

2011

.....
ANNUAL
REPORT



Our Biggest Investment is you.

To Our Shareholders,

On behalf of the Board of Directors and the Bank's Management Staff I am pleased to share the financial results and successful performance of Portage Bancshares, Inc. for 2011. Although 2011 continued to be a challenging year in the banking industry, our continued emphasis on "Neighbors Serving Neighbors" along with local ownership, local management, and most of all local decisions has contributed to another solid year for Portage Bancshares, Inc.

Our financial performance in 2011 was simply outstanding! Total Deposits as of December 31, 2011 amounted to \$227.5 million as compared to \$206.6 million in 2010, for an increase of \$20.9 million or 10.12%. Total Assets again demonstrated solid growth of \$22.8 million over the previous year which represented an increase of 9.27%. Loan Growth for our Bank was purposely slowed based on the economy and our commitment to approve only the very best credits presented to our Bank. This effort resulted in us having a Net Loan Decrease of \$5.8 million.

The above growth resulted in earnings for 2011 of \$1.302 million. Earnings per share were \$3.16 which compares very favorably among our peers. We are extremely proud of these results during very challenging economic conditions which are influencing the banking industry.

In addition to these strong results we had many other accomplishments: We strengthened the Bank's Liquidity position to a level that is the strongest in bank history. We made steps to increase our efficiency, completed our first Super Stock Subscription offering with 10 new Shareholders raising \$427,601 in additional capital, brought our marketing efforts in-house thus saving \$32,000. And lastly, we rolled out several new products, including structured CDs.

Lastly, we are excited about the growth our Kent Office has experienced since their doors opened for business in July, 2006. In 2011, Net Loans increased from \$45.4 million to \$47.9 million and Total Deposits increased from \$44.2 million to \$56.7 million. This far surpasses the 5 year goal of \$35 million. This Deposit Growth milestone is an accomplishment we are extremely proud of.

I would like to extend a sincere thank you to our Board of Directors for their continued leadership and support. A special thank you goes out to our Employees whose dedication and compassion to build a solid foundation of customer service has been unprecedented since the day our doors opened.

Most of all, thank you to our customers and shareholders for having the confidence in us to make our "Company" successful.

Sincerely,

A handwritten signature in black ink that reads "Richard J. Coe". The signature is written in a cursive style with a large initial 'R'.

Richard J. Coe
Chief Executive Officer

TABLE OF CONTENTS

**PORTAGE BANCSHARES, INC.
CONSOLIDATED AUDITED FINANCIAL STATEMENTS
DECEMBER 31, 2011**

Report of Independent Auditors	1
Financial Statements	
Consolidated Balance Sheet	2
Consolidated Statement of Income	3
Consolidated Statement of Changes in Stockholders' Equity	4
Consolidated Statement of Cash Flows	5
Notes to Consolidated Financial Statements	6 - 27

REPORT OF INDEPENDENT AUDITORS

**Board of Directors and Shareholders
Portage Bancshares, Inc.**

We have audited the accompanying consolidated balance sheets of Portage Bancshares, Inc. and subsidiary as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Portage Bancshares, Inc. and subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

A. R. Anodgrass, A.C.

Wexford, PA

March 29, 2012

PORTAGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEET

December 31,

	2011	2010
Assets		
Cash and due from banks	\$ 21,979,486	\$ 9,577,582
Interest-bearing deposits in other financial institutions	410,610	115,854
Federal funds sold	72,000	48,000
Cash and cash equivalents	22,462,096	9,741,436
Investment securities available for sale	55,788,183	40,329,585
Loans	179,009,222	184,845,500
Less allowance for loan losses	3,388,963	2,586,857
Net loans	175,620,259	182,258,643
Regulatory stock	1,199,150	1,171,950
Premises and equipment, net	4,097,501	4,139,151
Bank-owned life insurance	5,412,848	4,240,954
Accrued interest receivable	802,003	787,709
Prepaid federal deposit insurance	948,931	1,166,163
Other assets	2,517,380	2,219,358
Total Assets	\$ 268,848,351	\$ 246,054,949
Liabilities		
Deposits		
Non-interest-bearing	\$ 24,577,239	\$ 21,455,459
Interest-bearing demand	22,327,389	24,940,777
Savings	90,326,001	75,151,719
Time	90,224,586	85,083,013
Total deposits	227,455,215	206,630,968
Federal Home Loan Bank advances	15,636,902	15,922,361
Subordinated debentures	2,450,000	2,450,000
Accrued interest payable and other liabilities	1,134,130	1,115,589
Total Liabilities	246,676,247	226,118,918
Stockholders' Equity		
Common stock, no par value; 800,000 shares authorized, 427,665 and 418,497 shares issued; 417,483 and 401,372 outstanding	14,268,885	13,948,963
Retained earnings	7,985,195	6,950,216
Accumulated other comprehensive income	518,632	40,989
Treasury stock, at cost (10,182 and 17,125 shares, at cost)	(600,608)	(1,004,137)
Total Stockholders' Equity	22,172,104	19,936,031
Total Liabilities and Stockholders' Equity	\$ 268,848,351	\$ 246,054,949

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31,

	2011	2010
Interest and Dividend Income		
Interest and fees on loans	\$ 10,141,129	\$ 10,514,011
Federal funds sold and other interest income	48,537	29,774
Investment securities:		
Taxable	869,550	696,201
Exempt from federal income tax	213,670	96,775
Other dividend income	56,670	52,767
Total interest and dividend income	<u>11,329,556</u>	<u>11,389,528</u>
Interest Expense		
Deposits	2,022,780	2,544,923
Federal Home Loan Bank advances	572,014	690,598
Subordinated debentures	82,744	82,887
Total interest expense	<u>2,677,538</u>	<u>3,318,408</u>
Net Interest Income	8,652,018	8,071,120
Provision for loan losses	1,542,671	1,043,148
Net Interest Income After Provision For Loan Losses	<u>7,109,347</u>	<u>7,027,972</u>
Noninterest Income		
Service charges on deposit accounts	208,380	228,056
Investment securities gains, net	112,356	—
Gain on sale of loans	—	212,311
Secondary market fees	387,325	451,087
Earnings on bank-owned life insurance	171,894	175,761
Other income	398,920	328,171
Total noninterest income	<u>1,278,875</u>	<u>1,395,386</u>
Noninterest Expense		
Salaries and employee benefits	3,355,467	3,033,550
Net occupancy and equipment expenses	421,935	429,384
Data processing	305,896	303,770
Professional fees	254,386	255,655
Marketing and business development	185,400	217,301
Franchise tax expense	255,704	215,000
Federal deposit insurance	234,205	502,083
Loss from other real estate owned	292,446	265,225
Other expense	1,246,525	1,249,752
Total noninterest expense	<u>6,551,964</u>	<u>6,471,720</u>
Income before income taxes	1,836,258	1,951,638
Income taxes	533,776	588,060
Net Income	<u>\$ 1,302,482</u>	<u>\$ 1,363,578</u>
Earnings Per Share		
Basic	\$ 3.16	\$ 3.41
Diluted	2.87	3.10

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2009	\$ 13,497,576	\$ 5,829,353	\$ 303,272	\$ (1,000,187)	\$ 18,630,014
Purchase of 3,648 shares of treasury stock				(223,090)	(223,090)
Retirement of 3,631 shares of treasury stock	(219,140)			219,140	—
Stock-based compensation expense	124,677				124,677
Exercise of 15,000 shares of stock options	375,000				375,000
Tax benefits from exercise of stock options	170,850				170,850
Cash dividends paid (\$0.60 per share)		(242,715)			(242,715)
Net income		1,363,578			1,363,578
Other comprehensive loss:					
Change in net loss on available-for-sale securities, net of reclassification adjustment, and related tax benefit of \$135,115			(262,283)		(262,283)
Comprehensive income					1,101,295
Balance, December 31, 2010	13,948,963	6,950,216	40,989	(1,004,137)	19,936,031
Purchase of 10,016 shares of treasury stock				(655,527)	(655,527)
Retirement of 10,099 shares of treasury stock	657,746			657,746	—
Stock-based compensation expense	128,777				128,777
Exercise of 19,267 shares of stock options	584,141				584,141
Tax benefits from exercise of stock options	238,459				238,459
Issuance of 6,860 shares of common stock for subscription and share purchase agreement	26,291			401,310	427,601
Cash dividends paid (\$0.65 per share)		(267,503)			(267,503)
Net income		1,302,482			1,302,482
Other comprehensive loss:					
Change in net gain on available-for-sale securities, net of reclassification adjustment, and related income tax provision of \$246,059			477,643		477,643
Comprehensive income					1,780,125
Balance, December 31, 2011	\$ 14,268,885	\$ 7,985,195	\$ 518,632	\$ (600,608)	\$ 22,172,104

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31,

	2011	2010

Operating Activities		
Net income	\$ 1,302,482	\$ 1,363,578
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	1,542,671	1,043,148
Depreciation	175,772	192,727
Net amortization of securities	578,208	330,257
Investment securities gains, net	(112,356)	—
Gain on sale of loans	—	(212,311)
Loss from other real estate owned	292,446	265,225
Stock-based compensation expense	128,777	124,677
Earnings on bank-owned life insurance	(171,894)	(175,761)
Deferred income taxes	(182,214)	(37,623)
Changes in net deferred loan fees	26,667	37,207
Decrease in prepaid federal deposit insurance	217,232	467,245
Amortization of Federal Home Loan Bank restructuring fee	146,990	—
Other, net	222,827	(198,626)
Net cash provided by operating activities	<u>4,167,608</u>	<u>3,199,743</u>
Investing Activities		
Investment securities available for sale		
Proceeds from repayments and maturities	15,868,656	15,523,905
Proceeds from sales	4,070,856	—
Purchases	(35,140,263)	(34,110,067)
Purchase of regulatory stock	(27,200)	(106,400)
Proceeds from sale of loans	—	3,241,395
Decrease (increase) in loans, net	4,193,506	(4,704,529)
Purchase of bank-owned life insurance	(1,000,000)	—
Purchase of premises and equipment	(134,167)	(72,690)
Disposal of premises and equipment	45	—
Proceeds from sale of other real estate owned	526,189	530,796
Net cash used for investing activities	<u>(11,642,378)</u>	<u>(19,697,590)</u>
Financing Activities		
Increase in deposits, net	20,824,247	20,724,791
Proceeds from Federal Home Loan Bank advances	8,136,822	—
Repayment of Federal Home Loan Bank advances	(9,092,810)	(4,008,785)
Decrease in treasury, tax, and loan	—	(33,124)
Purchases of treasury stock	(655,527)	(223,090)
Proceeds from the sale of treasury stock, net	427,601	—
Tax benefit from exercise of stock options	238,459	170,850
Proceeds from stock option exercises	584,141	375,000
Cash dividends paid	(267,503)	(242,715)
Net cash provided by financing activities	<u>20,195,430</u>	<u>16,762,927</u>
Increase in cash and cash equivalents	12,720,660	265,080
Cash and Cash Equivalents at Beginning of Year	9,741,436	9,476,356
Cash and Cash Equivalents at End of Year	<u>\$ 22,462,096</u>	<u>\$ 9,741,436</u>

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Nature of Operations and Basis of Presentation

Portage Bancshares, Inc. (the “Company”) is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiary, Portage Community Bank (the “Bank”). The Bank generates commercial, mortgage, and consumer loans and receives deposits from customers located primarily in Portage County in Ohio and the surrounding areas. The Bank is subject to regulations by the State of Ohio Division of Financial Institutions and the Company is subject to regulations by the Federal Reserve System through the Federal Reserve Bank of Cleveland.

The consolidated financial statements include the accounts of the Company and the Bank after elimination of all significant intercompany transactions and balances.

The accounting principles followed by the Company and the methods of applying these principles conform to U.S. generally accepted accounting principles and to general practice within the banking industry. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the balance sheet date and reported amounts of revenues and expenses for that period. Actual results could differ from those estimates.

Investment Securities

Currently, the Company’s investment securities portfolio is classified as available for sale. The portfolio serves principally as a source of liquidity and is carried at fair value with unrealized holding gains and losses for available-for-sale securities reported in other comprehensive income, net of tax, until realized. Debt securities acquired with the intent to hold to maturity would be classified as held to maturity and carried at cost adjusted for amortization of premium and accretion of discount, which are computed using the interest method and recognized as adjustments of interest income. Realized security gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Common stock of the Federal Home Loan Bank (“FHLB”) and Federal Reserve Bank represents ownership in institutions which are wholly owned by other financial institutions.

The Bank is a member of the FHLB of Cincinnati and, as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its \$100 par value. The stock does not have a readily determinable fair value and, as such, is classified

as restricted stock, carried at cost and evaluated by management. The stock’s value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared with the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB, and (d) the liquidity position of the FHLB.

While the Federal Home Loan Banks have been negatively impacted by the current economic conditions, the Federal Home Loan Bank of Cincinnati has reported profits for 2011, remains in compliance with regulatory capital and liquidity requirements, continues to pay dividends on the stock and make redemptions at the par value. With consideration given to these factors, management concluded that the stock was not impaired at December 31, 2011 or 2010.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security’s ability to recover any decline in its market value, and whether or not the Company intends to sell the security or whether it’s more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. A decline in value that is considered to be other than temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income.

Loans

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

Interest income is accrued on the interest method based upon the unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Past-due status is based on the contractual terms of the loan. Consumer loans are typically charged off no later than 120 days past due. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (continued)

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

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, since it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component is related to impaired loans, which are commercial and commercial real estate loans for which it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and commercial mortgage loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's obtainable market price or the fair value of the collateral if the loan is collateral-dependent. The Company individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. A component is maintained to cover uncertainties that could affect management's estimate of probable losses. This component of the allowance reflects the margin of imprecision inherent in the

underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is principally computed on the straight-line method over the estimated useful lives of the related assets, which range from 3 to 10 years for furniture, fixtures, and equipment and 25 to 50 years for building premises. Leasehold improvements are amortized over the shorter of their estimated useful lives or their respective lease terms, which range from 7 to 15 years. Expenditures for maintenance and repairs are expensed as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance (BOLI)

The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet, and any increases in the cash surrender value are recorded as noninterest income on the Consolidated Statement of Income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as noninterest income.

Other Real Estate Owned

Other real estate acquired through or in lieu of foreclosure is initially recorded at the lower of cost or fair value, less estimated costs to sell, and any loan balance in excess of fair value is charged to the allowance for loan losses. Subsequent valuations are periodically performed and write-downs are included in other operating expense, as are gains or losses upon sale and expenses related to maintenance of the properties.

Advertising Costs

Advertising costs are expensed as incurred.

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Benefit Plans

The 401(k) plan expense is the amount contributed and is determined by formula and by Board of Directors decision. Supplemental retirement expense allocates the benefits over the years of service.

Stock Options

During the years ended December 31, 2011 and 2010, the Company recorded \$128,777 and \$124,677 in compensation effects on the Company's Consolidated Statement of Income. As of December 31, 2011 and 2010, there was \$124,705 and \$231,122 of unrecognized compensation cost related to unvested share-based compensation awards granted. That cost is expected to be recognized over the next five years.

The cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) are classified as financing cash flows. The Company recognized \$238,459 and \$170,850 of excess tax benefits included as a financing cash inflow for the years ended December 31, 2011 and 2010, in the Consolidated Statement of Cash Flows.

For purposes of computing pro forma results, the Company estimated the fair values of stock options using the Black-Scholes option-pricing model. The model requires the use of subjective assumptions that can materially affect fair value estimates. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. The fair value of each stock option granted was estimated using the following weighted-average assumptions:

Grant Year	Expected Dividend Yield	Risk-Free Interest Rate	Expected Volatility	Expected Life (in years)
2011	1.00%	2.87%	6.26%	7.00

The weighted-average fair value of each stock option granted for 2011 was \$8.60.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share are calculated utilizing net income as reported in the numerator and average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options, warrants, and convertible securities are adjusted in the denominator.

Basic weighted-average common shares outstanding totaled 412,577 and 399,436 for December 31, 2011 and 2010, respectively. Diluted weighted-average common shares outstanding totaled 454,093 and 439,659 for December 31, 2011 and 2010, respectively. The diluted weighted-average common shares outstanding are solely the result of stock options.

Comprehensive Income

The Company is required to present comprehensive income and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income comprises unrealized holding gains (losses) on the available-for-sale securities portfolio. The Company has elected to report the effects of other comprehensive income in Note 15.

Cash Flow Information

For the purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits with other financial institutions, and federal funds sold with original maturities of less than 90 days.

Cash payments for interest in 2011 and 2010 were \$2,738,334 and \$3,438,367, respectively. Income tax payments totaled \$220,000 in 2011 and \$665,000 in 2010. The Company transferred \$875,540 and \$650,595 of loans from the portfolio to other real estate owned in 2011 and 2010, respectively. Fair value adjustments for securities available for sale in 2011 and 2010 were \$723,703 and \$(397,400), respectively.

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 (free of conditions that constrain it from taking advantage of that 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.

Reclassification

Certain items in the prior year's financial statements have been reclassified to conform to the current-year presentation. Such reclassifications did not affect consolidated net income or consolidated stockholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2: INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and fair values of securities available for sale are as follows:

2011

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Negotiable certificates of deposit	\$ 500,000	\$ 4,048	\$ (13,877)	\$ 490,171
U.S. government agency securities	11,598,974	66,734	(1,700)	11,664,008
Obligations of states and political subdivisions	9,441,113	341,213	(1,364)	9,780,962
Mortgage - backed securities in government - sponsored entities	33,462,290	481,232	(90,480)	33,853,042
Total	\$ 55,002,377	\$ 893,227	\$ (107,421)	\$ 55,788,183

2010

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ 15,386,069	\$ 33,459	\$ (198,596)	\$ 15,220,932
Obligations of states and political subdivisions	5,576,480	35,052	(154,268)	5,457,264
Mortgage - backed securities in government - sponsored entities	19,304,933	400,676	(54,220)	19,651,389
Total	\$ 40,267,482	\$ 469,187	\$ (407,084)	\$ 40,329,585

The amortized cost and fair value of debt securities at December 31, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due after one year through five years	\$ 6,375,546	\$ 6,415,998
Due after five years through ten years	6,479,238	6,680,019
Due after ten years	8,685,303	8,839,124
Mortgage - backed securities in government - sponsored entities	33,462,290	33,853,042
Total	\$ 55,002,377	\$ 55,788,183

Investment securities with a carrying value of \$14,660,659 and \$17,072,578 at December 31, 2011 and 2010, respectively, were pledged to secure deposits and other purposes as required by law.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 2: INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

In 2011, the Company realized gross gains of \$122,200 and gross losses of \$9,844 as a result of sales of \$4,070,856 in investment securities available for sale. There were no sales of investment securities in 2010. The following table shows the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31:

2011

	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Negotiable certificates of deposit	\$ 236,123	\$ (13,877)	\$ —	\$ —	\$ 236,123	\$ (13,877)
U.S. government agency securities	529,290	(731)	519,822	(969)	1,049,112	(1,700)
Obligations of states and political subdivisions	825,901	(1,364)	—	—	825,901	(1,364)
Mortgage-backed securities in government-sponsored entities	12,557,189	(90,480)	—	—	12,557,189	(90,480)
Total	\$ 14,148,503	\$ (106,452)	\$ 519,822	\$ (969)	\$ 14,668,325	\$ (107,421)

2010

	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	\$ 10,671,326	\$ (198,596)	\$ —	\$ —	\$ 10,671,326	\$ (198,596)
Obligations of states and political subdivisions	3,992,583	(154,268)	—	—	3,992,583	(154,268)
Mortgage-backed securities in government-sponsored entities	8,008,530	(54,220)	—	—	8,008,530	(54,220)
Total	\$ 22,672,439	\$ (407,084)	\$ —	\$ —	\$ 22,672,439	\$ (407,084)

The Company reviews its position quarterly and has asserted that at December 31, 2011, the declines outlined in the above table represent temporary declines and the Company does not intend to sell these securities and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were nineteen positions that were temporarily impaired at December 31, 2011. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes that are not expected to result in the noncollection of principal and interest during the period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS

The composition of net loans is as follows at December 31:

	<u>2011</u>	<u>2010</u>
Commercial loans	\$ 38,392,521	\$ 40,518,300
Commercial real estate loans	68,457,855	68,567,797
Consumer loans	7,285,564	7,374,933
Residential loans	38,172,289	41,603,174
Home equity lines of credit	26,901,221	27,004,430
	<u>179,209,450</u>	<u>185,068,634</u>
Net deferred loan fees	(200,228)	(223,134)
Less allowance for loan losses	<u>(3,388,963)</u>	<u>(2,586,857)</u>
<i>Net loans</i>	<u>\$ 175,620,259</u>	<u>\$ 182,258,643</u>

The Company's primary business activity is with customers located within its local trade area, which is concentrated in Portage County in Ohio. Commercial loans, commercial real estate loans, consumer loans, residential loans, and home equity lines of credit are granted. Although the Company has a diversified loan portfolio at December 31, 2011 and 2010, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area.

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial loans, commercial real estate loans, consumer loans, residential loans, and home equity lines of credit. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a 24-month period for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans.

The following qualitative factors are analyzed for each portfolio segment:

- ▶ Changes in trends in lending policies and procedures
- ▶ Changes in economic trends
- ▶ Changes in volume and terms
- ▶ Changes in experience, depth, and ability of management
- ▶ Changes in levels and trends in delinquencies
- ▶ Changes in historical loss allocations
- ▶ Changes in trends determined through loan review
- ▶ Changes in concentrations of credit
- ▶ Changes in trends in external factors

These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2011, the qualitative factor percentages for commercial loans, commercial real estate loans, and residential loans all increased while the qualitative factors for consumer loans and home equity lines of credit fluctuated minimally during the year. The effect of the levels and trends in delinquencies contributed to the increase in qualitative factor percentages for commercial loans, commercial real estate loans, and residential loans. Another factor contributing to the increase in the qualitative factors relating to the commercial, commercial real estate, and residential loan pools was the change in the underlying value of collateral. Although the decline in the value of real property and other collateral in the Company's local market area was not as significant or as wide spread as other areas of the country during the recent economic downturn, such declines did impact the credit quality of some of the Company's loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$3.4 million adequate to cover loan losses inherent in the loan portfolio, at December 31, 2011. The following tables presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans as of December 31:

2011

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Line of Credit	Unallocated	Total
Allowance for loan losses							
Beginning balance	\$ 853,940	\$ 989,167	\$ 166,191	\$ 355,411	\$ 222,148	\$ —	\$ 2,586,857
Charge-offs	(372,857)	(59,917)	(57,250)	(235,370)	(73,141)	—	(798,535)
Recoveries	4,896	24,419	25,972	—	2,683	—	57,970
Provision	301,130	908,294	(3,784)	282,284	54,747	—	1,542,671
Ending balance	\$ 787,109	\$ 1,861,963	\$ 131,129	\$ 402,325	\$ 206,437	\$ —	\$ 3,388,963
Ending balance: individually evaluated for impairment	\$ 312,860	\$ 1,010,594	\$ —	\$ —	\$ —	\$ —	\$ 1,323,454
Ending balance: collectively evaluated for impairment	\$ 474,249	\$ 851,369	\$ 131,129	\$ 402,325	\$ 206,437	\$ —	\$ 2,065,509
Loans receivable							
Ending balance	\$ 38,392,521	\$ 68,457,855	\$ 7,285,564	\$ 38,172,289	\$ 26,901,221	\$ —	\$ 179,209,450
Ending balance: individually evaluated for impairment	\$ 2,845,016	\$ 3,475,061	\$ —	\$ —	\$ —	\$ —	\$ 6,320,077
Ending balance: collectively evaluated for impairment	\$ 35,547,505	\$ 64,982,794	\$ 7,285,564	\$ 38,172,289	\$ 26,901,221	\$ —	\$ 172,889,373

2010

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Line of Credit	Unallocated	Total
Allowance for loan losses							
Beginning balance	\$ 925,702	\$ 1,209,050	\$ 149,691	\$ 299,965	\$ 135,137	\$ 58,362	\$ 2,777,907
Charge-offs	(491,662)	(334,007)	(167,469)	(157,727)	(158,491)	—	(1,309,356)
Recoveries	7,636	12,696	27,646	14,000	13,180	—	75,158
Provision	412,265	101,428	156,322	199,173	232,322	(58,362)	1,043,148
Ending balance	\$ 853,941	\$ 989,167	\$ 166,190	\$ 355,411	\$ 222,148	\$ —	\$ 2,586,857
Ending balance: individually evaluated for impairment	\$ 173,712	\$ 103,049	\$ —	\$ 20,352	\$ —	\$ —	\$ 297,113
Ending balance: collectively evaluated for impairment	\$ 680,229	\$ 886,118	\$ 166,190	\$ 335,059	\$ 222,148	\$ —	\$ 2,289,744
Loans receivable							
Ending balance	\$ 40,518,300	\$ 68,567,797	\$ 7,374,933	\$ 41,603,174	\$ 27,004,430	\$ —	\$ 185,068,634
Ending balance: individually evaluated for impairment	\$ 1,248,597	\$ 1,342,220	\$ —	\$ 106,596	\$ —	\$ —	\$ 2,697,413
Ending balance: collectively evaluating for impairment	\$ 39,269,703	\$ 67,225,577	\$ 7,374,933	\$ 41,496,578	\$ 27,004,430	\$ —	\$ 182,371,221

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

Credit Quality Information

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2011 and 2010, respectively. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans.

Management utilizes a seven-point internal risk rating system to monitor the credit quality of the overall portfolio. The first three categories are considered not criticized and are aggregated as Pass-rated. Pass-rated loans are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. The criticized rating categories utilized by management generally follow bank regulatory definitions. Special Mention category loans have a potential weakness or risk that exists, which could cause a more serious problem if not corrected. The Substandard category loans have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. The Doubtful category loans have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances. The Loss category loans are considered uncollectible, or of such value that continuance as an asset is not warranted.

As of December 31, 2011

	Commercial	Commercial Real Estate	Total
Pass	\$ 31,134,965	\$ 59,281,812	\$ 90,416,777
Special Mention	3,211,454	4,037,958	7,249,412
Substandard	3,823,952	3,244,429	7,068,381
Doubtful	222,150	1,893,656	2,115,806
Loss	—	—	—
Ending balance	<u>\$ 38,392,521</u>	<u>\$ 68,457,855</u>	<u>\$ 106,850,376</u>

As of December 31, 2010

	Commercial	Commercial Real Estate	Total
Pass	\$ 32,702,681	\$ 57,441,847	\$ 90,144,528
Special Mention	3,071,445	6,982,231	10,053,676
Substandard	4,260,143	4,097,219	8,357,362
Doubtful	484,031	46,500	530,531
Loss	—	—	—
Ending balance	<u>\$ 40,518,300</u>	<u>\$ 68,567,797</u>	<u>\$ 109,086,097</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

Credit Quality Information (Continued)

For consumer loans, residential loans, and home equity lines of credit, the Company evaluates credit quality based on whether the loan is considered performing or non-performing. The following tables present the balances of these loans by classes of the loan portfolio based on payment performance as of December 31:

2011

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 7,245,461	\$ 37,416,905	\$ 26,820,014	\$ 71,482,380
Nonperforming	40,103	755,384	81,207	876,694
Total	\$ 7,285,564	\$ 38,172,289	\$ 26,901,221	\$ 72,359,074

2010

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 7,318,944	\$ 40,569,051	\$ 26,751,135	\$ 74,639,130
Nonperforming	55,989	1,034,123	253,295	1,343,407
Total	\$ 7,374,933	\$ 41,603,174	\$ 27,004,430	\$ 75,982,537

Age Analysis of Past Due Loans Receivable by Class

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31:

2011

	30 – 59 Days	60 – 89 Days	90 Days or	Total Past	Current	Nonaccrual	Total Loans
	Past Due	Past Due	Greater & Accruing	Due			
Commercial	\$ 350,986	\$ —	\$ —	\$ 350,986	\$ 37,873,269	\$ 519,252	\$ 38,392,521
Commercial real estate	124,451	71,306	—	195,757	65,611,466	2,846,389	68,457,855
Consumer	130,721	—	—	130,721	7,245,461	40,103	7,285,564
Residential	190,339	—	—	190,339	37,416,905	755,384	38,172,289
Home equity lines of credit	1,100	17,062	—	18,162	26,820,014	81,207	26,901,221
Total	\$ 797,597	\$ 88,368	\$ —	\$ 885,965	\$ 174,967,115	\$ 4,242,335	\$179,209,450

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

Age Analysis of Past Due Loans Receivable by Class (Continued)

	2010						
	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or Greater & Accruing	Total Past Due	Current	Nonaccrual	Total Loans
Commercial	\$ 38,267	\$ 78,250	\$ —	\$ 116,517	\$ 39,833,789	\$ 684,511	\$ 40,518,300
Commercial real estate	228,339	191,012	173,411	592,762	67,494,222	1,073,575	68,567,797
Consumer	28,580	7,643	9,213	45,436	7,328,157	46,776	7,374,933
Residential	1,065,633	104,450	265,511	1,435,594	40,834,562	768,612	41,603,174
Home equity lines of credit	129,797	6,719	—	136,516	26,751,135	253,295	27,004,430
Total	\$ 1,490,616	\$ 388,074	\$ 448,135	\$ 2,326,825	\$ 182,241,865	\$ 2,826,769	\$ 185,068,634

Interest income that would have been recorded had nonaccrual loans not been placed on nonaccrual status was \$290,955 and \$260,074 in 2011 and 2010, respectively.

Impaired Loans

The following tables present the recorded investment and unpaid principal balances of impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31:

	2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial loans	\$ 2,056,973	\$ 2,071,373	\$ —	\$ 777,758	\$ 52,109
Commercial real estate loans	1,030,285	1,394,113	—	936,555	30,996
Consumer loans	—	—	—	—	—
Residential loans	—	—	—	75,287	1,077
Home equity lines of credit	—	—	—	—	—
	\$ 3,087,258	\$ 3,456,486	\$ —	\$ 1,789,600	\$ 84,182
With an allowance recorded:					
Commercial loans	\$ 788,043	\$ 1,163,310	\$ 312,860	\$ 565,281	\$ 10,698
Commercial real estate loans	2,444,776	2,623,528	1,010,594	1,732,817	408
Consumer loans	—	—	—	—	—
Residential loans	—	—	—	—	—
Home equity loans of credit	—	—	—	—	—
	\$ 3,232,819	\$ 3,786,838	\$ 1,323,454	\$ 2,298,098	\$ 11,106
Total:					
Commercial loans	\$ 2,845,016	\$ 3,234,683	\$ 312,860	\$ 1,343,039	\$ 62,807
Commercial real estate loans	3,475,061	4,017,641	1,010,594	2,669,372	31,404
Consumer loans	—	—	—	—	—
Residential loans	—	—	—	75,287	1,077
Home equity lines of credit	—	—	—	—	—
	\$ 6,320,077	\$ 7,252,324	\$ 1,323,454	\$ 4,087,698	\$ 95,288

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

Impaired Loans (Continued)

2010

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial loans	\$ 786,585	\$ 1,187,426	\$ 173,712	\$ 803,729	\$ —
Commercial real estate loans	180,364	225,625	103,049	689,166	46,890
Consumer loans	—	—	—	5,987	—
Residential loans	86,244	140,432	20,352	89,121	—
Home equity lines of credit	—	—	—	—	—
	<u>\$ 1,053,193</u>	<u>\$ 1,553,483</u>	<u>\$ 297,113</u>	<u>\$ 1,588,003</u>	<u>\$ 46,890</u>
With an allowance recorded					
Commercial loans	\$ 462,012	\$ 462,012	\$ —	\$ 410,571	\$ —
Commercial real estate loans	1,161,856	1,340,608	—	1,291,767	—
Consumer loans	—	—	—	—	—
Residential loans	20,352	20,352	—	21,520	—
Home equity loans of credit	—	—	—	—	—
	<u>\$ 1,644,220</u>	<u>\$ 1,822,972</u>	<u>\$ —</u>	<u>\$ 1,723,858</u>	<u>\$ —</u>
Total					
Commercial loans	\$ 1,248,597	\$ 1,649,438	\$ 173,712	\$ 1,214,300	\$ —
Commercial real estate loans	1,342,220	1,566,233	103,049	1,980,933	46,890
Consumer loans	—	—	—	5,987	—
Residential loans	106,596	160,784	20,352	110,641	—
Home equity lines of credit	—	—	—	—	—
	<u>\$ 2,697,413</u>	<u>\$ 3,376,455</u>	<u>\$ 297,113</u>	<u>\$ 3,311,861</u>	<u>\$ 46,890</u>

The table below summarizes the Company's total troubled debt restructurings before and after modifications as of December 31:

2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Pre-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial loans	6	\$ 2,439,774	\$ 2,326,860
Commercial real estate loans	6	\$ 2,524,373	\$ 2,517,149

The commercial loans and commercial real estate loans were modified by lowering the stated interest rates and/or extending the terms of the original loans. No principal reductions were made. Additional interest income of \$13,307 would have been recognized for the year ended December 31, 2011, at the original interest rate as compared to the adjusted interest rate on the commercial and commercial real estate loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: LOANS (Continued)

Related Party Loans

Certain directors and executive officers of the Company, members of their immediate families, and their related interest were indebted to the Company at December 31, 2011 and 2010. Such loans are made in the ordinary course of business in accordance with the Company's normal lending policies, including the interest rate charged and collateralization, and do not represent more than a normal collection risk. A summary of the activity on the related party loans to certain directors and executive officers and their related companies and immediate families consists of the following:

<i>2010</i>	<i>Advances</i>	<i>Repayments</i>	<i>2011</i>
\$ 158,517	\$ 34,628	\$ (71,700)	\$ 121,445

NOTE 4: PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	<u>2011</u>	<u>2010</u>
Land and land improvements	\$ 1,561,926	\$ 1,561,926
Building and leasehold improvements	2,846,770	2,766,926
Furniture, fixtures, and equipment	1,608,067	1,553,834
	6,016,763	5,882,686
Less accumulated depreciation	(1,919,262)	(1,743,535)
Total	<u>\$ 4,097,501</u>	<u>\$ 4,139,151</u>

Depreciation charged to operations was \$175,772 in 2011 and \$192,727 in 2010.

NOTE 5: DEPOSITS

Time deposits at December 31, 2011, mature \$56,497,696, \$22,277,974, \$3,309,315, \$3,127,745, \$3,843,373, and \$1,168,483 during 2012, 2013, 2014, 2015, 2016, and 2018 respectively.

Time deposits include certificates of deposit in denominations of \$100,000 or more. Such deposits aggregated \$4,676,575 and \$3,784,274 at December 31, 2011 and 2010, respectively.

Included in certificates of deposit at December 31, 2011 and 2010, were \$26,990,350 and \$24,510,808, respectively, obtained through the Certificate of Deposit Account Registry Services (CDARS). This service allows deposit customers to maintain fully insured balances in excess of the \$250,000 FDIC insurance limit without the inconvenience of having multi-banking relationships. Under the reciprocal program, which the Company is currently participating in, customers agree to allow the Company to place their deposits with participating banks in the CDARS program, in insurable amounts under \$250,000. In exchange, other banks in the program agree to place their deposits with Portage Community Bank, also in insurable amounts under \$250,000.

Related-party deposits were \$865,332 and \$989,633 at December 31, 2011 and 2010, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6: FHLB ADVANCES

The following table sets forth information concerning other borrowings with the FHLB:

Description	Maturity Range		Weighted-average interest rate	At December 31,	
	from	to		2011	2010
Mortgage match - amortizing	01/01/12	04/01/22	2.75%	\$ 9,500,080	\$ 15,922,361
Mortgage match - non-amortizing	01/06/14	01/06/16	2.25%	6,136,822	—
			2.55%	<u>\$ 15,636,902</u>	<u>\$ 15,922,361</u>

At December 31, 2011, the Bank had a cash management line of credit enabling it to borrow up to \$15.0 million from the Federal Home Loan Bank of Cincinnati (“FHLB”). The line of credit must be renewed on an annual basis. There were no borrowings from the line of credit outstanding as of December 31, 2011 and December 31, 2010. The Bank has a remaining borrowing capacity of \$39.6 million at December 31, 2011.

The advances were collateralized by \$22,829,877 and \$23,724,318 of first mortgage loans under a blanket lien arrangement at December 31, 2011 and 2010, respectively.

Maturities over the next five years and thereafter were as follows:

Year Ending December 31,	Amount	Weighted-Average Rate
2012	\$ 2,007,794	2.52 %
2013	1,737,757	2.48
2014	1,648,975	2.46
2015	4,075,727	2.60
2016	4,194,491	2.65
Thereafter	1,972,158	2.77
	<u>\$ 15,636,902</u>	2.55 %

Monthly principal and interest payments are due on the mortgage match fixed rate amortizing borrowings; additionally, a 10 percent principal curtailment is due on the borrowing’s anniversary date. Monthly interest payments are due on the mortgage match fixed rate non-amortizing borrowings and principal payments are paid in total at maturity.

The Company maintains a \$1,000,000 unsecured line of credit and the Bank a \$1,000,000 unsecured line of credit with another financial institution. No amounts were outstanding under these lines of credit at December 31, 2011 and 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7: SUBORDINATED DEBENTURES

In March 2004, Portage Bancshares Capital Trust I, a trust formed by the Company, issued \$2,500,000 of floating rate, trust preferred securities as part of a pooled offering of such securities. The Company issued \$2,450,000 subordinated debentures to the trust in exchange for the proceeds of the offering. The debentures and related debt issuance costs represent the sole assets of the trust. The trust is not consolidated with the Company's financial statements, but rather the subordinated debentures are shown as a liability. The trust preferred securities must be redeemed no later than April 23, 2034. The Company had the option to call the trust preferred securities at par at five years from date of issuance. The subordinated debentures are also redeemable in whole or in part from time to time, upon the occurrence of specific events defined within the trust indenture. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years. The subordinated debentures may be included in Tier I capital with certain limitations applicable under current regulatory guidelines and interpretations.

The interest rate on the trust preferred securities and the subordinated debentures is computed as the three-month London Interbank Offering Rate (LIBOR) plus 285 points. At December 31, 2011 and 2010, this equated to 3.41 percent and 3.15 percent, respectively.

NOTE 8: INCOME TAXES

The provision for federal income taxes consists of:

	<u>2011</u>	<u>2010</u>
Current payable	\$ 694,723	\$ 625,683
Deferred	(160,947)	(37,623)
Total provision	<u>\$ 553,776</u>	<u>\$ 588,060</u>

No valuation allowance was established at December 31, 2011 and 2010, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential. The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Allowance for loan losses	\$ 929,173	\$ 679,967
Accrued expenses and employee benefits	206,321	187,862
Deferred loan fees	51,663	58,558
Stock-based compensation	75,616	57,097
Other	58,144	150,715
Deferred tax assets	<u>1,320,917</u>	<u>1,134,199</u>
Deferred tax liabilities:		
Depreciation	86,289	66,544
Unrealized gain on available-for-sale securities	267,174	21,115
Federal Home Loan Bank stock dividends	45,526	45,526
Prepaid expenses	10,472	4,562
Security accretion	782	666
Deferred tax liabilities	<u>410,243</u>	<u>138,413</u>
Net deferred tax assets	<u>\$ 910,674</u>	<u>\$ 995,786</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8: INCOME TAXES (Continued)

The reconciliation between the federal statutory rate and the Company's effective consolidated income tax rate is as follows:

	2011		2010	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 624,328	34.0 %	\$ 663,557	34.0 %
Tax-exempt interest	(57,649)	(3.1)	(28,308)	(1.5)
Earnings on bank-owned life insurance	(58,444)	(3.2)	(59,759)	(3.1)
Other	25,541	1.4	12,570	0.6
Actual tax expense and effective rate	<u>\$ 533,776</u>	<u>29.1 %</u>	<u>\$ 588,060</u>	<u>30.1 %</u>

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Bank recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the income taxes in the Consolidated Statement of Income. With few exceptions, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2007.

NOTE 9: EMPLOYEE BENEFITS

401(k) Plan

The Company sponsors a 401(k) plan covering substantially all employees. The Company matches contributions at the rate of 100 percent of each participant's voluntary contributions, limited to a maximum of 6 percent of a covered employee's annual compensation. In addition to the Company's matching contribution, a profit sharing contribution to the plan can be made at the discretion of the Board. Employee voluntary contributions are vested at all times. Employers' matching contributions vest 20 percent per year and are fully vested after five years. The expense related to the plan was \$143,613 and \$129,673 for the years ended December 31, 2011 and 2010, respectively.

Supplemental Retirement Plan

The Company sponsors a supplemental retirement plan ("SERP") which covers several key members of management. Participants will receive annually a percentage of their base compensation at the time of their retirement for a maximum of ten years. The liability recorded at December 31, 2011 and 2010, was \$606,826 and \$552,534, respectively. The expense related to the plan was \$80,501 and \$79,717 for 2011 and 2010, respectively. Distributions to participants were \$26,209 in 2011 and 2010, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9: EMPLOYEE BENEFITS (Continued)

Stock Option Plan

The Company has a fixed director and employee stock-based compensation plan. Under the plan, the Company may grant options for up to 200,000 shares of common stock. The exercise price for the purchase of shares subject to a stock option may not be less than 100 percent of the fair market value of the shares covered by the option on the date of the grant. The term of stock options will not exceed ten years from the date of grant. Vesting occurs at 20 percent per year of service.

The following table presents share data related to the outstanding options:

	2011	Weighted-Average Exercise Price	2010	Weighted-Average Exercise Price
Outstanding, January 1	149,559	\$ 42.03	164,559	\$ 40.48
Granted	2,600	63.10	—	—
Exercised	(19,267)	30.32	(15,000)	25.00
Forfeited	—	—	—	—
Outstanding, December 31	<u>132,892</u>	<u>\$ 44.14</u>	<u>149,559</u>	<u>\$ 42.03</u>
Exercisable at year-end	<u>115,446</u>	<u>\$ 42.15</u>	<u>124,239</u>	<u>\$ 39.27</u>

The following table summarizes the characteristics of stock options at December 31, 2011:

Grant Date	Exercise Price	<i>Outstanding</i>			<i>Exercisable</i>	
		Shares	Remaining Average Life	Average Exercise Price	Shares	Average Exercise Price
5/13/2002	\$ 30.00	20,300	0.40	\$ 30.00	20,300	\$ 30.00
1/6/2004	30.00	19,750	2.00	30.00	19,750	30.00
6/15/2005	42.25	18,500	3.50	42.25	18,500	42.25
11/16/2005	45.00	20,500	3.90	45.00	20,500	45.00
1/24/2007	50.00	23,742	5.10	50.00	19,896	50.00
10/22/2008	58.50	27,500	6.80	58.50	16,500	58.50
1/24/2011	63.10	2,600	9.10	63.10	—	63.10
		<u>132,892</u>		<u>\$ 44.14</u>	<u>115,446</u>	<u>\$ 42.15</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10: LOAN COMMITMENTS

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party.

The contractual amounts of financial instruments with off-balance-sheet risk at year-end were as follows:

	<u>2011</u>		<u>2010</u>	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused business lines of credit	\$ 1,064,942	\$ 10,596,023	\$ 832,376	\$ 10,834,265
Unused construction lines of credit	333,048	318,077	4,779	266,017
Unused consumer lines of credit	105,878	21,440,244	163,342	20,971,641
Standby letters of credit	—	56,000	—	40,000
Total	<u>\$ 1,503,868</u>	<u>\$ 32,410,344</u>	<u>\$ 1,000,497</u>	<u>\$ 32,111,923</u>

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments have interest rates ranging from 2.30 percent to 18.00 percent at December 31, 2011, and 2.75 percent to 18.00 percent at December 31, 2010.

Standby letters of credit represent conditional commitments issued to guarantee performance of a customer to a third party. The coverage period for these instruments is typically a one-year period with renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments.

Contingent Liabilities

The Company is involved in various legal actions from the normal course of business activities. Management believes the liability, if any; arising from such actions will not have a material adverse effect on the Company's financial position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11: REGULATORY RESTRICTIONS

Restriction on Cash and Due From Banks

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve was \$803,000 and \$711,000 for the years ended December 31, 2011 and 2010, respectively.

Loans

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific obligations. Further, such secured loans are limited in amount up to 10 percent of the Bank's common stock and capital surplus.

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by an Ohio state-chartered bank. Under the Ohio Banking Code, cash dividends may not exceed net profits as defined for that year, combined with retained net profits for the two preceding years less any required transfers to surplus. Under this formula, the amount available for payment of dividends in 2011 is \$2,666,060 plus 2012 profits retained up to the date of the dividend declaration.

NOTE 12: REGULATORY MATTERS

Federal regulations require the Company to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2011 and 2010, the FDIC categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier I risk-based, and Tier I Leverage capital ratios must be at least 10 percent, 6 percent, and 5 percent, respectively.

The Company's actual capital ratios are presented in the following table that shows the Company's met all regulatory capital requirements. The capital position of the Bank does not significantly differ from the Company's capital position.

	<u>2011</u>		<u>2010</u>	
	Amount	Ratio	Amount	Ratio
<u>Total Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 23,911	13.32 %	\$ 22,152	12.30 %
For Capital Adequacy Purposes	14,357	8.00	14,411	8.00
To Be Well Capitalized	17,947	10.00	18,013	10.00
<u>Tier I Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 21,653	12.07 %	\$ 19,895	11.04 %
For Capital Adequacy Purposes	7,179	4.00	7,205	4.00
To Be Well Capitalized	10,768	6.00	10,808	6.00
<u>Tier I Capital (to Average Assets)</u>				
Actual	\$ 21,653	8.02 %	\$ 19,895	8.08 %
For Capital Adequacy Purposes	10,805	4.00	9,851	4.00
To Be Well Capitalized	13,507	5.00	12,314	5.00

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13: FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels defined by U.S. generally accepted accounting principles are as follows:

- Level I:** Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II:** Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
- Level III:** Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

This hierarchy requires the use of observable market data when available.

The following tables present the assets reported on the consolidated balance sheet at their fair value as of December 31, 2011 and 2010, respectively, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

DECEMBER 31, 2011

	Level I	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Securities available for sale:				
Negotiable certificates of deposit	\$ —	\$ 490,171	\$ —	\$ 490,171
U.S. government agency securities	—	11,666,008	—	11,666,008
Obligations of states and political subdivisions	—	9,780,962	—	9,780,962
Mortgage-backed securities in government sponsored entities	—	33,853,042	—	33,853,042
Total	\$ —	\$ 55,788,183	\$ —	\$ 55,788,183

DECEMBER 31, 2010

	Level I	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. government agency securities	—	\$ 15,220,932	—	\$ 15,220,932
Obligations of states and political subdivisions	—	5,457,264	—	5,457,264
Mortgage-backed securities in government sponsored entities	—	19,651,389	—	19,651,389
Total	\$ —	\$ 40,329,585	\$ —	\$ 40,329,585

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13: FAIR VALUE MEASUREMENTS (Continued)

The following table presents the assets measured on a nonrecurring basis on the Consolidated Balance Sheets at their fair value as of December 31, 2011 and 2010, by level within the fair value hierarchy. Impaired loans that are collateral-dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secures the impaired loan include: quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III input. Other real estate owned (“OREO”) is measured at fair value, less cost to sell at the date of the foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management. The assets are carried at fair value, less cost to sell. Income and expense from operations and changes in valuation allowance are included in the net expenses from OREO.

DECEMBER 31, 2011

	Level I	Level II	Level III	Total
Assets:				
Impaired Loans	\$ —	\$ —	\$ 4,996,623	\$ 4,996,623
Other real estate owned	—	—	643,191	643,191

DECEMBER 31, 2010

	Level I	Level II	Level III	Total
Assets:				
Impaired Loans	\$ —	\$ —	\$ 2,400,300	\$ 2,400,300
Other real estate owned	—	—	586,286	586,286

NOTE 14. FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company’s financial instruments at December 31 is as follows:

	2011		2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 22,462,096	\$ 22,462,096	\$ 9,741,436	\$ 9,741,436
Investment securities available for sale	55,788,183	55,788,183	40,329,585	40,329,585
Net loans	175,620,259	180,046,000	182,258,643	186,117,000
Bank-owned life insurance	5,412,848	5,412,848	4,240,954	4,240,954
Regulatory stock	1,199,150	1,199,150	1,171,950	1,171,950
Accrued interest receivable	802,003	802,003	787,709	787,709
Financial liabilities:				
Deposits	\$ 227,455,215	\$ 227,978,000	\$ 206,630,968	\$ 207,294,955
Federal Home Loan Bank advances	15,636,902	16,484,029	15,922,361	17,021,072
Subordinated debentures	2,450,000	2,133,947	2,450,000	2,192,260
Accrued interest payable	154,623	154,623	215,419	215,419

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS (Continued)

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. As many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Regulatory Stock, Accrued Interest Receivable, and Accrued Interest Payable

The fair value is equal to the current carrying value.

Investment Securities

The fair value of investment securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans

The fair value is estimated by discounting the future cash flows using a simulation model that estimates future cash flows through the utilization of current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates of fair value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS (Continued)

Deposits, Federal Home Loan Bank Advances, and Subordinated Debentures

Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end. Fair value for time deposits, Federal Home Loan Bank advances, and subordinated debentures is estimated by discounting the future cash flows using a simulation model which estimates future cash flows and constructs discount rates that consider reinvestment opportunities, operating expenses, noninterest income, credit quality, and prepayment risk.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 10.

NOTE 15: OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) components and related taxes were as follows.

	December 31,	
	2011	2010
Unrealized holding gains (losses) on available for sale securities:	\$ 836,058	\$ (397,399)
Reclassification adjustments for gains later recognized into net income:	(112,356)	—
Net unrealized gains (losses):	<u>723,702</u>	<u>(397,399)</u>
Tax effect:	<u>(246,059)</u>	<u>135,116</u>
<i>Other comprehensive income (loss):</i>	<u>\$ 477,643</u>	<u>\$ (262,283)</u>

NOTE 16: SUBSCRIPTION AND SHARE PURCHASE AGREEMENT

The Company offered shares of no par commons stock for purchase through the terms of a Subscription and Share Purchase Agreement (the "Agreement") entered into on January 13, 2011 and ending on February 3, 2011. The Agreement allowed the Company to sell up to 10,000 shares of common stock at an offering price of \$63.10 per share to a limited number of offerees. The minimum purchase by a subscriber was 500 shares. Through the Agreement, the Company sold 6,860 shares of its common stock and received proceeds of \$427,601, net of offering expenses of \$5,265.

NOTE 17: SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2011, through March 29, 2012, for potential recognition and disclosure in the consolidated financial statements. No events have occurred that would require additional adjustments to or disclosure in the consolidated financial statements, which were issued on March 29, 2012.

PORTAGE BANCSHARES, INC.

Officers

Margaret F. Medzie

President

Thomas S. Siciliano

Treasurer

Timothy E. Crock

Secretary

PORTAGE COMMUNITY BANK

Directors

Dr. Aaron A. Moats

Chairman of the Board

Margaret F. Medzie

Vice Chairwoman of the Board

Richard J. Coe

Director

Kevin T. Lewis

Director

Thomas S. Siciliano

Director

Dr. Emilio D. Ferrara

Director

James V. Damicone

Director

Richard L. Leonard

Director

Timothy E. Crock

Director

Divisional Responsibilities

Adam B. Rubin

Vice President, Real Estate Division

Dennis P. Juvan

Registered Representative

Portage Community Financial Services

PORTAGE COMMUNITY BANK

Officers

Richard J. Coe

Chief Executive Officer

Kevin T. Lewis

President & Chief Lending Officer

Donald D. Herman

Vice President & Chief Financial Officer

Constance M. Bennett

Vice President & Chief Operations Officer

Jill M. Conard

Vice President, Main Office Administrator

D. Ty Barksdale

Vice President, Commercial Lending

Douglas L. Blay

Vice President, Commercial Lending

Deborah A. Bish

Vice President, Commercial Lending

Dominic Bellino

Vice President, Loan Operations

Tracy L. Sites

Assistant Vice President, Consumer Lending

Robert S. Standardi

Assistant Vice President, Controller

Thomas M. Biltz

Business Development Officer

Michelle A. Spellman

Operations Officer

Grace H. Beers

Operations Officer

Shelly K. Feciuch

Loan Operations Officer

