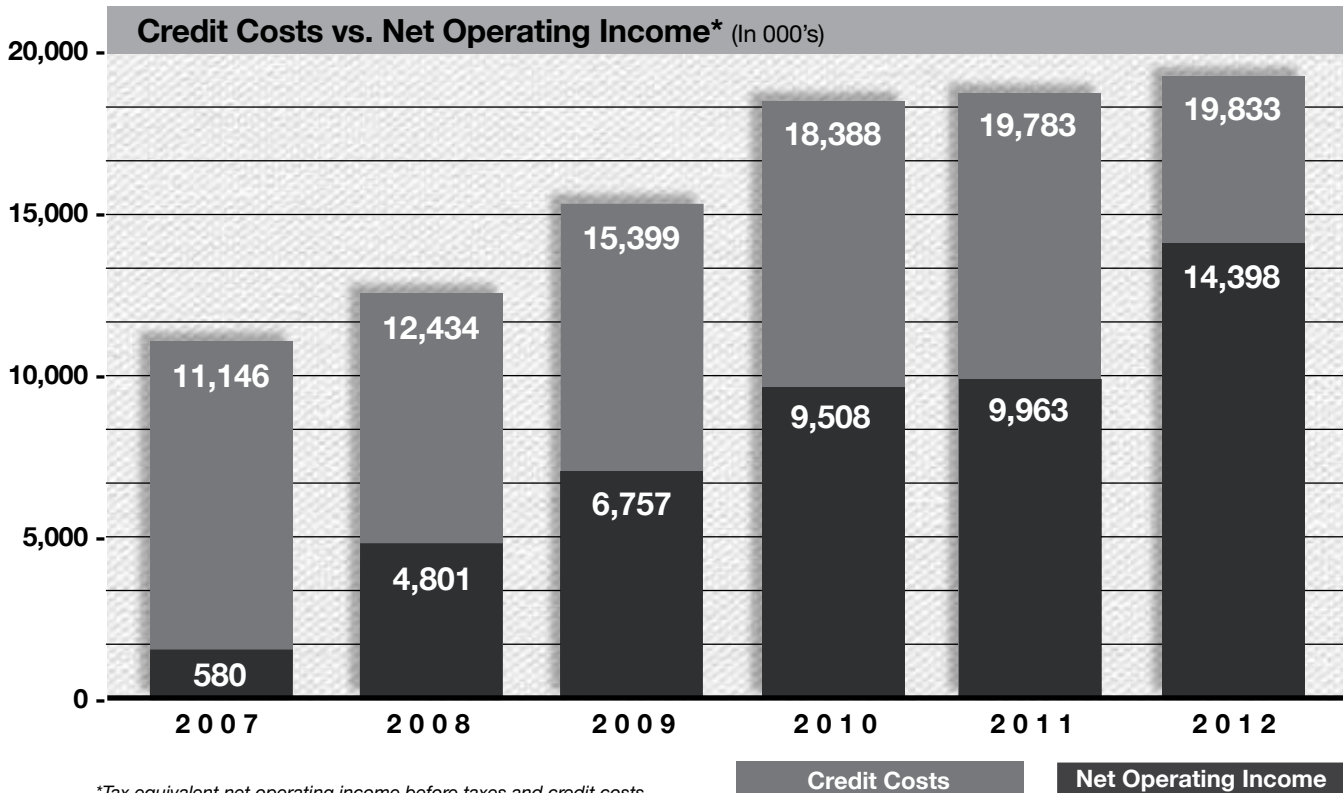
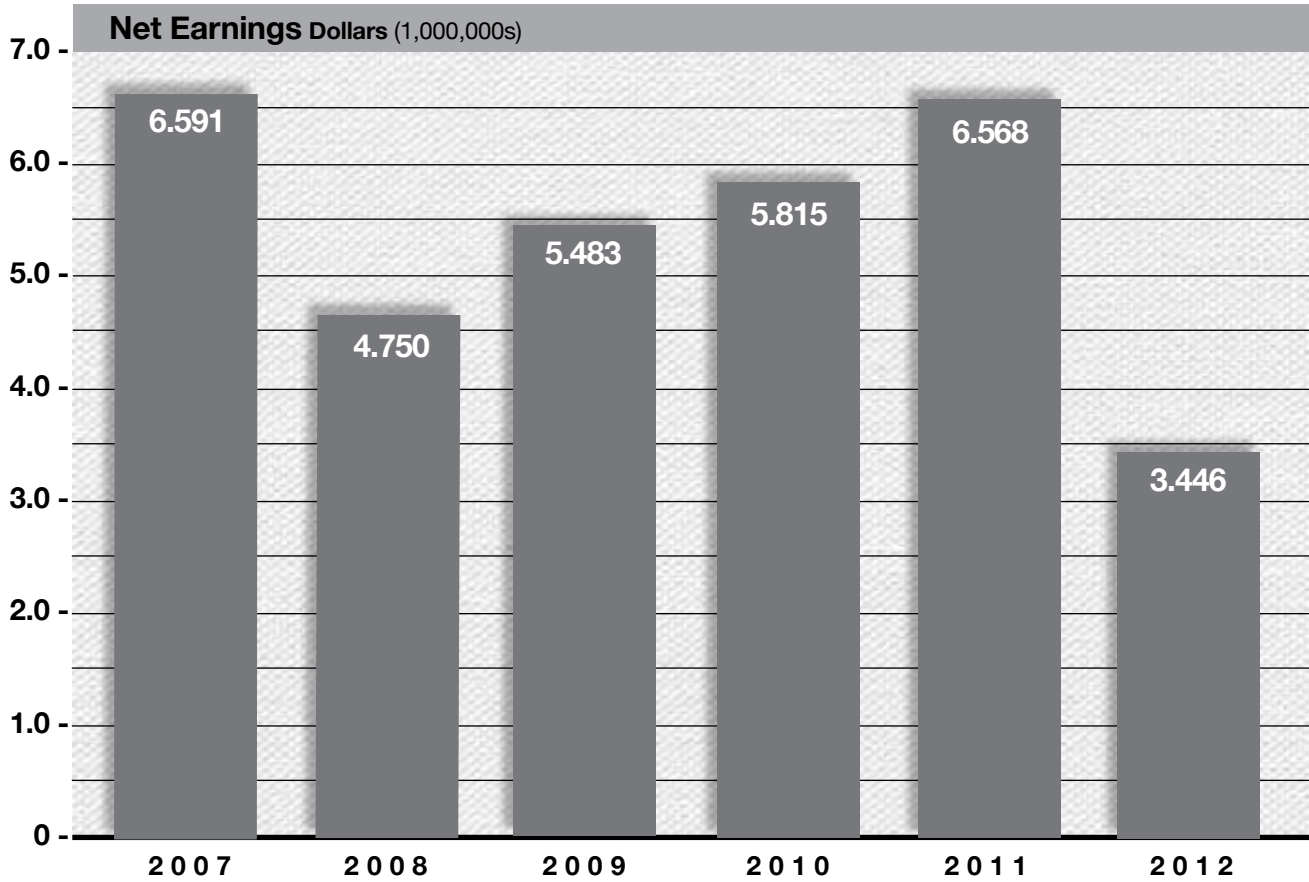
We have received numerous positive comments from stock analysts indicating their confidence in the company based on the elements described in this letter, and expect the common stock trading price to improve in 2013 as a result.

With these elements of strength and your continued support, we can continue to pursue in confidence our mission of ***Community Building through Community Banking.***

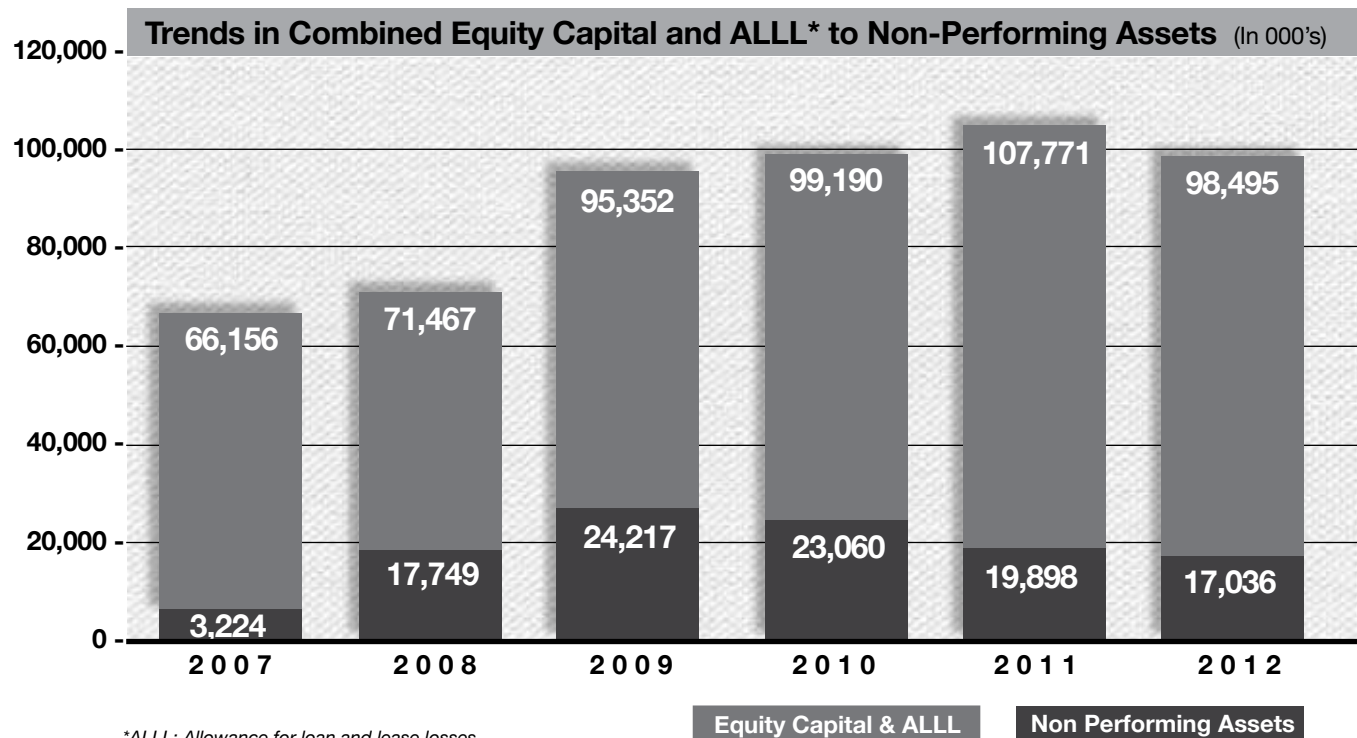
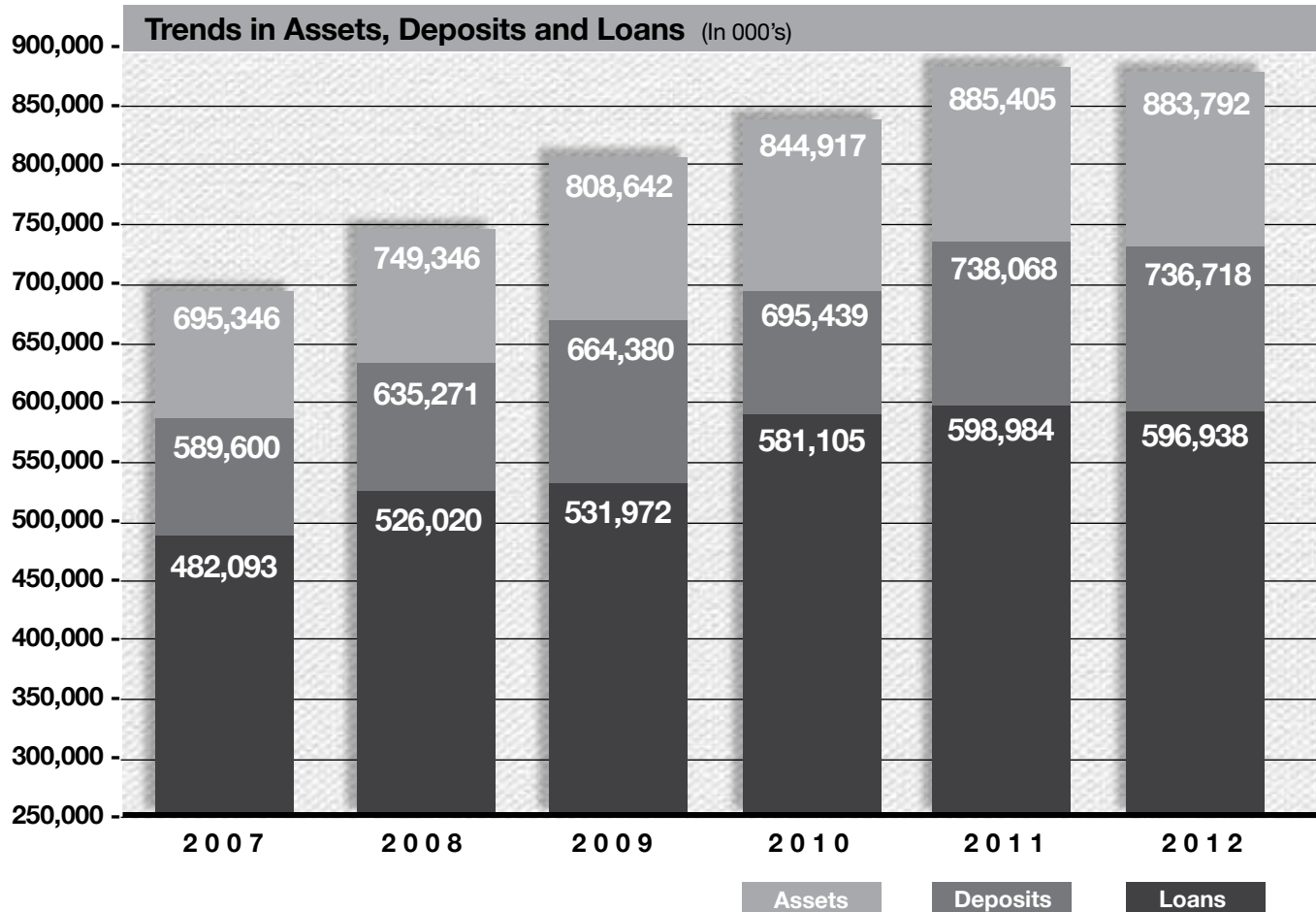
Respectfully and Gratefully,



Stephen G. Gaddis, President and CEO



*Tax equivalent net operating income before taxes and credit costs.





Wipfli LLP
403 East Third Street
Sterling, IL 61081

815.626.1277
Fax 815.626.9118

www.wipfli.com

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Foresight Financial Group, Inc.

We have audited the accompanying consolidated financial statements of Foresight Financial Group, Inc. and Subsidiaries, which comprise the consolidated balances sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012, 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 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 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 Foresight Financial Group, Inc. and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in accordance with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information included in Schedules 1 and 2 is presented for purposes of additional analyses and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Wipfli LLP

Sterling, Illinois
March 7, 2013

CONSOLIDATED BALANCE SHEETS

(000s omitted except share data)

December 31,

A S S E T S	2012	2011
Cash and due from banks	\$19,733	\$17,121
Interest-bearing deposits in banks	7,347	8,396
Federal funds sold	2,137	0
Total cash and cash equivalents	29,217	25,517
Securities:		
Securities held-to-maturity (HTM)	1,728	2,042
Securities available-for-sale (AFS)	213,845	221,634
Non-marketable equity securities, at cost	2,184	2,177
Loans held for sale	5,598	2,198
Loans, net of allowance for loan losses of \$14,948 and \$11,173, respectively	596,938	598,984
Foreclosed assets, net	6,770	5,997
Premises and equipment, net	10,230	10,115
Other assets	17,282	16,741
Total assets	\$883,792	\$885,405
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	\$92,336	\$82,036
Interest-bearing	644,382	656,032
Total deposits	736,718	738,068
Federal funds purchased	5,114	3,899
Securities sold under agreements to repurchase	25,046	27,698
Federal Home Loan Bank (FHLB) advances and other borrowings	19,850	14,400
Subordinated debentures	10,000	0
Accrued interest payable and other liabilities	3,517	4,742
Total liabilities	800,245	788,807
Stockholders' equity:		
Preferred stock (no par value; authorized 500,000 shares; 15,750 shares issued)	0	15,394
Common stock (\$.25 par value; authorized 5,000,000 shares; 3,867,169 and 3,867,129 shares issued, respectively)	966	966
Additional paid-in capital	7,763	7,666
Retained earnings	72,821	71,193
Treasury stock, at cost (207,657 shares)	(4,060)	(4,060)
Accumulated other comprehensive income	6,057	5,439
Total stockholders' equity	83,547	96,598
Total liabilities and stockholders' equity	\$883,792	\$885,405

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

(000s omitted except share data)

For the years ended December 31,

	2012	2011	2010
Interest and dividend income:			
Loans, including fees	\$31,487	\$33,530	\$31,789
Debt securities:			
Taxable	3,472	3,915	4,642
Tax-exempt	3,900	3,900	4,061
Interest-bearing deposits in banks and other	57	16	36
Federal funds sold	11	11	7
Total interest and dividend income	38,927	41,372	40,535
Interest expense:			
Deposits	7,231	9,313	11,832
Federal funds purchased	3	7	13
Securities sold under agreements to repurchase	128	167	180
FHLB and other borrowings	245	341	418
Subordinated debentures	189	0	0
Total interest expense	7,796	9,828	12,443
Net interest and dividend income	31,131	31,544	28,092
Provision for loan losses	13,444	7,195	8,382
Net interest and dividend income, after provision for loan losses	17,687	24,349	19,710
Noninterest income:			
Customer service fees	1,275	1,369	1,520
Gain on sales and calls of AFS securities, net	191	334	180
Gain on sales of loans, net	1,500	968	1,183
Loan servicing fees, net	832	616	811
Other	2,360	2,367	2,614
Total noninterest income	6,158	5,654	6,308
Noninterest expenses:			
Salaries and employee benefits	10,822	10,540	10,045
Occupancy expense of premises, net	2,030	1,904	1,900
Outside services	751	723	699
Data processing	1,072	959	837
Foreclosed assets, net	954	2,768	1,126
Other	4,790	4,535	4,835
Total noninterest expenses	20,419	21,429	19,442
Income before income taxes	3,426	8,574	6,576
Income tax expense	(20)	2,006	761
Net income	\$3,446	\$6,568	\$5,815
Earnings per common share:			
Basic	\$0.60	\$1.53	\$1.32
Diluted	\$0.60	\$1.52	\$1.32

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(000s omitted except share data)

For the years ended December 31,

	2012	2011	2010
Net income	\$3,446	\$6,568	\$5,815
Other comprehensive income:			
Unrealized holding gains on securities available for sale	1,228	7,603	(2,459)
Reclassification adjustments for net securities gains recognized in income	(191)	(334)	(180)
	1,037	7,269	(2,639)
Deferred income tax effect	(418)	(2,958)	1,014
Total other comprehensive income (loss)	619	4,311	(1,625)
Total comprehensive income	\$4,065	\$10,879	\$4,190

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(000s omitted except share data)

For the years ended December 31,

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2010	\$15,094	\$966	\$7,487	\$62,353	(\$4,060)	\$2,753	\$84,593
Net income				5,815			5,815
Other comprehensive loss						(1,625)	(1,625)
Cash dividends (\$.28 per share)				(1,025)			(1,025)
Accretion of preferred stock warrants	150			(150)			0
Cash dividends on preferred stock				(814)			(814)
Stock-based compensation expense			81				81
Balance, December 31, 2010	15,244	966	7,568	66,179	(4,060)	1,128	87,025
Net income				6,568			6,568
Other comprehensive income						4,311	4,311
Cash dividends (\$.16 per share)				(586)			(586)
Accretion of preferred stock warrants	150			(150)			0
Cash dividends on preferred stock				(818)			(818)
Stock-based compensation expense			98				98
Balance, December 31, 2011	15,394	966	7,666	71,193	(4,060)	5,439	96,598
Net income				3,446			3,446
Other comprehensive income						619	619
Remption of preferred stock	(15,750)						(15,750)
Cash dividends (\$.16 per share)				(586)			(586)
Accretion of preferred stock warrants	356			(356)			0
Cash dividends on preferred stock				(877)			(877)
Stock-based compensation expense			97				97
Balance, December 31, 2012	\$0	\$966	\$7,763	\$72,820	(\$4,060)	\$6,058	\$83,547

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(000s omitted except share data)

	For the years ended December 31,		
	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$3,446	\$6,568	\$5,815
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Provision for loan losses	13,444	7,195	8,382
Provision for foreclosed asset losses	744	2,410	900
Depreciation	862	799	741
Net amortization of securities	1,242	974	1,094
Deferred income tax benefit	(1,642)	(473)	(822)
Net gain on the sales and calls of AFS securities	(191)	(334)	(180)
Net (gain) loss on the sales of foreclosed assets	(207)	12	50
Stock-based compensation expense	97	98	81
Net change in:			
Servicing rights	(128)	8	(251)
Loans held for sale	(3,400)	(1,019)	(732)
Other assets	812	305	1,016
Accrued expenses and other liabilities	(1,226)	400	259
Net cash provided by operating activities	13,853	16,943	16,353
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sales of AFS securities	6,685	13,966	14,551
Proceeds from maturities, calls, and paydowns of HTM securities	359	606	999
Proceeds from maturities, calls, and paydowns of AFS securities	65,079	48,466	56,977
Purchases of AFS securities	(64,034)	(75,388)	(52,762)
Purchases of non-marketable equity securities	(7)	(124)	(244)
Loan originations and principal collections, net	(14,765)	(27,693)	(66,113)
Proceeds from sales of foreclosed assets	2,057	1,608	810
Purchases of premises and equipment, net	(977)	(471)	(2,131)
Net cash used in investing activities	(5,603)	(39,030)	(47,913)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	(1,350)	42,629	31,059
Net change in securities sold under agreements to repurchase	(2,652)	1,371	1,973
Cash dividends paid	(1,463)	(1,404)	(1,839)
Net change in federal funds purchased	1,215	1,815	(2,648)
Proceeds from issuance of subordinated debentures	10,000	0	0
Redemption of preferred stock	(15,750)		
Proceeds from lines of credit and FHLB advances and other borrowings	17,000	10,500	19,750
Payments on lines of credit and FHLB advances and other borrowings	(11,550)	(25,800)	(16,550)
Net cash (used in) provided by financing activities	(4,550)	29,111	31,745
Net increase in cash and cash equivalents	3,700	7,024	185
Cash and cash equivalents at beginning of year	25,517	18,493	18,308
Cash and cash equivalents at end of year	\$29,217	\$25,517	\$18,493

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(000s omitted except share data)

For the years ended December 31,

	2012	2011	2010
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	\$8,093	\$10,040	\$12,790
Income taxes	\$2,009	\$2,190	\$1,905
SUPPLEMENTAL SCHEDULE OF NONCASH AND FINANCING ACTIVITIES:			
Foreclosed assets acquired in settlement of loans	\$3,367	\$2,619	\$8,598

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of Foresight Financial Group, Inc. (Company) and its wholly owned subsidiaries (Banks) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The following is a description of the more significant accounting policies:

(a) Nature of Operations

The Company provides a variety of banking services to individuals and businesses through its facilities in the Rockford, Freeport, German Valley, Davis, Lena, Winnebago, Pecatonica, and Seward, Illinois areas. Its primary deposit products are demand deposits and certificates of deposit and its primary lending products are agribusiness, commercial, real estate, and installment loans.

(b) Basis of Consolidation

The consolidated financial statements include the accounts and results of operations of the Company and its wholly owned subsidiaries, German-American State Bank (German), State Bank of Davis (Davis), State Bank (Freeport), Northwest Bank of Rockford (Northwest), and Lena State Bank (Lena) (collectively the "Banks"). All significant intercompany accounts and transactions have been eliminated in consolidation.

(c) Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through March 7, 2013, which is the date the financial statements were available to be issued.

(d) 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The allowance for loan losses, fair values of securities, fair values of foreclosed assets, deferred tax assets and liabilities and fair values of financial instruments are particularly subject to change in the near-term.

(e) Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing deposits in banks, and federal funds sold, all of which generally mature within ninety days. Cash flows from loans, deposits, federal funds purchased, securities sold under agreements to repurchase, and treasury stock are reported net.

(f) Interest-bearing Deposits in Banks

Interest-bearing deposits in banks are largely comprised of liquid non-maturing deposits in banks but also include some small balances in time deposits in banks with varying maturities. Interest-bearing deposits in banks are carried at cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)

(g) Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity (HTM) and recorded at amortized cost. Securities not classified as HTM are classified as available for sale (AFS) and recorded at fair value, with unrealized gains or losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of HTM and AFS securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses.

In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific-identification method.

(h) Non-Marketable Equity Securities

The Banks, as members of the Federal Home Loan Bank (FHLB) system, are required to maintain a minimum investment in capital stock of the FHLB in an amount equal to the greater of 1% of their mortgage-related assets or 5% of advances from the FHLB. The Banks may choose to invest in amounts greater than the minimum investment. Excess capital stock redemptions are subject to guidelines established by the FHLB. FHLB stock is reported at cost since no ready market exists and it has no quoted market value. FHLB stock is periodically evaluated for impairment based on the ultimate recovery of par value.

(i) Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or market in the aggregate.

Mortgage loans held for sale are generally sold with mortgage servicing rights retained by the Company. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

(j) Loans and Allowance for Loan Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal balances less the allowance for loan losses. Interest income is accrued daily on the outstanding balances.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. The accrual of interest on loans is discontinued at the time the loan is 90-days delinquent 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 delinquent. Generally, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)***(j) Loans and Allowance for Loan Losses (continued)***

Generally, interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these 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.

Loan origination fees approximate direct loan origination costs and are generally recognized as income upon receipt.

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses relating to specifically identified loans, as well as probable credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio including the nature of the portfolio, credit concentrations, trends in historical loss experience, specifically impaired loans, and economic conditions. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change materially in the near term. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries.

The allowance consists of specific and general components. The specific component relates to loans classified as impaired. For loans classified as impaired, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical-loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is 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.

A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Loans for which the terms have been modified to provide a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Impaired loans are measured on an individual basis based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral less costs to sell if the loan is collateral dependent. The amount of impairment, if any, and subsequent changes are included in the allowance for loan losses. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception, unless collateral dependent, then reported using the fair value of collateral method.

For impaired loans, accrual of interest is discontinued when management believes, after considering collection efforts and other factors, the borrower's financial condition is such that the collection of interest is doubtful. Cash collections on impaired loans are credited to the loan receivable balance, and no interest income is recognized on those loans until the principal balance has been collected.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)

(k) Loan Commitments

The Banks enter into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit issued to meet customer-financing needs. Loan commitments are recorded when they are funded. Standby or performance letters of credit are considered financial guarantees in accordance with accounting standards and are recorded at fair value, if material.

(l) Loan Servicing

Mortgage servicing rights are recognized as separate assets when rights are acquired through a sale of loans and are reported in other assets. When the originating mortgage loans are sold into the secondary market, the Company allocates the total cost of the mortgage loans between mortgage servicing rights and the loans, based on their relative fair values. The cost of originated mortgage-servicing rights is amortized in proportion to, and over the period of, estimated net servicing revenues. Impairment of mortgage-servicing rights is assessed based on the fair value of those rights. The amount of impairment is the amount by which the capitalized mortgage servicing rights exceed their fair value. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions.

Residential mortgage loans are generally sold to the secondary market. At the time the loans are sold, a gain or loss is calculated based on the cash received versus the carrying value of the assets transferred.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

(m) Mortgage-Banking Derivatives

Commitments to fund mortgage loans (interest-rate locks) to be sold into the secondary market and mandatory delivery forward commitments for the future delivery of these mortgage loans are to be accounted for as derivatives not qualifying for hedge accounting. The fair values of these mortgage derivatives are to be estimated based on the net future cash flows related to the associated servicing of the loans and on changes in mortgage interest rates from the date of the commitments. Changes in fair values on these derivatives are to be included in net gains on sales of loans. The Company has deemed the effect of these derivatives to be immaterial to the consolidated financial statements and has elected not to record fair values associated with these derivatives.

(n) Foreclosed Assets

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated cost of disposal when acquired. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Costs after acquisition are generally expensed. Revenues and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)

(o) Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation, based on the estimated useful lives of the assets. Depreciation is generally computed on the straight-line method over estimated useful lives ranging from 3 to 40 years.

(p) Bank-Owned Life Insurance

The Bank has purchased life insurance policies on certain key employees. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

(q) Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located in the area and communities noted above. Note 3 details the types of securities in which the Company invests. Note 4 details the types of lending in which the Company engages. The Company does not have any significant concentrations with any one industry or customer.

(r) Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. The Company files consolidated Federal and State income tax returns.

The Company may also recognize a liability for unrecognized tax benefits from uncertain tax positions. Unrecognized tax benefits represent the differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured in the financial statements. Interest and penalties related to unrecognized tax benefits are classified as income taxes, if applicable. No liabilities for unrecognized tax benefits from uncertain tax positions have been recorded.

(s) Comprehensive Income

Accounting principles generally require the Company to include in net income recognized revenue, expenses, gains and losses. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)

(t) Earnings Per Share

Basic earnings per share (EPS) represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method. The dividends on preferred stock and the accretion of the preferred warrants are subtracted from net income in arriving at the net income available to common stockholders.

(u) Loss Contingencies

Loss contingencies, including claims and legal actions arising from time to time 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 could have a material effect on the consolidated financial statements.

(v) Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

(w) Trust Assets

Assets of the trust department of State Bank, other than trust cash on deposit at the Bank, are not included in these financial statements because they are not assets of the Company.

(x) Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

(y) Stock Compensation Plans

The Company records the cost of stock-based employee compensation using the fair-value method. Compensation expense for share-based awards is recorded over the vesting period at the fair value of the award at the time of grant. The Company has historically assumed no projected forfeitures on its stock based compensation, since forfeitures have not been significant.

(z) Reclassifications

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(1) Summary of Significant Accounting Policies (continued)

(aa) Adoption of New Accounting Standards

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. The primary purpose of this new guidance is to provide additional clarity in determining whether a restructuring constitutes a troubled debt restructuring. This update is effective for financial statements issued for annual periods ending after December 15, 2012. The Company adopted this new accounting standard effective December 31, 2012. The adoption of this accounting standard did not have a significant effect on the financial statements of the Company.

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This standard results in common fair value measurement and disclosure requirements in U.S. and international accounting standards by changing certain fair value concepts and requiring additional disclosures about fair value. This update is effective for fiscal years beginning after December 15, 2011. The Company adopted this new accounting standard effective December 31, 2012. The adoption of this accounting standard did not have a significant effect on the financial statements of the Company.

In June 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-05, Presentation of Comprehensive Income. This standard eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all components of net income and other comprehensive income be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update is effective for fiscal years ending after December 15, 2012. The Company retroactively adopted this new accounting standard effective December 31, 2012. The Company has chosen to present comprehensive income in a separate statement of comprehensive income.

(2) Cash and Due From Banks

The Banks are required to maintain reserve balances, in cash or on deposit with the Federal Reserve Bank, based upon a percentage of deposits. The total required reserve balances as of December 31, 2012 and 2011 was approximately \$2,251 and \$2,900, respectively.

In the normal course of business, the Company maintains cash and due from bank balances in accounts with correspondent banks. Balances in these accounts may exceed the Federal Insurance Deposit Corporation's insured limit of \$250,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(3) Securities

The following tables reflect the amortized costs and approximate fair values of securities at December 31:

Held-to-Maturity 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal	\$1,728	\$108	\$0	\$1,836

Held-to-Maturity 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal	\$2,042	\$77	(\$9)	\$2,110

Available-for-Sale 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government sponsored agencies	\$32,916	\$728	(\$97)	\$33,547
State and municipal	95,497	7,277	(143)	102,631
Mortgage-backed – residential	75,289	2,476	(98)	77,667
	\$203,702	\$10,481	(\$338)	\$213,845

Available-for-Sale 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government sponsored agencies	\$43,836	\$903	(\$9)	\$44,730
State and municipal	99,179	5,830	(205)	104,804
Mortgage-backed - residential	69,513	2,640	(53)	72,100
	\$212,528	\$9,373	(\$267)	\$221,634

For the years ended December 31, 2012, 2011 and 2010, proceeds from sales of available-for-sale securities amounted to \$6,685, \$13,996 and \$14,551, respectively. Gross realized gains and losses from the sales and calls of available-for-sale securities for the years ended December 31 are as follows:

	2012	2011	2010
Realized gains	\$191	\$368	\$257
Realized losses	\$0	(\$34)	(\$77)

Securities with carrying amounts of approximately \$99,121 and \$101,632 at December 31, 2012 and 2011, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

The amortized costs and fair values of securities at December 31, 2012 are shown below by contractual maturities, except for U.S. agencies which are shown by contractual maturities or their expected call dates if the call dates are considered likely to occur based on present market conditions. Expected maturities may differ from contractual maturities on mortgage-backed securities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(3) Securities (continued)

Held-to-Maturity	Amortized Cost	Fair Value
Due in one year or less	\$170	\$171
Due after one year through five years	155	160
Due after five years through ten years	395	420
Due after ten years	1,008	1,085
	\$1,728	\$1,836

Available-for-Sale	Amortized Cost	Fair Value
Due in one year or less	\$11,742	\$11,817
Due after one year through five years	19,426	20,375
Due after five years through ten years	31,579	33,262
Due after ten years	65,666	70,724
	128,413	136,178
Mortgage-backed - residential	75,289	77,667
	\$203,702	\$213,845

The following tables show the fair values and unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2012 and 2011:

There were no held-to-maturity securities in an unrealized loss position at December 31, 2012.

2011						
Held-to-Maturity						
	Less than 12 Months			12 Months or More		
	Fair Value	Gross Unrealized Loss	No. of Securities	Fair Value	Gross Unrealized Loss	No. of Securities
State and municipal	\$285	\$1	1	\$145	\$8	2
Total temporarily impaired	\$285	\$1	1	\$145	\$8	2

2012						
Available-for-Sale						
	Less than 12 Months			12 Months or More		
	Fair Value	Gross Unrealized Loss	No. of Securities	Fair Value	Gross Unrealized Loss	No. of Securities
U.S. Government sponsored agencies	\$11,601	\$97	37	\$0	\$0	0
State and municipal	1,995	33	6	246	110	1
Mortgage-backed - residential	7,153	98	11	0	0	0
Total temporarily impaired	\$20,749	\$228	54	\$246	\$110	1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(3) Securities (continued)

	2011					
	Available-for-Sale					
	Less than 12 Months			12 Months or More		
	Fair Value	Gross Unrealized Loss	No. of Securities	Fair Value	Gross Unrealized Loss	No. of Securities
U.S. Government sponsored agencies	\$2,749	\$9	9	\$0	\$0	0
State and municipal	2,401	26	18	1,203	179	10
Mortgage-backed - residential	8,537	53	14	0	0	0
Total temporarily impaired	\$13,687	\$88	41	\$1,203	\$179	10

Unrealized losses on securities have not been recognized into income because the bonds are of high credit quality, management has the intent and ability to hold for the foreseeable future and the decline in fair value is largely due to market interest rate fluctuations and current bond markets. The fair value is expected to recover as the bonds approach their maturity dates and/or market rates. The unrealized losses on the remaining securities have not been recognized into income because the bonds are of high credit quality and management has the intent and ability to hold for the foreseeable future.

(4) Loans

The following table presents total loans at December 31 by portfolio segment and class of loan:

	2012	2011
Real estate:		
Commercial real estate	\$180,822	\$173,480
Agricultural real estate	71,715	60,229
Residential real estate	110,903	128,210
Commercial:		
Commercial and industrial	175,945	183,844
Agricultural production	59,669	48,589
Consumer and other	12,832	15,805
	611,886	610,157
Allowance for loan losses	(14,948)	(11,173)
	\$596,938	\$598,984

The following is a summary of the activity in the allowance for loan losses for the years ended December 31:

	2012	2011	2010
Balance at beginning of year	\$11,173	\$12,165	\$10,759
Provision charged to operations, net	13,444	7,195	8,362
Recoveries on loans previously charged-off	497	286	442
	25,114	19,646	19,563
Less loans charged-off	(10,166)	(8,473)	(7,398)
Balance at end of year	\$14,948	\$11,173	\$12,165

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans

Detailed analysis of the allowance for loan losses by portfolio segments at December 31 are as follows:

	As of December 31, 2012			
	Real Estate	Commercial	Consumer	Total
Balance at beginning of year	\$7,216	\$3,836	\$121	\$11,173
Provision charged to operations, net	12,110	1,319	15	13,444
Recoveries on loans previously charged-off	108	338	51	497
	19,434	5,493	187	25,114
Less loans charged-off	(9,144)	(946)	(76)	(10,166)
Balance at end of year	\$10,290	\$4,547	\$111	\$14,948
Allowance for loan losses:				
Individually evaluated for impairment	\$4,776	\$1,518	\$22	\$6,316
Collectively evaluated for impairment	5,514	3,029	89	8,632
Totals	\$10,290	\$4,547	\$111	\$14,948

	As of December 31, 2011			
	Real Estate	Commercial	Consumer	Total
Balance at beginning of year	\$7,331	\$4,594	\$240	\$12,165
Provision charged to operations, net	5,888	1,376	(69)	7,195
Recoveries on loans previously charged-off	124	97	65	286
	13,343	6,067	236	19,646
Less loans charged-off	(6,127)	(2,231)	(115)	(8,473)
Balance at end of year	\$7,216	\$3,836	\$121	\$11,173
Allowance for loan losses:				
Individually evaluated for impairment	\$2,934	\$812	\$8	\$3,754
Collectively evaluated for impairment	4,282	3,024	113	7,419
Totals	\$7,216	\$3,836	\$121	\$11,173

Detailed analysis of loans evaluated for impairment by portfolio segment for the year ended December 31 follows:

	2012			
	Real Estate	Commercial	Consumer	Total
Loans:				
Individually evaluated for impairment	\$21,118	\$6,847	\$196	\$28,161
Collectively evaluated for impairment	342,322	228,767	12,636	583,725
Totals	\$363,440	\$235,614	\$12,832	\$611,886

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans (continued)

	2011			
	Real Estate	Commercial	Consumer	Total
Loans:				
Individually evaluated for impairment	\$28,256	\$5,398	\$190	\$33,844
Collectively evaluated for impairment	333,663	227,035	15,615	576,313
Totals	\$361,919	\$232,433	\$15,805	\$610,157

Detailed information regarding impaired loans by class of loan as of December 31 follows:

	As of December 31, 2012				
	Recorded Investment	Principal Balance	Related Allowance	Average Investment	Interest Recognized
Loans with no related allowance for loan losses:					
Real estate:					
Commercial real estate	\$1,491	\$1,602	N/A	\$1,554	\$54
Residential real estate	3,826	5,062	N/A	4,376	140
Agricultural real estate	167	167	N/A	174	0
Commercial					
Commercial & industrial	4,092	4,241	N/A	4,756	215
Agricultural production	0	0	N/A	0	0
Consumer and other	159	220	N/A	201	10
Totals	9,735	11,292		11,061	419
Loans with an allowance for loan losses:					
Real estate:					
Commercial real estate	9,175	9,698	2,342	9,257	334
Residential real estate	6,459	7,340	2,434	6,673	225
Agricultural real estate	0	0	0	0	0
Commercial					
Commercial & industrial	2,401	3,962	1,186	2,505	92
Agricultural production	354	358	332	416	0
Consumer and other	37	38	22	40	2
Totals	18,426	21,396	6,316	18,891	653
Grand Totals	\$28,161	\$32,688	\$6,316	\$29,951	\$1,072

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans (continued)

	As of December 31, 2011				
	Recorded Investment	Principal Balance	Related Allowance	Average Investment	Interest Recognized
Loans with no related allowance for loan losses:					
Real estate:					
Commercial real estate	\$9,557	\$10,163	N/A	\$6,965	\$227
Residential real estate	7,543	8,535	N/A	6,086	227
Agricultural real estate	295	295	N/A	215	0
Commercial					
Commercial & industrial	4,037	5,039	N/A	4,086	176
Agricultural production	0	0	N/A	0	0
Consumer and other	130	130	N/A	131	9
Total	21,562	24,162		17,483	639
Loans with an allowance for loan losses:					
Real estate:					
Commercial real estate	3,402	3,448	714	2,489	149
Residential real estate	7,459	8,072	2,220	6,211	339
Agricultural real estate	0	0	0	0	0
Commercial					
Commercial & industrial	998	1,015	472	771	54
Agricultural production	363	363	340	267	0
Consumer and other	60	99	8	62	2
Total	12,282	12,997	3,754	9,800	544
Grand Total	\$33,844	\$37,159	\$3,754	\$27,283	\$1,183

The average balance of impaired loans during the year ended December 31, 2010 approximated \$26,920. Interest income and other loan income recognized on impaired loans during 2010 approximated \$347. The Banks have no commitments to loan additional funds to the borrowers of impaired or non-accrual loans.

The Company regularly evaluates various attributes of loans to determine the appropriateness of the allowance for loan losses. The Company generally monitors credit quality indicators for all loans using the following internally prepared ratings:

'Pass' ratings are assigned to loans with adequate collateral and debt service ability such that collectibility of the contractual loan payments is highly probable.

'Special Mention' ratings are assigned to loans where management has some concern that the collateral or debt service ability may not be adequate, though the collectibility of the contractual loan payments is still probable.

'Substandard' ratings are assigned to loans that do not have adequate collateral and/or debt service ability such that collectibility of the contractual loan payments is no longer probable.

'Doubtful' ratings are assigned to loans that do not have adequate collateral and/or debt service ability, and collectibility of the contractual loan payments is unlikely.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans (continued)

Information regarding the credit quality indicators most closely monitored by class of loan at December 31 follows:

	As of December 31, 2012				Totals
	Pass	Special Mention	Substandard	Doubtful	
Real estate:					
Commercial real estate	\$161,858	\$12,720	\$6,244		\$180,822
Residential real estate	92,191	12,455	6,209	\$48	110,903
Agricultural real estate	71,064	484	167		71,715
Commercial:					
Commercial & industrial	166,925	3,458	5,561		175,944
Agricultural production	59,306	9	301	54	59,670
Consumer and other	12,591	54	187		12,832
Total	\$563,935	\$29,180	\$18,669	\$102	\$611,886

	As of December 31, 2011				Totals
	Pass	Special Mention	Substandard	Doubtful	
Real estate:					
Commercial real estate	\$157,749	\$7,762	\$7,969		\$173,480
Residential real estate	111,061	6,511	10,547	\$91	128,210
Agricultural real estate	56,606	3,328	295		60,229
Commercial:					
Commercial & industrial	164,626	14,699	4,444	75	183,844
Agricultural production	48,058	168	304	59	48,589
Consumer and other	15,519	97	189		15,805
Total	\$553,619	\$32,565	\$23,748	\$225	\$610,157

Loan aging information by class of loan at December 31 follows:

As of December 31, 2012	Loans Past Due 30-89 Days	Loans Past Due 90+ Days	Total Past Due
Real estate:			
Commercial real estate	\$1,203	\$1,715	\$2,918
Residential real estate	1,424	2,641	4,065
Agricultural real estate			
Commercial			
Commercial & industrial	1,599	2,377	3,976
Agricultural production		301	301
Consumer and other	57	40	97
Total	\$4,283	\$7,074	\$11,357

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans (continued)

As of December 31, 2012	Total Past Due	Total Current	Total Loans	90+ Days Due and Accruing Interest	Total Non-accrual Loans
Real Estate:					
Commercial real estate	\$2,918	\$169,709	\$172,627	\$292	\$2,428
Residential real estate	4,065	115,053	119,118	103	4,402
Agricultural real estate		71,715	71,715		167
Commercial:					
Commercial & industrial	3,976	171,960	175,936	12	2,432
Agricultural production	301	59,368	59,669		355
Consumer and other	97	12,724	12,821	11	64
Total	\$11,357	\$600,529	\$611,886	\$418	\$9,848

As of December 31, 2011	Loans Past Due 30-89 Days	Loans Past Due 90+ Days	Total Past Due
Real estate:			
Commercial real estate	\$539	\$5,184	\$5,723
Residential real estate	908	6,274	7,182
Agricultural real estate		295	295
Commercial			
Commercial & industrial	259	1,329	1,588
Agricultural production		304	304
Consumer and other	101	121	222
Total	\$1,807	\$13,507	\$15,314

As of December 31, 2011	Total Past Due	Total Current	Total Loans	90+ Days Due and Accruing Interest	Total Non-accrual Loans
Real Estate:					
Commercial real estate	\$5,723	\$167,757	\$173,480		\$5,519
Residential real estate	7,182	121,028	128,210	\$224	6,050
Agricultural real estate	295	59,934	60,229		295
Commercial:					
Commercial & industrial	1,588	182,256	183,844	5	1,324
Agricultural production	304	48,285	48,589		363
Consumer and other	222	15,583	15,805	50	71
Total	\$15,314	\$594,843	\$610,157	\$279	\$13,622

When, for economic or legal reasons related the borrower's financial difficulties, the Company grants a concession to the borrower that the Company would not otherwise consider, the modified loan is classified as a troubled debt restructuring. Loan modifications may consist of forgiveness of interest and/or principal, a reduction of the interest rate, interest only payments for a period of time, and/or extending amortization terms. All troubled debt restructurings are classified as impaired loans.

The following table presents information regarding modifications of loans that are classified as troubled debt restructurings by class of loan that occurred during the years ended December 31:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(4) Loans (continued)

	As of December 31, 2012		
	Number of Loans	Pre-Modification Investment	Post-Modification Investment
Real Estate:			
Commercial real estate	5	\$3,605	\$3,605
Residential real estate	2	261	167
Agricultural real estate	0		
Commercial			
Commercial & industrial	0		
Agricultural production	0		
Consumer and Other	0		
Total	7	\$3,866	\$3,772

	As of December 31, 2011		
	Number of Loans	Pre-Modification Investment	Post-Modification Investment
Real Estate:			
Commercial real estate	13	\$8,535	\$8,177
Residential real estate	60	9,646	9,646
Agricultural real estate	0		
Commercial			
Commercial & industrial	7	3,585	2,440
Agricultural production	0		
Consumer and Other	1	7	7
Total	81	\$21,773	\$20,270

The following table summarizes troubled debt restructurings that defaulted at December 31, within 12 months of their modification date:

	As of December 31, 2012	
	Number of Loans	Recorded Investment
Real Estate:		
Commercial real estate	3	\$3,886
Residential real estate	6	2,037
Total	9	\$5,924

	As of December 31, 2011	
	Number of Loans	Recorded Investment
Real Estate:		
Commercial real estate	2	\$1,270
Residential real estate	6	1,038
Total	8	\$2,308

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(5) Loan Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. Mortgage loans serviced for others as of December 31, 2012 and 2011, were approximately \$277,333 and \$249,326, respectively. Custodial escrow balances maintained in conjunction with serviced loans were approximately \$2,536 and \$1,910 at December 31, 2012 and 2011, respectively.

The following summarizes the activity pertaining to mortgage servicing rights for the years ended December 31:

	2012	2011	2010
Mortgage servicing rights:			
Balance at beginning of year	\$1,521	\$1,529	\$1,277
Mortgage servicing rights capitalized	940	643	970
Mortgage servicing rights amortized	(813)	(651)	(718)
Balance at end of year	\$1,648	\$1,521	\$1,529

The approximate fair values of the mortgage servicing rights were deemed to be greater than their carrying values as of December 31, 2012, 2011, and 2010. The differences between the fair values and carrying values were considered immaterial.

(6) Mortgage Banking Loan Commitments

The Company enters into commitments to fund residential mortgage loans (interest rate locks) at specified times in the future, with the intention that these loans will be subsequently sold to third-party investors. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60-days after inception of the rate lock. It is the Company's practice to enter into mandatory delivery forward commitments for the future delivery of residential mortgage loans to third-party investors when an interest rate lock commitment is granted. These mandatory delivery forward commitments bind the Company to deliver a residential mortgage loan to a third-party investor even if the underlying loan never funds. As of December 31, 2012 and 2011, the Company had approximately \$3,537 and \$4,055 in interest rate lock commitments outstanding. As of December 31, 2012 and 2011, the Company had approximately \$11,440 and \$7,053 in mandatory delivery forward commitments outstanding. These outstanding mortgage loan commitments are considered to be derivatives. The fair values associated with these derivatives were considered to be immaterial as of December 31, 2012 and 2011.

(7) Allowance for Losses on Foreclosed Assets

Foreclosed assets are presented in the balance sheets net of an allowance for losses. Activity in the allowance for losses on foreclosed assets for the years ended December 31, was as follows:

	2012	2011	2010
Balance at beginning of year	\$3,320	\$910	\$20
Provision for losses	744	2,410	900
Charge-offs	0	00	10
Reversals from sales	(353)		
Recoveries	0	0	0
Balance at end of year	\$3,711	\$3,320	\$910

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(8) Premises and Equipment

The components of premises and equipment at December 31 are as follows:

	2012	2011
Land	\$2,065	\$1,969
Buildings and leasehold improvements	10,978	10,726
Furniture, fixtures, and equipment	9,686	9,057
	22,729	21,752
Less accumulated depreciation	12,499	11,637
	\$10,230	\$10,115

Depreciation expense for the years ended December 31, 2012, 2011 and 2010 amounted to \$862, \$799, and \$741, respectively.

(9) Other Assets

The components of other assets at December 31 are as follows:

	2012	2011
Cash surrender value of bank-owned life insurance	\$5,110	\$4,933
Accrued interest receivable	4,935	5,341
Mortgage servicing rights, net of amortization	1,648	1,521
Net deferred tax assets	2,321	1,098
Federal Deposit Insurance Corporation assessments	1,334	1,910
Other	1,934	1,938
	\$17,282	\$16,741

(10) Time Deposits

The aggregate amount of time deposits with minimum a denomination of \$100 was approximately \$132,364 and \$143,916 at December 31, 2012 and 2011, respectively.

At December 31, 2012, the scheduled maturities of time deposits are as follows:

2013	\$154,783
2014	95,831
2015	56,409
2016	32,016
2017 and thereafter	29,410
	\$368,449

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(11) Dividends

State banking regulations restrict the amount of dividends that a bank may pay to its stockholders. The regulations provide that dividends are limited to the balance of undivided profits, subject to capital-adequacy requirements, plus an additional amount equal to the bank's current-year earnings through the date of any declaration of dividends. Additionally, dividends were limited under the terms of the TARP agreement as described in Note 23.

(12) Employee Benefit Plans

The Company and the Banks maintain a 401(k) plan with profit sharing features covering substantially all employees under which they match 50% of eligible employee contributions to a maximum employee contribution of 6% of annual salary. Total 401(k) expense was approximately \$215, \$247, and \$237, for 2012, 2011, and 2010, respectively. Each plan participant elects how the employer contributions are invested. Participants choose between purchasing the Company's common stock and investing in the plan's investment funds.

In addition, Northwest, German-American, and Lena maintain salary-continuation plans whereby certain officers are provided with guaranteed annual payments for periods ranging from ten to thirteen years after reaching a retirement age of 65. The salary-continuation plans are funded by whole life insurance policies purchased by the Banks which had an aggregate death benefit of approximately \$9,099 and \$8,961 as of December 31, 2012 and 2011, respectively (see Note 9 for cash surrender value of bank-owned life insurance). The Banks accrue for the total amounts to be paid over the employee's active service life. The accrued benefits were \$875, \$894, and \$912 at December 31, 2012, 2011, and 2010, respectively. Salary-continuation expenses were \$41, \$51, and \$48 in 2012, 2011, and 2010, respectively.

(13) Income Taxes

The components of income tax expense (benefit) for the years ended December 31 are as follows:

	2012	2011	2010
Current – federal	\$992	\$1,623	\$1,140
– state	630	857	443
	1,622	2,480	1,583
Deferred – federal	(1,270)	(144)	(752)
– state	(372)	(330)	(70)
	(1,642)	(474)	(822)
Total income tax expense	(\$20)	\$2,006	\$761

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(13) Income Taxes (continued)

A reconciliation of the differences between the statutory federal income tax rate and the effective federal income tax rate with the resulting dollar amounts is shown in the following table:

	2012		2011		2010	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
Statutory federal tax	\$1,165	34.0%	\$2,915	34.0%	\$2,236	34.0%
Increase (decrease) in taxes resulting from:						
Tax-exempt interest	(1,413)	(41.2%)	(1,452)	(16.9%)	(1,518)	(23.1%)
Bank-owned life insurance	(65)	(1.9%)	(63)	(0.7%)	(346)	(5.3%)
State taxes, net of federal benefit	170	4.9%	348	4.1%	246	3.7%
Other	123	3.6%	258	3.0%	143	2.2%
Effective tax rates	(\$20)	(.6%)	\$2,006	23.5%	\$761	11.5%

The tax effects of existing temporary differences that give rise to significant portions of the deferred tax liabilities and deferred tax assets at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Deferred tax assets:		
Allowance for loan losses	\$5,825	\$4,358
Allowance for losses on foreclosed assets and non-accrual interest	1,516	1,396
Deferred compensation and other	723	562
Total gross deferred tax assets	8,064	6,316
Deferred tax liabilities:		
FHLB stock dividend	129	129
Security accretion	47	35
Available-for-sale securities	4,085	3,666
Tax depreciation in excess of book depreciation	848	788
Mortgage servicing rights and other	634	600
Total gross deferred tax liabilities	5,743	5,218
Net deferred tax assets	\$2,321	\$1,098

No valuation allowance has been recorded since deferred tax assets are expected to be realized.

With few exceptions, the Company is no longer subject to federal or state examinations by tax authorities for years before 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(14) Transactions with Related Parties

The Company and subsidiary banks have had, and may be expected to have in the future, loans or other banking transactions in the ordinary course of business with directors, significant stockholders, principal officers, their immediate families, and affiliated companies in which they are principal stockholders (commonly referred to as related parties). In management's opinion, these loans and transactions were on the same terms as those for comparable loans and transactions with non-related parties.

Loans to related parties amounted to approximately \$16,656 and \$14,209 at December 31, 2012 and 2011, respectively.

Deposit accounts from related parties totaled approximately \$10,233 and \$10,612 at December 31, 2012 and 2011, respectively.

(15) Financial Instruments with Off-Balance-Sheet Risk and Concentrations

Financial instruments with off-balance-sheet risk:

The Banks are parties to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit, credit lines, letters of credit, and overdraft protection. They involve, to varying degrees, elements of credit risk in excess of amounts recognized on the consolidated balance sheets.

The Banks' exposures to credit losses in the event of nonperformance by the other parties to the financial instruments, for commitments to extend credit, and letters of credit are represented by the contractual amounts of those instruments. The Banks use the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contractual amounts of the Banks' exposure to off-balance-sheet risk as of December 31 is approximately as follows:

	2012	2011
Unused lines of credit and other loan commitments	\$123,738	\$123,099
Commercial letters of credits	395	1,352
Performance and standby letters of credit	616	761
	\$124,749	\$125,212

Commitments to extend credit are agreements to lend to customers as long as there are no violations of any conditions established in the contracts. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Banks evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Banks upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, crops, livestock, property and equipment, residential real estate, and income-producing commercial properties.

Standby, performance and commercial letters of credit are conditional commitments issued by the Banks to guarantee the performance of a customer to a third party. They are considered financial guarantees under FASB guidance. The fair value of these financial guarantees is considered immaterial.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(15) Financial Instruments with Off-Balance-Sheet Risk and Concentrations (continued)

Concentration of credit risk:

The Company and its subsidiary banks provide several types of loans to customers including real estate, agricultural, commercial, and installment loans. The largest component of loans is secured by residential real estate, commercial real estate, or other interest in real property. Lending activities are conducted with customers in a wide variety of industries as well as with individuals with a wide variety of credit requirements. The Company does not have a concentration of loans in any specific industry. Credit risk, as it relates to the Company's business activities, tends to be geographically concentrated in that the majority of the customer base lies within the surrounding communities served by its subsidiary banks.

(16) Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase amounted to \$25,045 and \$27,698 at December 31, 2012 and 2011, respectively, and are secured by investment securities with fair values of approximately \$36,227 and \$37,563. The weighted-average interest rates on these agreements were 0.18% and 0.54% at December 31, 2012 and 2011, respectively. Securities sold under agreements to repurchase mature on a daily basis.

(17) Federal Home Loan Bank (FHLB) Advances and Other Borrowings

<i>FHLB:</i>	2012	2011
Fixed-rate advances with rates ranging from .07% to 3.16% with weighted-average rates of .98% to 3.16% as of December 31, 2012 and 2011, respectively. Interest is payable monthly with principal due at maturity.	\$19,850	\$14,400

Advances are collateralized by 1-4 family mortgage loans and other qualifying loans. The total amounts of collateral securing FHLB advances were approximately \$82,708 and \$86,879 as of December 31, 2012 and 2011, respectively.

The Banks participate in the Federal Reserve Bank of Chicago's Discount Window Lending Program. Primary advances generally mature daily and bear interest at a general approved rate in relation to the federal funds rate. The primary advance interest rate at December 31, 2012 was 75-basis points. Outstanding advances were \$0 at December 31, 2012 and 2011. Advances are secured by investment securities pledged totaling approximately \$11,663 and \$8,950 at December 31, 2012 and 2011, respectively, to the Federal Reserve Bank.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(17) Federal Home Loan Bank (FHLB) Advances and Other Borrowings (continued)

At December 31, 2012, the scheduled maturities of Federal Home Loan Bank advances and other borrowings are as follows:

	2012	2011
2012	\$0	\$3,050
2013	11,100	4,600
2014	2,750	2,750
2015	4,000	2,500
2016	1,300	1,500
2017	700	0
	\$19,850	\$14,400

The Company issued \$10,000,000 of Subordinated Debentures in the fiscal year ended 2012 that qualify as Tier 2 regulatory capital (with certain limitations applicable) for the Company. The Company issued the Subordinated Debentures for capital raising purposes primarily for the redemption of preferred stock as part of the Troubled Asset Relief Program. Note 22 details the Troubled Asset Relief Program. The Debentures mature on August 30, 2019 and the Company may redeem some or all of the Subordinated Debentures at any time after the third anniversary of their issuance in accordance with the contract price limitations. The redemption may be subject to approval by the Federal Reserve and must be on a pro rata basis amongst all holders. The terms call for interest payments to be made quarterly in arrears on the last day of March, June, September and December. The annual rate of interest on the Subordinated Debentures is 6.00%. The interest payments can be deferred for so long as the Company or a specific Bank remains subject to any regulatory order limiting or prohibiting the payment of dividends or interest on indebtedness of the Company, including the Debentures. If interest payments are deferred the interest will accrue until paid. The agreement contains certain restrictive covenants.

(18) Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an 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. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company 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 the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(18) Fair Value Measurements (continued)

The following is a description of valuation methodologies used for assets recorded at fair value:

Securities available-for-sale: The fair values of the Company's securities available-for-sale are primarily determined by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The values determined by matrix pricing are considered Level 2 fair value measurements.

Collateral-dependent impaired loans: The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. The fair value of collateral dependent impaired loans is generally based on recent real estate appraisals. Adjustments are routinely made in the appraisal process by 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. Non-real estate collateral may be valued using an appraisal, net book value of the borrower's financial statements or aging reports, adjusted or discounted based on management's expertise and knowledge of the borrower and borrower's business. Fair value measurements prepared internally are based on management's comparisons to sales of comparable assets, but include significant unobservable data and are therefore considered Level 3 measurements.

Foreclosed assets: Real estate acquired through or in lieu of loan foreclosure are not measured at fair value on a recurring basis. However, other real estate is initially measured at fair value (less estimated costs to sell) when it is acquired and may also be measured at fair value (less estimated costs to sell) if it becomes subsequently impaired. The fair value measurement for each property may be obtained from an independent appraiser or prepared internally. Fair value measurements obtained from independent appraisers generally utilize a market approach based on sales of comparable assets and/or an income approach. Such measurements are usually considered Level 2 measurements. However, management routinely evaluates fair value measurements of independent appraisers by comparing actual selling prices to the most recent appraisals. If management determines significant adjustments should be made to the independent appraisals based on these evaluations, these measurements are considered Level 3 measurements. Fair value measurements prepared internally are based management's comparisons to sales of comparable assets, but include significant unobservable data and are therefore considered Level 3 measurements.

Mortgage servicing rights: Loan servicing rights are initially recorded at approximate fair value and are subsequently measured using 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. Loan servicing rights are valued for impairment subsequent to initial recording. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Loan servicing rights do not trade in an active market with readily observable prices. Accordingly, the Company determines the fair value of loan servicing rights by estimating the present value of the future cash flows associated with the loans being serviced. Key economic assumptions used in measuring the fair value of loan servicing rights include prepayment speeds and discount rates. While market-based data is used to determine the input assumptions, the Company incorporates its own estimates of assumptions market participants would use in determining fair value of loan servicing rights (Level 3).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(18) Fair Value Measurements (continued)

The following table presents the Company's approximate fair-value hierarchy for the assets measured at fair value as of December 31:

As of December 31, 2012	Total	Fair Value Measurements at Reporting Date Using		
		(Level 1)	(Level 2)	(Level 3)
Assets measured at fair value on a recurring basis:				
Assets:				
Securities available-for-sale	\$213,845		\$213,845	
Assets measured at fair value on a non-recurring basis:				
Assets:				
Collateral-dependent impaired loans	\$12,110			\$12,110
Foreclosed assets	\$6,770			\$6,770
Mortgage servicing rights	\$1,648			\$1,648

Collateral-dependent impaired loans, which are measured for impairment using the fair value of collateral, had a carrying value of \$18,426 with specific reserves of \$6,316 as of December 31, 2012.

Foreclosed assets, which are measured at the lower of carrying or fair value less costs to sell, were carried at their fair value of \$6,770, which is comprised of the outstanding balance of \$10,481, net of an allowance for losses of \$3,711 as of December 31, 2012.

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	Unobservable Input
Collateral dependent impaired loans, net of specific reserves	\$12,110	Sales comparison approach	Appraised values
Foreclosed assets	\$6,770	Sales comparison approach	Appraised values

Management reduced the appraised values by estimated selling and holding costs in a range of 10% to 30%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(18) Fair Value Measurements (continued)

As of December 31, 2011	Fair Value Measurements at Reporting Date Using			
	Total	(Level 1)	(Level 2)	(Level 3)
Assets measured at fair value on a recurring basis:				
Assets:				
Securities available-for-sale	\$221,634		\$221,634	
Assets measured at fair value on a non-recurring basis:				
Assets:				
Collateral-dependent impaired loans	\$8,528			\$8,528
Foreclosed assets	\$5,997			\$5,997
Mortgage servicing rights	\$1,521			\$1,521

Collateral-dependent impaired loans, which are measured for impairment using the fair value of collateral, had a carrying value of \$12,282, with specific reserves of \$3,754 as of December 31, 2011.

Foreclosed assets, which are measured at the lower of carrying or fair value less costs to sell, had a carrying amount of \$5,997, which is comprised of the outstanding balance of \$9,317, net of an allowance for losses of \$3,320 as of December 31, 2011.

FASB guidance requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates may not be realized in immediate settlement of the instrument. Accounting guidance excludes certain financial instruments and certain nonfinancial instruments from its disclosure requirements. These fair value disclosures may not represent the fair value of the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents: The carrying amounts are reasonable estimates of fair value.

Securities: See previous description in this footnote for securities available-for-sale. The fair values of the Company's securities held-to-maturity are primarily determined by matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Non-marketable equity securities: No ready market exists for the equity securities as they have no quoted market value. The carrying amount of equity securities approximates its fair value.

Loans held for sale: The fair values of loans held for sale are based on commitments on hand from investors or prevailing market prices.

Loans: For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other 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. For fair value estimates for collateral-dependent impaired loans, see previous description in this footnote.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(18) Fair Value Measurements (continued)

Deposits: The fair values disclosed for demand deposits, savings accounts, and certain money market deposits are, by definition, equal to the amount payable on demand at the reporting date (carrying amounts). Fair values for 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.

Federal funds purchased and securities sold under agreements to repurchase: The carrying amounts of federal funds and securities sold under agreements to repurchase approximate fair value.

FHLB advances: The fair value of FHLB advances was estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Subordinated debentures: The fair value of subordinated debentures approximates their fair value based on the Company's current incremental borrowing rate approximating the instruments current fixed rate.

Other borrowings: The carrying amounts of other borrowings approximate their fair value.

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

Off-balance-sheet financial instruments: No estimated fair value is attributable to unused lines of credit and letters of credit as they are deemed immaterial.

The estimated fair values of the Company's financial instruments as of December 31 are as follows:

	December 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$29,217	\$29,217	\$25,517	\$25,517
Securities	215,573	215,681	223,676	223,744
Non-marketable equity securities	2,184	2,184	2,177	2,177
Loans held for sale	5,598	5,598	2,198	2,198
Loans, net of allowance	596,938	597,466	598,984	601,258
Accrued interest receivable	4,935	4,935	5,341	5,341
Financial liabilities:				
Deposits	\$736,718	\$741,050	\$738,068	\$741,822
Federal funds purchased	5,114	5,114	3,899	3,899
Securities sold under agreements to repurchase	25,046	25,051	27,698	27,716
FHLB advances and other borrowings	19,850	20,105	14,400	14,716
Subordinated Debentures	10,000	10,000	0	0
Accrued interest payable	886	886	1,186	1,186

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(19) Stock-Compensation Plans

The Company has entered into non-qualified and incentive stock option agreements whereby shares of common stock were made available for purchase by certain executive officers. All incentive and non-qualified options have been issued pursuant to various shareholder approved stock option plans. In May of 2008, the stockholders' approved an additional 100,000 shares of common stock be made available for future purchase by certain officers. Under these agreements, the exercise price of each option equals the market price of the Company's stock on the grant date. The options' maximum terms are ten years. The options vest under a three, five or seven year period after the date of grant. The Company's general practice is to use previously authorized but unissued shares of common stock to satisfy stock option exercises. Currently, the Company has a sufficient number of authorized common shares to satisfy expected stock option exercises, but treasury stock may also be used.

The fair value of each option award is estimated on the date of grant using a closed form option valuation model (Black-Scholes) based on the assumptions noted in the table below. 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, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield in effect at the time of the grant.

No options were granted for the years ended December 31, 2012 and 2011. The weighted average fair value of options granted during the year ended December 31, 2010 was \$2.90.

The fair value of options granted is estimated on the date of grant using the following weighted-average assumptions:

	2012	2011	2010
Risk-free interest rate	N/A	N/A	1.27%
Expected option life	N/A	N/A	10
Expected stock-price volatility	N/A	N/A	36.67%
Dividend yield	N/A	N/A	1.82%

For the years ended December 31, 2012, 2011 and 2010, the Company recognized \$97, \$98 and \$81 in compensation expense for stock options, respectively. No tax benefits were recognized for the three year period ended December 31, 2012. As of December 31, 2012, stock-based compensation expense not yet recognized totaled \$245, and is expected to be recognized over a weighted-average remaining period of 1.8 years. The intrinsic value of options exercised during the years ended December 31, 2012, 2011 and 2010 was \$0, \$4 and \$3, respectively. The total fair value of shares vested during the years ended December 31, 2012, 2011 and 2010 was \$341, \$338 and \$90, respectively.

During 2010, the Company modified the exercise price on 49,760 fully and partially vested incentive stock options outstanding affecting thirteen employees. The options were originally granted in 2004, 2005 and 2008 and represented a weighted average exercise price of \$19.57 per share. As a result of the modification, the weighted average exercise price on the modified options was reduced to \$10.43 per share. Consistent with generally accepted accounting principles, the Company revaluated the fair value of the modified options resulting in additional compensation expense of \$75 to be recognized over the remaining vesting period. For the modified options already fully vested, the Company recognized the additional compensation expense in 2010. The fair value of the stock options granted in 2008, 2005 and 2004 were revised from \$5.08, \$12.55 and \$9.37 per share, respectively as originally reported to modified fair values of \$7.21, \$14.08, and \$10.74 per share, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(19) Stock-Compensation Plans (continued)

The following tables summarize the activity of options and non-vested shares granted, exercised, or forfeited for the year ended December 31, 2012:

	2012	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Shares under option, beginning of year	157,530	\$10.32	7.4	\$280
Granted during the year	0			
Forfeited and canceled during the year	0			
Exercised during the year	(40)	10.25		0
Shares under option, end of year	157,490	\$10.32	6.4	\$292
Options exercisable, end of year	84,198	\$10.37	5.61	\$153
Shares available for grant, end of year	0			

	Number of Options	Weighted Average Fair Value at Grant
Non-vested options, December 31, 2011	101,256	\$10.26
Granted during the year	0	
Vested during the year	(27,964)	10.24
Forfeited or expired during the year	0	
Non-vested options, December 31, 2012	73,292	\$10.27

The following table summarizes information about fixed stock options outstanding at December 31, 2012:

Exercise Price	Number Outstanding at 12/31/12	Remaining Contractual Life (Years)	Number Exercisable at 12/31/12
\$10.00	26,500	5.0	21,200
\$10.25	93,280	7.5	37,288
\$10.50	20,000	7.5	8,000
\$11.00	8,030	2.5	8,030
\$11.00	9,680	1.5	9,680
	157,490		84,198

During 2012, the Company approved a new equity incentive plan to promote the long-term financial success of the Company through stock based awards to employees, directors or service providers who contribute to that success. This equity incentive plan permits Company management to approve and grant a maximum of 150,000 shares of common stock based awards in the form of any combination of stock options, stock appreciation rights, stock awards or cash incentive awards. As of December 31, 2012, no awards under this plan have been granted.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(20) Earnings Per Common Share

For the years ended December 31, earnings per common share have been computed based on the following:

	2012	2011	2010
Net income	\$3,446	\$6,568	\$5,815
Less - preferred stock dividends	(877)	(818)	(818)
Less - accretion of preferred stock warrants	(356)	(150)	(150)
Net income available to common stockholders	\$2,213	\$5,600	\$4,847
Average number of common shares outstanding	3,659,504	3,659,306	3,659,058
Effect of dilutive options	28,345	26,162	1,216
Average number of common shares outstanding used to calculate diluted earnings per common share	3,687,849	3,685,468	3,660,274

The total outstanding options of common stock which were excluded in the computation of diluted earnings per common share for the years ended 2012, 2011 and 2010 were 0, 0 and 71,170, respectively because they were considered anti-dilutive.

(21) Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and its subsidiaries to maintain minimum amounts and ratios (set forth in the following table) of total and Tier-I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier-I capital (as defined) to average assets (as defined). Management believes that as of December 31, 2012, that the Company and the Banks meet all capital-adequacy requirements to which they are subject.

As of December 31, 2012, the most recent notifications from the Federal Deposit Insurance Corporation (FDIC) categorized all five Banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, minimum total risk-based, Tier-I risk-based, and Tier-I leverage ratios as set forth in the table must be maintained. There are no conditions or events occurring since the FDIC notified each Bank which management believes have changed the categories of the Banks.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(000s omitted except share data)

(21) Regulatory Matters (continued)

The actual capital amounts and ratios for the Company and Banks as of December 31 are presented in the following tables:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount In \$000s	Ratio	Amount In \$000s	Ratio	Amount In \$000s	Ratio
As of December 31, 2012:						
Total Capital to Risk						
Weighted Assets:						
Company	\$95,572	14.68%	\$52,082	8.00%	N/A	N/A
Northwest	23,492	13.43%	13,989	8.00%	\$17,486	10.00%
German	19,466	12.11%	12,861	8.00%	16,077	10.00%
Davis	13,568	14.26%	7,609	8.00%	9,511	10.00%
Freeport	21,495	13.10%	13,124	8.00%	16,405	10.00%
Lena	8,668	16.78%	4,132	8.00%	5,165	10.00%
Tier-I Capital to Risk						
Weighted Assets:						
Company	\$77,350	11.88%	\$26,041	4.00%	N/A	N/A
Northwest	21,277	12.17%	6,994	4.00%	\$10,492	6.00%
German	17,444	10.85%	6,431	4.00%	9,646	6.00%
Davis	12,364	13.00%	3,805	4.00%	5,707	6.00%
Freeport	19,428	11.84%	6,562	4.00%	9,843	6.00%
Lena	8,011	15.51%	2,066	4.00%	3,099	6.00%
Tier-I Capital to Average Assets:						
Company	\$77,350	8.74%	\$35,403	4.00%	N/A	N/A
Northwest	21,277	8.78%	9,688	4.00%	\$12,110	5.00%
German	17,444	8.57%	8,140	4.00%	10,175	5.00%
Davis	12,364	8.97%	5,512	4.00%	6,890	5.00%
Freeport	19,428	8.97%	8,660	4.00%	10,825	5.00%
Lena	8,011	10.05%	3,189	4.00%	3,987	5.00%
As of December 31, 2011:						
Total Capital to Risk						
Weighted Assets:						
Company	\$99,291	15.06%	\$52,727	8.00%	N/A	N/A
Northwest	23,655	12.68%	14,927	8.00%	\$18,659	10.00%
German	18,941	12.50%	12,120	8.00%	15,150	10.00%
Davis	13,271	13.51%	7,857	8.00%	9,822	10.00%
Freeport	21,160	12.88%	13,142	8.00%	16,428	10.00%
Lena	9,008	17.27%	4,173	8.00%	5,216	10.00%
Tier-I Capital to Risk						
Weighted Assets:						
Company	\$91,018	13.81%	\$26,364	4.00%	N/A	N/A
Northwest	21,316	11.42%	7,463	4.00%	\$11,195	6.00%
German	17,036	11.24%	6,060	4.00%	9,090	6.00%
Davis	12,038	12.26%	3,929	4.00%	5,893	6.00%
Freeport	19,100	11.63%	6,571	4.00%	9,857	6.00%
Lena	8,351	16.01%	2,086	4.00%	3,129	6.00%
Tier-I Capital to Average Assets:						
Company	\$91,018	10.30%	\$35,354	4.00%	N/A	N/A
Northwest	21,316	8.65%	9,852	4.00%	\$12,316	5.00%
German	21,316	8.82%	7,728	4.00%	9,660	5.00%
Davis	12,038	8.62%	5,587	4.00%	6,984	5.00%
Freeport	19,100	8.83%	8,651	4.00%	10,814	5.00%
Lena	8,351	10.30%	3,243	4.00%	4,053	5.00%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(000s omitted except share data)

(22) TARP Capital Purchase Plan (in actual dollars)

On May 15, 2009, as part of the United States Treasury Department's (UST) Troubled Asset Relief Program (TARP) Capital Purchase Program, the Company issued 15,000 shares of fixed rate cumulative perpetual preferred stock (Series A preferred stock) to the UST for total proceeds of \$15,000. The Series A preferred stock had no par value and a redemption value of \$1,000 per share. The UST also received warrants to purchase 750 shares of fixed rate cumulative preferred stock (Series B preferred stock) for an exercise price of \$.01 per share. The UST immediately exercised the warrants. The Series B preferred stock had no par value and a redemption value of \$1,000 per share. The Series A and Series B preferred stock were redeemable by the Company at any time. The dividend rate on the Series A preferred stock was 5% for the first five years and 9% thereafter. The dividend rate on the Series B preferred stock was 9%. Dividends on the preferred stock were cumulative and were payable quarterly in arrears on the 15th of February, May, August and November. The redemption value of the 750 shares of Series B preferred stock was being accreted as an increase to preferred stock over five years which was the Company's expected redemption period. The Series A and Series B preferred stock were included as Tier-1 capital for regulatory purposes.

Under the terms of the TARP agreement, the Company was subject to certain dividend limitations. Generally, without the UST's consent, the Company was limited to a maximum quarterly dividend of \$.08 per common share until May 14, 2012. Additionally, without the UST's consent, the Company was limited to a maximum dividend of 103% of the aggregate per share dividends of the prior fiscal year for the period from May 15, 2012 to May 14, 2019.

Additionally under the terms of the TARP agreement, without the consent of the UST, the Company generally could not acquire additional shares of treasury stock, except in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice. The TARP agreement also placed certain restrictions on executive compensation, the effect of which did not have a material effect on the consolidated financial statements.

Effective December 11, 2012, the Company redeemed the Series A and B preferred stock for total proceeds of \$15,750. As a result, the Company is no longer under the terms of the TARP agreement as of December 31, 2012.

CONSOLIDATING SCHEDULE 1 - BALANCE SHEET

(000s omitted except share data)

December 31, 2012

A S S E T S	German-American State Bank	State Bank of Davis
Cash and due from banks	\$2,765	\$1,706
Interest-bearing deposits in banks	512	3,187
Federal funds sold		0
Securities:		
Securities held-to-maturity		1,703
Securities available-for-sale	39,509	37,744
Non-marketable equity securities, at cost	534	313
Loans held for sale		
Loans, net	152,536	88,479
Foreclosed assets, net	38	67
Premises and equipment	1,125	1,020
Other assets	3,683	1,614
Investment in subsidiary banks		
Total assets	\$200,702	\$135,833
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest bearing	\$20,847	\$11,129
Interest-bearing	147,914	102,364
Total deposits	168,761	113,493
Federal funds purchased	2,410	2,704
Securities sold under agreements to repurchase		5,792
Federal Home Loan Bank borrowings and other	10,000	0
Subordinated debentures		
Accrued interest payable and other liabilities	1,002	359
Total liabilities	182,173	122,348
Stockholders' equity:		
Preferred stock		
Common stock	400	100
Additional paid-in capital	2,756	1,559
Retained earnings	14,288	10,705
Treasury stock		
Accumulated other comprehensive income	1,085	1,121
Total stockholders' equity	18,529	13,485
Total liabilities and stockholders' equity	\$200,702	\$135,833

Northwest Bank	State Bank	Lena State Bank	Foresight Financial Group, Inc.	Eliminations	Consolidated Total
\$8,982	\$4,656	\$1,624	\$4,422	(\$4,422)	\$19,733
1,026	1,265	1,357			7,347
50	301	1,786			2,137
25					1,728
51,740	53,848	31,004			213,845
636	448	253			2,184
5,598					5,598
156,796	154,826	44,131	170		596,938
3,696	53	341	2,575		6,770
4,754	1,898	548	885		10,230
6,580	1,557	2,735	1,113		17,282
			84,581	(84,581)	
\$239,883	\$218,852	\$83,779	\$93,746	(\$89,003)	\$883,792
\$31,572	\$20,088	\$8,925		(\$225)	\$92,336
177,614	156,713	63,974		(4,197)	644,382
209,186	176,801	72,899		(4,422)	736,718
	0				5,114
3,866	15,388				25,046
3,000	5,350	1,500			19,850
			\$10,000		10,000
980	466	511	199		3,517
217,032	198,005	74,910	10,199	(4,422)	800,245
			0		0
1,450	1,000	500	966	(3,450)	966
7,148	4,565	3,677	7,763	(19,705)	7,763
12,679	13,863	3,833	72,820	(55,367)	72,821
			(4,060)		(4,060)
1,574	1,419	859	6,058	(6,059)	6,057
22,851	20,847	8,869	83,547	(84,581)	83,547
\$239,883	\$218,852	\$83,779	\$93,746	(\$89,003)	\$883,792

For the year ended December 31, 2012

	German-American State Bank	State Bank of Davis
Interest and dividend income:		
Loans, including fees	\$7,780	\$4,705
Securities:		
Taxable	717	645
Tax-exempt	686	765
Dividends	1	1
Interest-bearing deposits in banks	10	8
Federal funds sold	3	3
Total interest and dividend income	9,197	6,127
Interest expense:		
Deposits	1,840	1,258
Federal funds purchased	2	0
Securities sold under agreements to repurchase		66
Federal Home Loan Bank advances and other borrowings	59	3
Subordinated debentures		
Total interest expense	1,901	1,327
Net interest and dividend income	7,296	4,800
Provision for loan losses	940	884
Net interest and dividend income, after provision for loan losses	6,356	3,916
Noninterest income:		
Customer service fees	378	115
Equity in earnings of subsidiaries		
Gain on sales and calls of AFS securities, net	18	37
Gain on sales of loans, net		
Loan-servicing fees		
Other	619	270
Total noninterest income	1,015	422
Noninterest expenses:		
Salaries and employee benefits	2,163	930
Occupancy expense of premises, net	407	186
Outside services	194	143
Data processing	304	121
Foreclosed assets, net	(17)	82
Other	1,068	564
Total noninterest expenses	4,119	2,026
Income before income taxes	3,252	2,312
Income tax expense (benefit)	1,069	663
Net income	\$2,183	\$1,649

CONSOLIDATING SCHEDULE 2 - STATEMENT OF INCOME
(000s omitted except share data)

Northwest Bank	State Bank	Lena State Bank	Foresight Financial Group, Inc.	Eliminations	Consolidated Total
\$9,030	\$7,795	\$2,177			\$31,487
817	776	517			3,472
853	1,003	593			3,900
					2
16	9	12	13	(\$13)	55
2	2	1			11
10,718	9,585	3,300	13	(13)	38,927
1,723	1,644	779		(\$13)	7,231
1	0	0			3
12	50		0		128
51	127	5			245
			189		189
1,787	1,821	784	189	(13)	7,796
8,931	7,764	2,516	(176)	0	31,131
8,225	2,910	485	0		13,444
706	4,854	2,031	(176)	0	17,687
423	220	139			1,275
			\$4,277	(\$4,277)	0
133	1	2			191
1,500					1,500
832					832
549	643	262	17		2,360
3,437	864	403	4,294	(4,277)	6,158
4,728	1,822	799	380		10,822
930	314	184	9		2,030
64	162	130	58		751
296	278	73			1,072
289			600		954
1,890	713	380	175		4,790
8,197	3,289	1,566	1,222	0	20,419
(4,054)	2,429	868	2,896	(4,277)	3,426
(1,986)	652	132	(550)		(20)
(\$2,068)	\$1,777	\$736	\$3,446	(\$4,277)	\$3,446

GENERAL INFORMATION

Foresight Financial Group, Inc.
3106 North Rockton Ave.
Rockford, IL 61103

Phone: 815/847-7500
Fax: 815/967-6107
E-mail: dcooke@ffgbank.net

Registrar, Transfer Agent and
Change of Address:

Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016-3572
Telephone: 1-800-358-5948
E-mail: info@rtco.com
Internet Address: www.rtco.com

Foresight common stock is listed
on the NASDAQ Bulletin Board
under the symbol FGFH

For more information,
contact Foresight
Financial Group, Inc. at its
Corporate Address
or visit our
website at
www.foresightfg.com

DIRECTORS

Foresight Financial Group, Inc. Rockford, IL

Stephen G. Gaddis
John Jeschke
Brent Myers
Dr. Carolyn Sluiter
Robert W. Stenstrom
Doug Wagner
Richard L. Weigle

Northwest Bank of Rockford Rockford, IL

Stephen G. Gaddis
Charles B. Kullberg
Stephen P. McKeever
John J. Morrissey
Richard Rosenstiel
Robert W. Stenstrom
Tom Walsh

German-American State Bank German Valley, IL

Robert Borneman
John Collman
Jack Janssen
Gary R. Johnson
James G. Sacia
Jeff Sterling
Richard Weigle

State Bank of Davis Davis, IL

Dan Dietmeier
John Jeschke
Brent Myers
Thomas Olsen
Dr. Carolyn Sluiter
Judd Thrumen

Lena State Bank Lena, IL

Todd Bussian, O.D.
Dr. Gordon Dammann
John Jeschke
Dr. James Moest
Brent Myers
Steven Rothschild

State Bank Freeport, IL

Douglas Cross
Bruce Johnson
Dr. Joe Kanosky
Fred Kundert
Marilyn Smit
Brian Stewart
Sharon Summers
Doug Wagner

