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2012 Annual Report



**PORTAGE BANCSHARES, INC.
CONSOLIDATED AUDITED FINANCIAL STATEMENTS
DECEMBER 31, 2012**

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REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders

Portage Bancshares, Inc.

Ravenna, Ohio

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Portage Bancshares, Inc. and subsidiary which comprise the consolidated balance sheet as of December 31, 2012 and 2011; the related consolidated statement of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

A. R. Anodgum, A.C.

Wexford, Pennsylvania

April 16, 2013

**PORTAGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEET**

December 31,

	2012	2011
Assets		
Cash and due from banks	\$ 10,517,434	\$ 21,979,486
Interest-bearing deposits in other financial institutions	1,614,007	410,610
Federal funds sold	80,000	72,000
Cash and cash equivalents	12,211,441	22,462,096
Investment securities available for sale	56,028,665	55,788,183
Loans held for sale	1,027,867	266,016
Loans	192,916,140	178,743,206
Less allowance for loan losses	3,403,695	3,388,963
Net loans	189,512,445	175,354,243
Regulatory stock	1,233,550	1,199,150
Premises and equipment, net	4,026,294	4,097,501
Bank-owned life insurance	5,601,489	5,412,848
Accrued interest receivable	768,478	802,003
Prepaid federal deposit insurance	756,821	948,931
Other assets	1,759,534	2,517,380
Total Assets	\$ 272,926,584	\$ 268,848,351
Liabilities		
Deposits		
Non-interest-bearing	\$ 27,446,904	\$ 24,577,239
Interest-bearing demand	21,954,445	22,327,389
Savings	91,402,321	90,326,001
Time	87,110,836	90,224,586
Total deposits	227,914,506	227,455,215
Federal Home Loan Bank advances	17,021,134	15,636,902
Subordinated debentures	2,450,000	2,450,000
Accrued interest payable and other liabilities	1,436,252	1,134,130
Total Liabilities	248,821,892	246,676,247
Stockholders' Equity		
Common stock, no par value; 800,000 shares authorized, 447,110 and 427,665 shares issued; 430,277 and 417,483 outstanding	15,126,162	14,268,885
Retained earnings	9,383,065	7,985,195
Accumulated other comprehensive income	695,567	518,632
Treasury stock, at cost (16,833 and 10,182 shares, at cost)	(1,100,102)	(600,608)
Total Stockholders' Equity	24,104,692	22,172,104
Total Liabilities and Stockholders' Equity	\$ 272,926,584	\$ 268,848,351

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31,

	2012	2011
Interest and Dividend Income		
Interest and fees on loans	\$ 9,854,230	\$ 10,141,129
Federal funds sold and other interest income	51,105	48,537
Investment securities:		
Taxable	779,033	869,550
Exempt from federal income tax	345,910	213,670
Other dividend income	59,655	56,670
Total interest and dividend income	11,089,933	11,329,556
Interest Expense		
Deposits	1,379,387	2,022,780
Federal Home Loan Bank advances	536,506	572,014
Subordinated debentures	86,596	82,744
Total interest expense	2,002,489	2,677,538
Net Interest Income	9,087,444	8,652,018
Provision for loan losses	1,268,273	1,542,671
Net Interest Income After Provision For Loan Losses	7,819,171	7,109,347
Noninterest Income		
Service charges on deposit accounts	187,004	208,380
Investment securities gains, net	33,277	112,356
Secondary market fees	505,934	387,325
Earnings on bank-owned life insurance	188,641	171,894
Investment banking fees and commissions	199,173	182,570
Other income	227,651	216,350
Total noninterest income	1,341,680	1,278,875
Noninterest Expense		
Salaries and employee benefits	3,493,132	3,355,467
Net occupancy and equipment expenses	407,761	421,935
Data processing	314,211	305,896
Professional fees	248,791	254,386
Marketing and business development	229,179	185,400
Franchise tax expense	276,134	255,704
Federal deposit insurance	208,501	234,205
Loss from other real estate owned	242,926	292,446
Other expense	1,329,803	1,246,525
Total noninterest expense	6,750,438	6,551,964
Income before income taxes	2,410,413	1,836,258
Income taxes	721,138	533,776
Net Income	\$ 1,689,275	\$ 1,302,482
Earnings Per Share		
Basic	\$ 3.98	\$ 3.16
Diluted	3.68	2.87

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31,

	2012	2011
Net income	\$ 1,689,275	\$ 1,302,482
Other comprehensive income:		
Unrealized holding gains on investment securities available for sale	301,361	836,058
Tax effect	(102,463)	(284,260)
Reclassification of investment securities gains recognized in net income	(33,277)	(112,356)
Tax effect	11,314	38,201
Total other comprehensive income	176,935	477,643
Comprehensive income	<u>\$ 1,866,210</u>	<u>\$ 1,780,125</u>

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, 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 income, net			477,643		477,643
Balance, December 31, 2011	14,268,885	7,985,195	518,632	(600,608)	22,172,104
Purchase of 16,506 shares of treasury stock				(1,116,221)	(1,116,221)
Retirement of 5,155 shares of treasury stock	(341,777)			341,777	—
Stock-based compensation expense	67,502				67,502
Exercise of 24,600 shares of stock options	755,150				755,150
Tax benefits from exercise of stock options	324,954				324,954
Issuance of 4,700 shares of common stock for subscription and share purchase agreement	51,448			274,950	326,398
Cash dividends paid (\$0.70 per share)		(291,405)			(291,405)
Net income		1,689,275			1,689,275
Other comprehensive income, net			176,935		176,935
Balance, December 31, 2012	\$ 15,126,162	\$ 9,383,065	\$ 695,567	\$ (1,100,102)	\$ 24,104,692

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31,

	2012	2011
Operating Activities		
Net income	\$ 1,689,275	\$ 1,302,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,268,273	1,542,671
Depreciation	163,592	175,772
Net amortization of securities	822,078	578,208
Investment securities gains, net	(33,277)	(112,356)
Originations of loans held for sale	(18,499,205)	(11,683,575)
Proceeds from sale of loans held for sale	17,737,354	12,689,930
Loss from other real estate owned	242,926	292,446
Stock-based compensation expense	67,502	128,777
Earnings on bank-owned life insurance	(188,641)	(171,894)
Deferred income taxes	27,024	(160,947)
Amortization of deferred loan fees, net	29,449	26,667
Decrease in prepaid federal deposit insurance	192,110	217,232
Amortization of Federal Home Loan Bank restructuring fee	149,399	146,990
Other, net	542,252	201,560
Net cash provided by operating activities	<u>4,210,111</u>	<u>5,173,963</u>
Investing Activities		
Investment securities available for sale:		
Proceeds from repayments and maturities	23,299,624	15,868,656
Proceeds from sales	4,022,405	4,070,856
Purchases	(28,083,230)	(35,140,263)
Purchase of regulatory stock	(34,400)	(27,200)
Decrease (increase) in loans, net	(15,701,761)	3,187,151
Purchase of bank-owned life insurance	—	(1,000,000)
Purchase of premises and equipment	(94,250)	(134,167)
Disposal of premises and equipment	1,865	45
Proceeds from sale of other real estate owned	435,981	526,189
Net cash used for investing activities	<u>(16,153,766)</u>	<u>(12,648,733)</u>
Financing Activities		
Increase in deposits, net	459,291	20,824,247
Proceeds from Federal Home Loan Bank advances	3,500,000	8,136,822
Repayment of Federal Home Loan Bank advances	(2,265,167)	(9,092,810)
Purchases of treasury stock	(1,116,221)	(655,527)
Proceeds from the sale of treasury stock, net	326,398	427,601
Tax benefit from exercise of stock options	324,954	238,459
Proceeds from stock option exercises	755,150	584,141
Cash dividends paid	(291,405)	(267,503)
Net cash provided by financing activities	<u>1,693,000</u>	<u>20,195,430</u>
Increase (decrease) in cash and cash equivalents	(10,250,655)	12,720,660
Cash and Cash Equivalents at Beginning of Year	<u>22,462,096</u>	<u>9,741,436</u>
Cash and Cash Equivalents at End of Year	<u>\$ 12,211,441</u>	<u>\$ 22,462,096</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.

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.

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.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or estimated fair value, as determined on an aggregate basis. Loans held for sale were \$1,027,867 and \$266,016 at December 31, 2012 and 2011, respectively.

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 non accrual 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 non interest 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 non interest 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes (Continued)

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.

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. The director deferral plan expense is comprised of the annual amount of director fees deferred by participating directors and related interest earned.

Stock Options

During the years ended December 31, 2012 and 2011, the Company recorded \$67,502 and \$128,777 in compensation expenses on the Company's Consolidated Statement of Income. As of December 31, 2012 and 2011, there was \$65,213 and \$124,705 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 \$324,954 and \$238,459 of excess tax benefits included as a financing cash inflow for the years ended December 31, 2012 and 2011, 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
2012	1.00%	1.40%	5.35%	7.00

The weighted-average fair value of each stock option granted for 2012 and 2011 was \$4.45 and \$8.60, respectively.

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 424,399 and 412,577 for December 31, 2012 and 2011, respectively. Diluted weighted-average common shares outstanding totaled 459,427 and 454,093 for December 31, 2012 and 2011, 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 investment securities portfolio.

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 2012 and 2011 were \$2,030,133 and \$2,738,334, respectively. Income tax payments totaled \$325,000 in 2012 and \$220,000 in 2011. The Company transferred \$245,837 and \$875,540 of loans from the portfolio to other real estate owned in 2012 and 2011, respectively. Fair value adjustments for securities available for sale in 2012 and 2011 were \$268,082 and \$723,703, 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:

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	6,883,694	74,806	(3,613)	6,954,887
Obligations of states and political subdivisions	16,738,648	467,831	(27,103)	17,179,376
Mortgage-backed securities in government-sponsored entities	31,352,435	604,965	(62,998)	31,894,402
Total	<u>\$ 54,974,777</u>	<u>\$ 1,147,602</u>	<u>\$ (93,714)</u>	<u>\$ 56,028,665</u>

	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	<u>\$ 55,002,377</u>	<u>\$ 893,227</u>	<u>\$ (107,421)</u>	<u>\$ 55,788,183</u>

The amortized cost and fair value of debt securities at December 31, 2012, 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	\$ 3,963,341	\$ 4,063,013
Due after five years through ten years	8,359,350	8,582,058
Due after ten years	11,299,651	11,489,192
Mortgage-backed securities in government-sponsored entities	31,352,435	31,894,402
Total	<u>\$ 54,974,777</u>	<u>\$ 56,028,665</u>

Investment securities with a carrying value of \$13,619,711 and \$14,660,659 at December 31, 2012 and 2011, 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 2012, the Company realized gross gains of \$67,614 and gross losses of \$34,337 as a result of sales of \$4,022,405 in investment securities available for sale. 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.

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:

2012

	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	\$ 498,889	\$ (3,613)	\$ —	\$ —	\$ 498,889	\$ (3,613)
Obligations of states and political subdivisions	2,743,911	(27,103)	—	—	2,743,911	(27,103)
Mortgage-backed securities in government-sponsored entities	4,301,004	(57,729)	222,348	(5,269)	4,523,352	(62,998)
Total	\$ 7,543,804	\$ (88,445)	\$ 222,348	\$ (5,269)	\$ 7,766,152	\$ (93,714)

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)

The Company reviews its position quarterly and has asserted that at December 31, 2012, 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 eighteen positions that were temporarily impaired at December 31, 2012. 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>2012</u>	<u>2011</u>
Commercial loans	\$ 48,846,551	\$ 38,392,521
Commercial real estate loans	70,073,905	68,457,855
Consumer loans	6,726,395	7,285,564
Residential loans	42,216,307	37,906,273
Home equity lines of credit	25,261,729	26,901,221
	<u>193,124,887</u>	<u>178,943,434</u>
Net deferred loan fees	(208,747)	(200,228)
Less allowance for loan losses	(3,403,695)	(3,388,963)
<i>Net loans</i>	<u>\$ 189,512,445</u>	<u>\$ 175,354,243</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, 2012 and 2011, 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 2012, the qualitative factor percentages for commercial loans, commercial real estate loans, residential loans, and home equity lines of credit all increased while the qualitative factors for consumer loans fluctuated minimally during the year. The effect of the levels and trends in delinquencies and changes in volume and terms contributed to the increase in qualitative factor percentages for commercial loans, commercial real estate loans, residential loans, and home equity lines of credit. Another factor contributing to the increase in the qualitative factors relating to the commercial, commercial real estate, residential loan pools, and home equity lines of credit 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, 2012. 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:

2012

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Line of Credit	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 787,109	\$ 1,861,963	\$ 131,129	\$ 402,325	\$ 206,437	\$ —	\$ 3,388,963
Charge-offs	(333,223)	(778,618)	(22,079)	(140,897)	(27,636)	—	(1,302,453)
Recoveries	13,053	14,367	8,900	10,800	1,792	—	48,912
Provision	622,174	360,021	(54,249)	328,324	(27,368)	39,371	1,268,273
Ending balance	\$ 1,089,113	\$ 1,457,733	\$ 63,701	\$ 600,552	\$ 153,225	\$ 39,371	\$ 3,403,695
Ending balance: individually evaluated for impairment	\$ 438,388	\$ 578,018	\$ 25,536	\$ 61,000	\$ —	\$ —	\$ 1,102,942
Ending balance: collectively evaluated for impairment	\$ 650,725	\$ 879,715	\$ 38,165	\$ 539,552	\$ 153,225	\$ 39,371	\$ 2,300,753
Loans receivable:							
Ending balance	\$ 48,846,551	\$ 70,073,905	\$ 6,726,395	\$ 42,216,307	\$ 25,261,729	\$ —	\$ 193,124,887
Ending balance: individually evaluated for impairment	\$ 2,272,136	\$ 2,973,726	\$ 31,553	\$ 165,650	\$ —	\$ —	\$ 5,443,065
Ending balance: collectively evaluated for impairment	\$ 46,574,415	\$ 67,100,179	\$ 6,694,842	\$ 42,050,657	\$ 25,261,729	\$ —	\$ 187,681,822

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	\$ 37,906,273	\$ 26,901,221	\$ —	\$ 178,943,434
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	\$ 37,906,273	\$ 26,901,221	\$ —	\$ 172,623,357

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, 2012 and 2011, 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 Passrated. 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.

	<i>As of December 31, 2012</i>		
	Commercial	Commercial Real Estate	Total
Pass	\$ 42,831,724	\$ 61,686,944	\$ 104,518,668
Special mention	2,198,367	3,959,770	6,158,137
Substandard	3,487,680	4,250,272	7,737,952
Doubtful	328,780	176,919	505,699
Loss	—	—	—
Ending balance	\$ 48,846,551	\$ 70,073,905	\$ 118,920,456

	<i>As of December 31, 2011</i>		
	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	\$ 38,392,521	\$ 68,457,855	\$ 106,850,376

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:

2012

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 6,682,135	\$ 41,424,078	\$ 25,174,215	\$ 73,280,428
Nonperforming	44,260	792,229	87,514	924,003
Total	\$ 6,726,395	\$ 42,216,307	\$ 25,261,729	\$ 74,204,431

2011

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 7,245,461	\$ 37,150,890	\$ 26,820,014	\$ 71,216,365
Nonperforming	40,103	755,384	81,207	876,694
Total	\$ 7,285,564	\$ 37,906,273	\$ 26,901,221	\$ 72,093,058

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:

2012

	30 – 59 Days	60 – 89 Days	90 Days or	Total Past	Current	Nonaccrual	Total Loans
	Past Due	Past Due	Greater & Accruing				
Commercial	\$ 9,691	\$ 22,167	\$ —	\$ 31,858	\$ 48,075,086	\$ 771,465	\$ 48,846,551
Commercial real estate	358,175	—	—	358,175	68,142,551	1,931,354	70,073,905
Consumer	93,816	—	11,251	105,067	6,693,386	33,009	6,726,395
Residential	631,810	51,166	—	682,976	41,424,078	792,229	42,216,307
Home equity lines of credit	156,486	—	—	156,486	25,174,214	87,515	25,261,729
Total	\$ 1,249,978	\$ 73,333	\$ 11,251	\$ 1,334,562	\$ 189,509,315	\$ 3,615,572	\$193,124,887

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 3: LOANS (CONTINUED)

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

	2011						
	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or Greater & Accruing	Total Past Due	Current	Nonaccrual	Total Loans
Commercial loans	\$ 350,986	\$ —	\$ —	\$ 350,986	\$ 37,873,269	\$ 519,252	\$ 38,392,521
Commercial real estate loans	124,451	71,306	—	195,757	65,611,466	2,846,389	68,457,855
Consumer loans	130,721	—	—	130,721	7,245,461	40,103	7,285,564
Residential loans	190,339	—	—	190,339	37,150,889	755,384	37,906,273
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	\$ 174,701,099	\$ 4,242,335	\$ 178,943,434

Interest income that would have been recorded had nonaccrual loans not been placed on nonaccrual status was \$187,103 and \$290,955 in 2012 and 2011, 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:

	2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial loans	\$ 1,616,748	\$ 1,616,748	\$ —	\$ 1,928,313	\$ 101,318
Commercial real estate loans	1,471,168	1,992,576	—	1,900,416	50,309
Consumer loans	6,018	6,018	—	3,764	197
Residential loans	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—
	\$ 3,093,934	\$ 3,615,342	\$ —	\$ 3,832,493	\$ 151,824
With an allowance recorded:					
Commercial loans	\$ 749,136	\$ 749,137	\$ 438,388	\$ 813,720	\$ 18,912
Commercial real estate loans	1,967,925	2,054,110	578,018	1,778,336	13,491
Consumer loans	25,536	25,536	25,536	5,911	—
Residential loans	165,650	165,650	61,000	14,328	122
Home equity loans of credit	—	—	—	—	—
	\$ 2,908,247	\$ 2,994,433	\$ 1,102,942	\$ 2,612,295	\$ 32,525
Total:					
Commercial loans	\$ 2,565,884	\$ 2,365,884	\$ 438,388	\$ 2,742,033	\$ 120,230
Commercial real estate loans	3,439,093	4,046,686	578,018	3,678,752	63,800
Consumer loans	31,553	31,553	25,536	9,675	197
Residential loans	165,650	165,650	61,000	14,328	122
Home equity lines of credit	—	—	—	—	—
	\$ 6,202,180	\$ 6,609,773	\$ 1,102,942	\$ 6,444,788	\$ 184,349

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 3: LOANS (CONTINUED)

Impaired Loans (Continued)

	2011				
	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
		Balance		Investment	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	—	—	—	—	—
	<u>\$ 3,087,258</u>	<u>\$ 3,465,486</u>	<u>\$ —</u>	<u>\$ 1,789,600</u>	<u>\$ 84,182</u>
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	—	—	—	—	—
	<u>\$ 3,232,819</u>	<u>\$ 3,786,838</u>	<u>\$ 1,323,454</u>	<u>\$ 2,298,098</u>	<u>\$ 11,106</u>
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	—	—	—	—	—
	<u>\$ 6,320,077</u>	<u>\$ 7,252,324</u>	<u>\$ 1,323,454</u>	<u>\$ 4,087,698</u>	<u>\$ 95,288</u>

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

	2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Pre-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial loans	1	\$ 120,636	\$ 120,636
Commercial real estate loans	1	450,887	450,887
Commercial real estate loans	2	27,330	25,981
Commercial real estate loans	2	168,650	165,650

	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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: LOANS (CONTINUED)

Troubled Debt Restructurings (Continued)

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 \$31,658 and \$13,307 would have been recognized for the years ended December 31, 2012 and 2011, respectively, at the original interest rate as compared to the adjusted interest rate on the commercial and commercial real estate loans.

The Company had payment defaults on three troubled debt restructuring contracts during 2012 totaling \$426,185. The Company had no payment defaults on troubled debt restructuring contracts in 2011.

NOTE 4: PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	<u>2012</u>	<u>2011</u>
Land and land improvements	\$ 1,561,926	\$ 1,561,926
Building and leasehold improvements	2,851,775	2,846,770
Furniture, fixtures, and equipment	1,695,447	1,608,067
	<u>6,109,148</u>	<u>6,016,763</u>
Less accumulated depreciation	(2,082,854)	(1,919,262)
Total	<u>\$ 4,026,294</u>	<u>\$ 4,097,501</u>

Depreciation charged to operations was \$163,592 in 2012 and \$175,772 in 2011.

NOTE 5: DEPOSITS

Time deposits at December 31, 2012, mature \$63,372,317, \$11,827,215, \$3,993,036, \$3,987,526, \$2,097,363, \$1,108,104, and \$725,275 during 2013, 2014, 2015, 2016, 2017, 2018, and 2019 respectively.

Time deposits include certificates of deposit in denominations of \$100,000 or more. Such deposits aggregated \$4,794,332 and \$4,676,575 at December 31, 2012 and 2011, respectively.

Included in certificates of deposit at December 31, 2012 and 2011, were \$29,410,666 and \$26,990,350, 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 \$981,986 and \$865,332 at December 31, 2012 and 2011, 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		2012	2011
Mortgage match - amortizing	01/01/13	11/01/27	2.29%	\$ 10,884,312	\$ 9,500,080
Mortgage match - non-amortizing	01/06/14	01/06/16	4.69	6,136,822	6,136,822
			3.15%	<u>\$ 17,021,134</u>	<u>\$ 15,636,902</u>

At December 31, 2012, 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, 2012 and December 31, 2011. The Bank has a remaining borrowing capacity of \$24.7 million at December 31, 2012.

The advances were collateralized by \$24,850,856 and \$22,829,877 of first mortgage loans under a blanket lien arrangement at December 31, 2012 and 2011, respectively.

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

Year Ending December 31,	Amount	Weighted- Average Rate
2013	\$ 2,302,498	3.27 %
2014	2,155,098	3.43
2015	4,511,476	3.24
2016	4,539,738	2.12
2017	1,203,761	1.92
Thereafter	2,308,563	1.74
	<u>\$ 17,021,134</u>	3.15 %

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, 2012 and 2011.

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, 2012 and 2011, this equated to 3.16 percent and 3.41 percent, respectively.

NOTE 8: INCOME TAXES

The provision for federal income taxes consists of:

	<u>2012</u>	<u>2011</u>
Current payable	\$ 694,114	\$ 694,723
Deferred	27,024	(160,947)
Total provision	<u>\$ 721,138</u>	<u>\$ 533,776</u>

No valuation allowance was established at December 31, 2012 and 2011, 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>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses	\$ 867,866	\$ 929,173
Accrued expenses and employee benefits	241,647	206,321
Deferred loan fees	53,954	51,663
Stock-based compensation	85,242	75,616
Other	46,164	58,144
Deferred tax assets	<u>1,294,873</u>	<u>1,320,917</u>
Deferred tax liabilities:		
Depreciation	90,398	86,289
Unrealized gain on available-for-sale securities	358,322	267,174
Federal Home Loan Bank stock dividends	45,526	45,526
Prepaid expenses	7,742	10,472
Security accretion	383	782
Deferred tax liabilities	<u>502,371</u>	<u>410,243</u>
Net deferred tax assets	<u>\$ 792,502</u>	<u>\$ 910,674</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:

	<u>2012</u>		<u>2011</u>	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 819,540	34.0 %	\$ 624,328	34.0 %
Tax-exempt interest	(110,450)	(4.6)	(57,649)	(3.1)
Earnings on bank-owned life insurance	(64,138)	(2.7)	(58,444)	(3.2)
Other	76,186	3.2	25,541	1.4
Actual tax expense and effective rate	<u>\$ 721,138</u>	<u>29.9%</u>	<u>\$ 533,776</u>	<u>29.1 %</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 2009.

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 % 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 \$155,404 and \$143,613 for the years ended December 31, 2012 and 2011, 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, 2012 and 2011, was \$664,442 and \$606,826, respectively. The expense related to the plan was \$83,825 and \$80,501 for 2012 and 2011, respectively. Distributions to participants were \$26,209 in 2012 and 2011, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 9: EMPLOYEE BENEFITS (CONTINUED)

Director Deferral Plan

During 2012, the Bank implemented a director deferral plan to provide post-separation payments to participating directors who elect to defer their directors' fees. The plan allows participating directors to defer a portion or all director fees during any plan year. The participants' deferral account balance within the plan is credited annually with interest, based on the Bank's return on equity on a tax deferred basis. The liability recorded at December 31, 2012 was \$46,285. The expense related to the plan was \$46,285 for 2012.

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:

	2012	Weighted-Average Exercise Price	2011	Weighted-Average Exercise Price
Outstanding, January 1	132,892	\$ 44.14	149,559	\$ 42.03
Granted	1,800	67.65	2,600	63.10
Exercised	(24,600)	30.70	(19,267)	30.32
Forfeited	—	—	—	—
Outstanding, December 31	110,092	\$ 47.53	132,892	\$ 44.14
Exercisable at year-end	101,840	\$ 46.29	115,446	\$ 42.15

The following table summarizes the characteristics of stock options at December 31, 2012:

Grant Date	Exercise Price	<i>Outstanding</i>			<i>Exercisable</i>	
		Shares	Remaining Average Life	Average Exercise Price	Shares	Average Exercise Price
1/6/2004	\$ 30.00	16,850	1.01	\$ 30.00	16,850	\$ 30.00
6/15/2005	42.25	17,100	2.45	42.25	17,100	42.25
11/16/2005	45.00	20,500	2.87	45.00	20,500	45.00
1/24/2007	50.00	23,742	4.06	50.00	24,870	50.00
10/22/2008	58.50	27,500	5.81	58.50	22,000	58.50
1/24/2011	63.10	2,600	8.06	63.10	520	63.10
1/25/2012	67.65	1,800	9.07	67.65	—	67.65
		110,092		\$ 47.53	101,840	46.29

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>2012</u>		<u>2011</u>	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused business lines of credit	\$ 7,832,628	\$ 13,782,733	\$ 1,064,942	\$ 10,596,023
Unused construction lines of credit	1,181,027	1,222,330	333,048	318,077
Unused consumer lines of credit	40,309	26,919,323	105,878	21,440,244
Standby letters of credit	—	50,000	—	56,000
Total	<u>\$ 9,053,964</u>	<u>\$ 41,974,386</u>	<u>\$ 1,503,868</u>	<u>\$ 32,410,344</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 2.25 percent to 18.00 percent at December 31, 2012, and 2.30 percent to 18.00 percent at December 31, 2011.

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.

NOTE 11: REGULATORY RESTRICTIONS

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.

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 \$873,000 and \$803,000 for the years ended December 31, 2012 and 2011, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 11: REGULATORY RESTRICTIONS (CONTINUED)

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 2012 is \$3,335,478 plus 2013 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, 2012 and 2011, 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.

	2012		2011	
	Amount	Ratio	Amount	Ratio
<u>Total Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 25,787,925	13.62 %	\$ 23,910,947	13.32 %
For Capital Adequacy Purposes	15,142,328	8.00	14,357,321	8.00
To Be Well Capitalized	18,927,911	10.00	17,946,651	10.00
<u>Tier I Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 23,409,125	12.37 %	\$ 21,653,472	12.07 %
For Capital Adequacy Purposes	7,571,164	4.00	7,178,660	4.00
To Be Well Capitalized	11,356,746	6.00	10,767,991	6.00
<u>Tier I Capital (to Average Assets)</u>				
Actual	\$ 23,409,125	8.53 %	\$ 21,653,472	8.02 %
For Capital Adequacy Purposes	10,976,400	4.00	10,805,440	4.00
To Be Well Capitalized	13,720,500	5.00	13,506,800	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 set forth the Company's financial assets by level within the fair value hierarchy that were measured at fair value on a recurring basis at December 31:

	2012			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. government agency securities	\$ 6,954,887	\$ —	\$ 6,954,887	\$ —
Obligations of states and political subdivisions	17,179,376	—	17,179,376	—
Mortgage-backed securities in government sponsored entities	31,894,402	—	31,894,402	—
Total	\$ 56,028,665	\$ —	\$ 56,028,665	\$ —

	2011			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
Negotiable certificates of deposit	\$ 490,171	\$ —	\$ 490,171	\$ —
U.S. government agency securities	11,664,008	—	11,664,008	—
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	\$ —

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

The Company's investment securities are valued by a third-party pricing service commonly used in the banking industry utilizing observable inputs. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of investment securities with similar characteristics and, because many fixed income investment securities do not trade on a daily basis, apply available information through processes such as benchmark yield curves, benchmarking of like investment securities, sector groupings, and matrix pricing. In addition, model processes, such as an option adjusted spread model, are used to develop prepayment estimates and interest rate scenarios for investment securities with prepayment features.

Management uses a recognized third-party pricing service to obtain fair values for the Company's fixed income securities portfolio. Documentation is maintained as to the methodology and summary of inputs used by the pricing service for the various types of securities, and management notes that the servicer maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Management does not have access to all of the individual specific assumptions and inputs used for each security. The significant observable inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications.

Based on management's review of the methodology and summary of inputs used, management has concluded these assets are properly classified as Level 2 assets.

The following tables set forth the Company's financial and non-financial assets by level within the fair value hierarchy that were measured at fair value on a non-recurring basis at December 31:

2012

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 5,099,238	\$ —	\$ —	\$ 5,099,238
Other real estate owned	207,774	—	—	207,774

2011

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 4,996,623	\$ —	\$ —	\$ 4,996,623
Other real estate owned	643,191	—	—	643,191

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

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.

The following table sets forth quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements at December 31, 2012:

	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Averages)
Impaired loans (collateral-dependent)	\$ 5,099,238	Appraisal of collateral (1)	Appraisal of adjustments (2)	0% - 9% (7.66%)
Other real estate owned	207,774	Appraisal of collateral (1), (3)	Appraisal of adjustments (2)	9%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include various Level III inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions, aging, and/or estimated liquidation expenses incurred when selling collateral. The range and weighted average of appraisal adjustments and liquidation expenses are presented as a percentage of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expense.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

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

2012

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:				
Cash and cash equivalents	\$ 12,211,441	\$12,211,441	\$	\$
Investment securities available for sale	56,028,665		56,028,665	
Loans held for sale	1,027,867	1,027,867		
Net loans	189,512,445			197,396,000
Bank-owned life insurance	5,601,489	5,601,489		
Regulatory stock	1,233,550	1,233,550		
Accrued interest receivable	768,478	768,478		
Financial liabilities:				
Deposits	\$227,914,506	\$140,803,670	\$	\$ 87,944,000
Federal Home Loan Bank advances	17,021,134			17,831,045
Subordinated debentures	2,450,000			1,625,000
Accrued interest payable	126,979	126,979		

2011

	Carrying Value	Fair Value
Financial assets:		
Cash and cash equivalents	\$ 22,462,096	\$ 22,462,096
Investment securities available for sale	55,788,183	55,788,183
Loans held for sale	266,016	266,016
Net loans	175,354,243	180,046,000
Bank-owned life insurance	5,412,848	5,412,848
Regulatory stock	1,199,150	1,199,150
Accrued interest receivable	802,003	802,003
Financial liabilities:		
Deposits	\$ 227,455,215	\$ 227,978,000
Federal Home Loan Bank advances	15,636,902	16,484,029
Subordinated debentures	2,450,000	2,133,947
Accrued interest payable	154,623	154,623

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 Held for Sale

The carrying amount of loans held for sale is the amount funded and approximates fair value due to the insignificant time between origination and date of sale.

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.

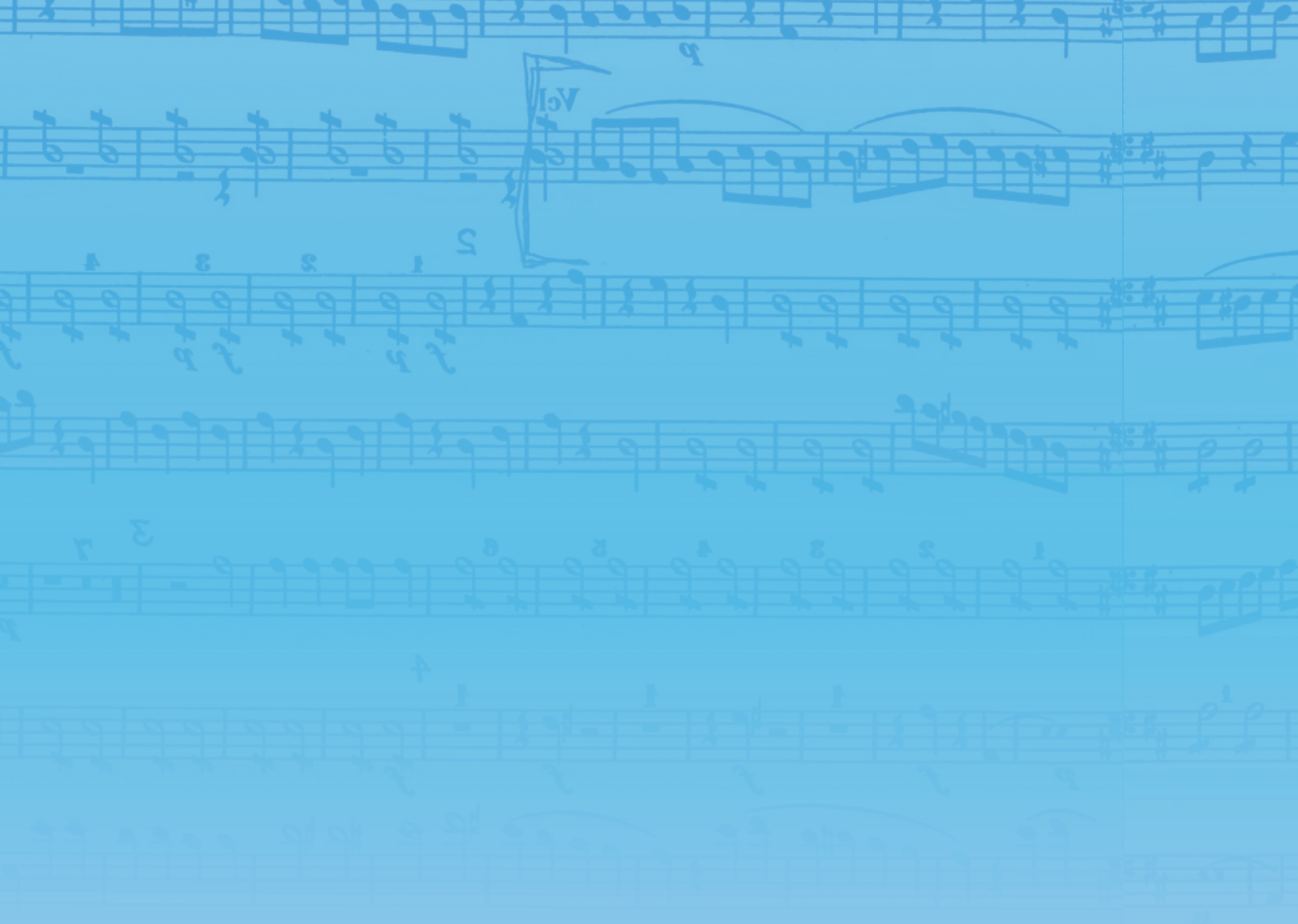
NOTE 15: SUBSCRIPTION AND SHARE PURCHASE AGREEMENT

The Company offered shares of no par common stock for purchase through the terms of the Agreement entered into on June 18, 2012 and ending on June 28, 2012. The Agreement allowed the Company to sell up to 10,000 shares of common stock at an offering price of \$70.15 per share to a limited number of offerees. The minimum purchase by a subscriber was 500 shares. Through the Agreement, the Company sold 4,700 shares of its common stock and received proceeds of \$326,398, net of offering expenses of \$3,307.

The Company offered shares of no par common 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 16: SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2012, through April 16, 2013, 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 April 16, 2013.





**PORTAGE BANCSHARES, INC.
CONSOLIDATED AUDITED FINANCIAL STATEMENTS
DECEMBER 31, 2012**

Report of Independent Auditors **2**

Financial Statements

 Consolidated Balance Sheet. **3**

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 Consolidated Statement of Changes in Stockholders' Equity **6**

 Consolidated Statement of Cash Flows **7**

Notes to Consolidated Financial Statements **8 - 31**

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders

Portage Bancshares, Inc.

Ravenna, Ohio

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Portage Bancshares, Inc. and subsidiary which comprise the consolidated balance sheet as of December 31, 2012 and 2011; the related consolidated statement of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

A. R. Anodgum, A.C.

Wexford, Pennsylvania

April 16, 2013

PORTAGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEET

December 31,

	2012	2011
Assets		
Cash and due from banks	\$ 10,517,434	\$ 21,979,486
Interest-bearing deposits in other financial institutions	1,614,007	410,610
Federal funds sold	80,000	72,000
Cash and cash equivalents	12,211,441	22,462,096
Investment securities available for sale	56,028,665	55,788,183
Loans held for sale	1,027,867	266,016
Loans	192,916,140	178,743,206
Less allowance for loan losses	3,403,695	3,388,963
Net loans	189,512,445	175,354,243
Regulatory stock	1,233,550	1,199,150
Premises and equipment, net	4,026,294	4,097,501
Bank-owned life insurance	5,601,489	5,412,848
Accrued interest receivable	768,478	802,003
Prepaid federal deposit insurance	756,821	948,931
Other assets	1,759,534	2,517,380
Total Assets	\$ 272,926,584	\$ 268,848,351
Liabilities		
Deposits		
Non-interest-bearing	\$ 27,446,904	\$ 24,577,239
Interest-bearing demand	21,954,445	22,327,389
Savings	91,402,321	90,326,001
Time	87,110,836	90,224,586
Total deposits	227,914,506	227,455,215
Federal Home Loan Bank advances	17,021,134	15,636,902
Subordinated debentures	2,450,000	2,450,000
Accrued interest payable and other liabilities	1,436,252	1,134,130
Total Liabilities	248,821,892	246,676,247
Stockholders' Equity		
Common stock, no par value; 800,000 shares authorized, 447,110 and 427,665 shares issued; 430,277 and 417,483 outstanding	15,126,162	14,268,885
Retained earnings	9,383,065	7,985,195
Accumulated other comprehensive income	695,567	518,632
Treasury stock, at cost (16,833 and 10,182 shares, at cost)	(1,100,102)	(600,608)
Total Stockholders' Equity	24,104,692	22,172,104
Total Liabilities and Stockholders' Equity	\$ 272,926,584	\$ 268,848,351

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31,

	2012	2011
Interest and Dividend Income		
Interest and fees on loans	\$ 9,854,230	\$ 10,141,129
Federal funds sold and other interest income	51,105	48,537
Investment securities:		
Taxable	779,033	869,550
Exempt from federal income tax	345,910	213,670
Other dividend income	59,655	56,670
Total interest and dividend income	11,089,933	11,329,556
Interest Expense		
Deposits	1,379,387	2,022,780
Federal Home Loan Bank advances	536,506	572,014
Subordinated debentures	86,596	82,744
Total interest expense	2,002,489	2,677,538
Net Interest Income	9,087,444	8,652,018
Provision for loan losses	1,268,273	1,542,671
Net Interest Income After Provision For Loan Losses	7,819,171	7,109,347
Noninterest Income		
Service charges on deposit accounts	187,004	208,380
Investment securities gains, net	33,277	112,356
Secondary market fees	505,934	387,325
Earnings on bank-owned life insurance	188,641	171,894
Investment banking fees and commissions	199,173	182,570
Other income	227,651	216,350
Total noninterest income	1,341,680	1,278,875
Noninterest Expense		
Salaries and employee benefits	3,493,132	3,355,467
Net occupancy and equipment expenses	407,761	421,935
Data processing	314,211	305,896
Professional fees	248,791	254,386
Marketing and business development	229,179	185,400
Franchise tax expense	276,134	255,704
Federal deposit insurance	208,501	234,205
Loss from other real estate owned	242,926	292,446
Other expense	1,329,803	1,246,525
Total noninterest expense	6,750,438	6,551,964
Income before income taxes	2,410,413	1,836,258
Income taxes	721,138	533,776
Net Income	\$ 1,689,275	\$ 1,302,482
Earnings Per Share		
Basic	\$ 3.98	\$ 3.16
Diluted	3.68	2.87

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31,

	2012	2011
Net income	\$ 1,689,275	\$ 1,302,482
Other comprehensive income:		
Unrealized holding gains on investment securities available for sale	301,361	836,058
Tax effect	(102,463)	(284,260)
Reclassification of investment securities gains recognized in net income	(33,277)	(112,356)
Tax effect	11,314	38,201
Total other comprehensive income	176,935	477,643
Comprehensive income	<u>\$ 1,866,210</u>	<u>\$ 1,780,125</u>

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, 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 income, net			477,643		477,643
Balance, December 31, 2011	14,268,885	7,985,195	518,632	(600,608)	22,172,104
Purchase of 16,506 shares of treasury stock				(1,116,221)	(1,116,221)
Retirement of 5,155 shares of treasury stock	(341,777)			341,777	—
Stock-based compensation expense	67,502				67,502
Exercise of 24,600 shares of stock options	755,150				755,150
Tax benefits from exercise of stock options	324,954				324,954
Issuance of 4,700 shares of common stock for subscription and share purchase agreement	51,448			274,950	326,398
Cash dividends paid (\$0.70 per share)		(291,405)			(291,405)
Net income		1,689,275			1,689,275
Other comprehensive income, net			176,935		176,935
Balance, December 31, 2012	\$ 15,126,162	\$ 9,383,065	\$ 695,567	\$ (1,100,102)	\$ 24,104,692

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31,

	2012	2011
Operating Activities		
Net income	\$ 1,689,275	\$ 1,302,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,268,273	1,542,671
Depreciation	163,592	175,772
Net amortization of securities	822,078	578,208
Investment securities gains, net	(33,277)	(112,356)
Originations of loans held for sale	(18,499,205)	(11,683,575)
Proceeds from sale of loans held for sale	17,737,354	12,689,930
Loss from other real estate owned	242,926	292,446
Stock-based compensation expense	67,502	128,777
Earnings on bank-owned life insurance	(188,641)	(171,894)
Deferred income taxes	27,024	(160,947)
Amortization of deferred loan fees, net	29,449	26,667
Decrease in prepaid federal deposit insurance	192,110	217,232
Amortization of Federal Home Loan Bank restructuring fee	149,399	146,990
Other, net	542,252	201,560
Net cash provided by operating activities	<u>4,210,111</u>	<u>5,173,963</u>
Investing Activities		
Investment securities available for sale:		
Proceeds from repayments and maturities	23,299,624	15,868,656
Proceeds from sales	4,022,405	4,070,856
Purchases	(28,083,230)	(35,140,263)
Purchase of regulatory stock	(34,400)	(27,200)
Decrease (increase) in loans, net	(15,701,761)	3,187,151
Purchase of bank-owned life insurance	—	(1,000,000)
Purchase of premises and equipment	(94,250)	(134,167)
Disposal of premises and equipment	1,865	45
Proceeds from sale of other real estate owned	435,981	526,189
Net cash used for investing activities	<u>(16,153,766)</u>	<u>(12,648,733)</u>
Financing Activities		
Increase in deposits, net	459,291	20,824,247
Proceeds from Federal Home Loan Bank advances	3,500,000	8,136,822
Repayment of Federal Home Loan Bank advances	(2,265,167)	(9,092,810)
Purchases of treasury stock	(1,116,221)	(655,527)
Proceeds from the sale of treasury stock, net	326,398	427,601
Tax benefit from exercise of stock options	324,954	238,459
Proceeds from stock option exercises	755,150	584,141
Cash dividends paid	(291,405)	(267,503)
Net cash provided by financing activities	<u>1,693,000</u>	<u>20,195,430</u>
Increase (decrease) in cash and cash equivalents	(10,250,655)	12,720,660
Cash and Cash Equivalents at Beginning of Year	<u>22,462,096</u>	<u>9,741,436</u>
Cash and Cash Equivalents at End of Year	<u>\$ 12,211,441</u>	<u>\$ 22,462,096</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.

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.

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.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or estimated fair value, as determined on an aggregate basis. Loans held for sale were \$1,027,867 and \$266,016 at December 31, 2012 and 2011, respectively.

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 non accrual 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 non interest 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 non interest 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes (Continued)

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.

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. The director deferral plan expense is comprised of the annual amount of director fees deferred by participating directors and related interest earned.

Stock Options

During the years ended December 31, 2012 and 2011, the Company recorded \$67,502 and \$128,777 in compensation expenses on the Company's Consolidated Statement of Income. As of December 31, 2012 and 2011, there was \$65,213 and \$124,705 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 \$324,954 and \$238,459 of excess tax benefits included as a financing cash inflow for the years ended December 31, 2012 and 2011, 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
2012	1.00%	1.40%	5.35%	7.00

The weighted-average fair value of each stock option granted for 2012 and 2011 was \$4.45 and \$8.60, respectively.

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 424,399 and 412,577 for December 31, 2012 and 2011, respectively. Diluted weighted-average common shares outstanding totaled 459,427 and 454,093 for December 31, 2012 and 2011, 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 investment securities portfolio.

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 2012 and 2011 were \$2,030,133 and \$2,738,334, respectively. Income tax payments totaled \$325,000 in 2012 and \$220,000 in 2011. The Company transferred \$245,837 and \$875,540 of loans from the portfolio to other real estate owned in 2012 and 2011, respectively. Fair value adjustments for securities available for sale in 2012 and 2011 were \$268,082 and \$723,703, 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:

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	6,883,694	74,806	(3,613)	6,954,887
Obligations of states and political subdivisions	16,738,648	467,831	(27,103)	17,179,376
Mortgage-backed securities in government-sponsored entities	31,352,435	604,965	(62,998)	31,894,402
Total	<u>\$ 54,974,777</u>	<u>\$ 1,147,602</u>	<u>\$ (93,714)</u>	<u>\$ 56,028,665</u>

	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	<u>\$ 55,002,377</u>	<u>\$ 893,227</u>	<u>\$ (107,421)</u>	<u>\$ 55,788,183</u>

The amortized cost and fair value of debt securities at December 31, 2012, 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	\$ 3,963,341	\$ 4,063,013
Due after five years through ten years	8,359,350	8,582,058
Due after ten years	11,299,651	11,489,192
Mortgage-backed securities in government-sponsored entities	31,352,435	31,894,402
Total	<u>\$ 54,974,777</u>	<u>\$ 56,028,665</u>

Investment securities with a carrying value of \$13,619,711 and \$14,660,659 at December 31, 2012 and 2011, 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 2012, the Company realized gross gains of \$67,614 and gross losses of \$34,337 as a result of sales of \$4,022,405 in investment securities available for sale. 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.

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:

2012

	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	\$ 498,889	\$ (3,613)	\$ —	\$ —	\$ 498,889	\$ (3,613)
Obligations of states and political subdivisions	2,743,911	(27,103)	—	—	2,743,911	(27,103)
Mortgage-backed securities in government-sponsored entities	4,301,004	(57,729)	222,348	(5,269)	4,523,352	(62,998)
Total	\$ 7,543,804	\$ (88,445)	\$ 222,348	\$ (5,269)	\$ 7,766,152	\$ (93,714)

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)

The Company reviews its position quarterly and has asserted that at December 31, 2012, 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 eighteen positions that were temporarily impaired at December 31, 2012. 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>2012</u>	<u>2011</u>
Commercial loans	\$ 48,846,551	\$ 38,392,521
Commercial real estate loans	70,073,905	68,457,855
Consumer loans	6,726,395	7,285,564
Residential loans	42,216,307	37,906,273
Home equity lines of credit	25,261,729	26,901,221
	<u>193,124,887</u>	<u>178,943,434</u>
Net deferred loan fees	(208,747)	(200,228)
Less allowance for loan losses	(3,403,695)	(3,388,963)
<i>Net loans</i>	<u>\$ 189,512,445</u>	<u>\$ 175,354,243</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, 2012 and 2011, 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 2012, the qualitative factor percentages for commercial loans, commercial real estate loans, residential loans, and home equity lines of credit all increased while the qualitative factors for consumer loans fluctuated minimally during the year. The effect of the levels and trends in delinquencies and changes in volume and terms contributed to the increase in qualitative factor percentages for commercial loans, commercial real estate loans, residential loans, and home equity lines of credit. Another factor contributing to the increase in the qualitative factors relating to the commercial, commercial real estate, residential loan pools, and home equity lines of credit 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, 2012. 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:

2012

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Line of Credit	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 787,109	\$ 1,861,963	\$ 131,129	\$ 402,325	\$ 206,437	\$ —	\$ 3,388,963
Charge-offs	(333,223)	(778,618)	(22,079)	(140,897)	(27,636)	—	(1,302,453)
Recoveries	13,053	14,367	8,900	10,800	1,792	—	48,912
Provision	622,174	360,021	(54,249)	328,324	(27,368)	39,371	1,268,273
Ending balance	\$ 1,089,113	\$ 1,457,733	\$ 63,701	\$ 600,552	\$ 153,225	\$ 39,371	\$ 3,403,695
Ending balance: individually evaluated for impairment	\$ 438,388	\$ 578,018	\$ 25,536	\$ 61,000	\$ —	\$ —	\$ 1,102,942
Ending balance: collectively evaluated for impairment	\$ 650,725	\$ 879,715	\$ 38,165	\$ 539,552	\$ 153,225	\$ 39,371	\$ 2,300,753
Loans receivable:							
Ending balance	\$ 48,846,551	\$ 70,073,905	\$ 6,726,395	\$ 42,216,307	\$ 25,261,729	\$ —	\$ 193,124,887
Ending balance: individually evaluated for impairment	\$ 2,272,136	\$ 2,973,726	\$ 31,553	\$ 165,650	\$ —	\$ —	\$ 5,443,065
Ending balance: collectively evaluated for impairment	\$ 46,574,415	\$ 67,100,179	\$ 6,694,842	\$ 42,050,657	\$ 25,261,729	\$ —	\$ 187,681,822

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	\$ 37,906,273	\$ 26,901,221	\$ —	\$ 178,943,434
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	\$ 37,906,273	\$ 26,901,221	\$ —	\$ 172,623,357

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, 2012 and 2011, 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 Passrated. 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.

	<i>As of December 31, 2012</i>		
	Commercial	Commercial Real Estate	Total
Pass	\$ 42,831,724	\$ 61,686,944	\$ 104,518,668
Special mention	2,198,367	3,959,770	6,158,137
Substandard	3,487,680	4,250,272	7,737,952
Doubtful	328,780	176,919	505,699
Loss	—	—	—
Ending balance	\$ 48,846,551	\$ 70,073,905	\$ 118,920,456

	<i>As of December 31, 2011</i>		
	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	\$ 38,392,521	\$ 68,457,855	\$ 106,850,376

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:

2012

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 6,682,135	\$ 41,424,078	\$ 25,174,215	\$ 73,280,428
Nonperforming	44,260	792,229	87,514	924,003
Total	\$ 6,726,395	\$ 42,216,307	\$ 25,261,729	\$ 74,204,431

2011

	Home Equity			Total
	Consumer	Residential	Lines of Credit	
Performing	\$ 7,245,461	\$ 37,150,890	\$ 26,820,014	\$ 71,216,365
Nonperforming	40,103	755,384	81,207	876,694
Total	\$ 7,285,564	\$ 37,906,273	\$ 26,901,221	\$ 72,093,058

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:

2012

	30 – 59 Days	60 – 89 Days	90 Days or	Total Past	Current	Nonaccrual	Total Loans
	Past Due	Past Due	Greater & Accruing				
Commercial	\$ 9,691	\$ 22,167	\$ —	\$ 31,858	\$ 48,075,086	\$ 771,465	\$ 48,846,551
Commercial real estate	358,175	—	—	358,175	68,142,551	1,931,354	70,073,905
Consumer	93,816	—	11,251	105,067	6,693,386	33,009	6,726,395
Residential	631,810	51,166	—	682,976	41,424,078	792,229	42,216,307
Home equity lines of credit	156,486	—	—	156,486	25,174,214	87,515	25,261,729
Total	\$ 1,249,978	\$ 73,333	\$ 11,251	\$ 1,334,562	\$ 189,509,315	\$ 3,615,572	\$193,124,887

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 3: LOANS (CONTINUED)

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

	2011						
	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or Greater & Accruing	Total Past Due	Current	Nonaccrual	Total Loans
Commercial loans	\$ 350,986	\$ —	\$ —	\$ 350,986	\$ 37,873,269	\$ 519,252	\$ 38,392,521
Commercial real estate loans	124,451	71,306	—	195,757	65,611,466	2,846,389	68,457,855
Consumer loans	130,721	—	—	130,721	7,245,461	40,103	7,285,564
Residential loans	190,339	—	—	190,339	37,150,889	755,384	37,906,273
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	\$ 174,701,099	\$ 4,242,335	\$ 178,943,434

Interest income that would have been recorded had nonaccrual loans not been placed on nonaccrual status was \$187,103 and \$290,955 in 2012 and 2011, 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:

	2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial loans	\$ 1,616,748	\$ 1,616,748	\$ —	\$ 1,928,313	\$ 101,318
Commercial real estate loans	1,471,168	1,992,576	—	1,900,416	50,309
Consumer loans	6,018	6,018	—	3,764	197
Residential loans	—	—	—	—	—
Home equity lines of credit	—	—	—	—	—
	\$ 3,093,934	\$ 3,615,342	\$ —	\$ 3,832,493	\$ 151,824
With an allowance recorded:					
Commercial loans	\$ 749,136	\$ 749,137	\$ 438,388	\$ 813,720	\$ 18,912
Commercial real estate loans	1,967,925	2,054,110	578,018	1,778,336	13,491
Consumer loans	25,536	25,536	25,536	5,911	—
Residential loans	165,650	165,650	61,000	14,328	122
Home equity loans of credit	—	—	—	—	—
	\$ 2,908,247	\$ 2,994,433	\$ 1,102,942	\$ 2,612,295	\$ 32,525
Total:					
Commercial loans	\$ 2,565,884	\$ 2,365,884	\$ 438,388	\$ 2,742,033	\$ 120,230
Commercial real estate loans	3,439,093	4,046,686	578,018	3,678,752	63,800
Consumer loans	31,553	31,553	25,536	9,675	197
Residential loans	165,650	165,650	61,000	14,328	122
Home equity lines of credit	—	—	—	—	—
	\$ 6,202,180	\$ 6,609,773	\$ 1,102,942	\$ 6,444,788	\$ 184,349

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 3: LOANS (CONTINUED)

Impaired Loans (Continued)

	2011				
	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
		Balance		Investment	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	—	—	—	—	—
	<u>\$ 3,087,258</u>	<u>\$ 3,465,486</u>	<u>\$ —</u>	<u>\$ 1,789,600</u>	<u>\$ 84,182</u>
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	—	—	—	—	—
	<u>\$ 3,232,819</u>	<u>\$ 3,786,838</u>	<u>\$ 1,323,454</u>	<u>\$ 2,298,098</u>	<u>\$ 11,106</u>
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	—	—	—	—	—
	<u>\$ 6,320,077</u>	<u>\$ 7,252,324</u>	<u>\$ 1,323,454</u>	<u>\$ 4,087,698</u>	<u>\$ 95,288</u>

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

	2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Pre-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial loans	1	\$ 120,636	\$ 120,636
Commercial real estate loans	1	450,887	450,887
Commercial real estate loans	2	27,330	25,981
Commercial real estate loans	2	168,650	165,650

	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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: LOANS (CONTINUED)

Troubled Debt Restructurings (Continued)

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 \$31,658 and \$13,307 would have been recognized for the years ended December 31, 2012 and 2011, respectively, at the original interest rate as compared to the adjusted interest rate on the commercial and commercial real estate loans.

The Company had payment defaults on three troubled debt restructuring contracts during 2012 totaling \$426,185. The Company had no payment defaults on troubled debt restructuring contracts in 2011.

NOTE 4: PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	<u>2012</u>	<u>2011</u>
Land and land improvements	\$ 1,561,926	\$ 1,561,926
Building and leasehold improvements	2,851,775	2,846,770
Furniture, fixtures, and equipment	1,695,447	1,608,067
	<u>6,109,148</u>	<u>6,016,763</u>
Less accumulated depreciation	(2,082,854)	(1,919,262)
Total	<u>\$ 4,026,294</u>	<u>\$ 4,097,501</u>

Depreciation charged to operations was \$163,592 in 2012 and \$175,772 in 2011.

NOTE 5: DEPOSITS

Time deposits at December 31, 2012, mature \$63,372,317, \$11,827,215, \$3,993,036, \$3,987,526, \$2,097,363, \$1,108,104, and \$725,275 during 2013, 2014, 2015, 2016, 2017, 2018, and 2019 respectively.

Time deposits include certificates of deposit in denominations of \$100,000 or more. Such deposits aggregated \$4,794,332 and \$4,676,575 at December 31, 2012 and 2011, respectively.

Included in certificates of deposit at December 31, 2012 and 2011, were \$29,410,666 and \$26,990,350, 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 \$981,986 and \$865,332 at December 31, 2012 and 2011, 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		2012	2011
Mortgage match - amortizing	01/01/13	11/01/27	2.29%	\$ 10,884,312	\$ 9,500,080
Mortgage match - non-amortizing	01/06/14	01/06/16	4.69	6,136,822	6,136,822
			3.15%	<u>\$ 17,021,134</u>	<u>\$ 15,636,902</u>

At December 31, 2012, 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, 2012 and December 31, 2011. The Bank has a remaining borrowing capacity of \$24.7 million at December 31, 2012.

The advances were collateralized by \$24,850,856 and \$22,829,877 of first mortgage loans under a blanket lien arrangement at December 31, 2012 and 2011, respectively.

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

Year Ending December 31,	Amount	Weighted- Average Rate
2013	\$ 2,302,498	3.27 %
2014	2,155,098	3.43
2015	4,511,476	3.24
2016	4,539,738	2.12
2017	1,203,761	1.92
Thereafter	2,308,563	1.74
	<u>\$ 17,021,134</u>	3.15 %

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, 2012 and 2011.

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, 2012 and 2011, this equated to 3.16 percent and 3.41 percent, respectively.

NOTE 8: INCOME TAXES

The provision for federal income taxes consists of:

	<u>2012</u>	<u>2011</u>
Current payable	\$ 694,114	\$ 694,723
Deferred	27,024	(160,947)
Total provision	<u>\$ 721,138</u>	<u>\$ 533,776</u>

No valuation allowance was established at December 31, 2012 and 2011, 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>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses	\$ 867,866	\$ 929,173
Accrued expenses and employee benefits	241,647	206,321
Deferred loan fees	53,954	51,663
Stock-based compensation	85,242	75,616
Other	46,164	58,144
Deferred tax assets	<u>1,294,873</u>	<u>1,320,917</u>
Deferred tax liabilities:		
Depreciation	90,398	86,289
Unrealized gain on available-for-sale securities	358,322	267,174
Federal Home Loan Bank stock dividends	45,526	45,526
Prepaid expenses	7,742	10,472
Security accretion	383	782
Deferred tax liabilities	<u>502,371</u>	<u>410,243</u>
Net deferred tax assets	<u>\$ 792,502</u>	<u>\$ 910,674</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:

	<u>2012</u>		<u>2011</u>	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 819,540	34.0 %	\$ 624,328	34.0 %
Tax-exempt interest	(110,450)	(4.6)	(57,649)	(3.1)
Earnings on bank-owned life insurance	(64,138)	(2.7)	(58,444)	(3.2)
Other	76,186	3.2	25,541	1.4
Actual tax expense and effective rate	<u>\$ 721,138</u>	<u>29.9%</u>	<u>\$ 533,776</u>	<u>29.1 %</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 2009.

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 % 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 \$155,404 and \$143,613 for the years ended December 31, 2012 and 2011, 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, 2012 and 2011, was \$664,442 and \$606,826, respectively. The expense related to the plan was \$83,825 and \$80,501 for 2012 and 2011, respectively. Distributions to participants were \$26,209 in 2012 and 2011, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 9: EMPLOYEE BENEFITS (CONTINUED)

Director Deferral Plan

During 2012, the Bank implemented a director deferral plan to provide post-separation payments to participating directors who elect to defer their directors' fees. The plan allows participating directors to defer a portion or all director fees during any plan year. The participants' deferral account balance within the plan is credited annually with interest, based on the Bank's return on equity on a tax deferred basis. The liability recorded at December 31, 2012 was \$46,285. The expense related to the plan was \$46,285 for 2012.

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:

	2012	Weighted-Average Exercise Price	2011	Weighted-Average Exercise Price
Outstanding, January 1	132,892	\$ 44.14	149,559	\$ 42.03
Granted	1,800	67.65	2,600	63.10
Exercised	(24,600)	30.70	(19,267)	30.32
Forfeited	—	—	—	—
Outstanding, December 31	110,092	\$ 47.53	132,892	\$ 44.14
Exercisable at year-end	101,840	\$ 46.29	115,446	\$ 42.15

The following table summarizes the characteristics of stock options at December 31, 2012:

Grant Date	Exercise Price	<i>Outstanding</i>			<i>Exercisable</i>	
		Shares	Remaining Average Life	Average Exercise Price	Shares	Average Exercise Price
1/6/2004	\$ 30.00	16,850	1.01	\$ 30.00	16,850	\$ 30.00
6/15/2005	42.25	17,100	2.45	42.25	17,100	42.25
11/16/2005	45.00	20,500	2.87	45.00	20,500	45.00
1/24/2007	50.00	23,742	4.06	50.00	24,870	50.00
10/22/2008	58.50	27,500	5.81	58.50	22,000	58.50
1/24/2011	63.10	2,600	8.06	63.10	520	63.10
1/25/2012	67.65	1,800	9.07	67.65	—	67.65
		<u>110,092</u>		\$ 47.53	<u>101,840</u>	46.29

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>2012</u>		<u>2011</u>	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused business lines of credit	\$ 7,832,628	\$ 13,782,733	\$ 1,064,942	\$ 10,596,023
Unused construction lines of credit	1,181,027	1,222,330	333,048	318,077
Unused consumer lines of credit	40,309	26,919,323	105,878	21,440,244
Standby letters of credit	—	50,000	—	56,000
Total	<u>\$ 9,053,964</u>	<u>\$ 41,974,386</u>	<u>\$ 1,503,868</u>	<u>\$ 32,410,344</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 2.25 percent to 18.00 percent at December 31, 2012, and 2.30 percent to 18.00 percent at December 31, 2011.

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.

NOTE 11: REGULATORY RESTRICTIONS

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.

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 \$873,000 and \$803,000 for the years ended December 31, 2012 and 2011, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 11: REGULATORY RESTRICTIONS (CONTINUED)

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 2012 is \$3,335,478 plus 2013 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, 2012 and 2011, 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.

	2012		2011	
	Amount	Ratio	Amount	Ratio
<u>Total Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 25,787,925	13.62 %	\$ 23,910,947	13.32 %
For Capital Adequacy Purposes	15,142,328	8.00	14,357,321	8.00
To Be Well Capitalized	18,927,911	10.00	17,946,651	10.00
<u>Tier I Capital (to Risk-Weighted Assets)</u>				
Actual	\$ 23,409,125	12.37 %	\$ 21,653,472	12.07 %
For Capital Adequacy Purposes	7,571,164	4.00	7,178,660	4.00
To Be Well Capitalized	11,356,746	6.00	10,767,991	6.00
<u>Tier I Capital (to Average Assets)</u>				
Actual	\$ 23,409,125	8.53 %	\$ 21,653,472	8.02 %
For Capital Adequacy Purposes	10,976,400	4.00	10,805,440	4.00
To Be Well Capitalized	13,720,500	5.00	13,506,800	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 set forth the Company's financial assets by level within the fair value hierarchy that were measured at fair value on a recurring basis at December 31:

	2012			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. government agency securities	\$ 6,954,887	\$ —	\$ 6,954,887	\$ —
Obligations of states and political subdivisions	17,179,376	—	17,179,376	—
Mortgage-backed securities in government sponsored entities	31,894,402	—	31,894,402	—
Total	\$ 56,028,665	\$ —	\$ 56,028,665	\$ —

	2011			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
Negotiable certificates of deposit	\$ 490,171	\$ —	\$ 490,171	\$ —
U.S. government agency securities	11,664,008	—	11,664,008	—
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	\$ —

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

The Company's investment securities are valued by a third-party pricing service commonly used in the banking industry utilizing observable inputs. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of investment securities with similar characteristics and, because many fixed income investment securities do not trade on a daily basis, apply available information through processes such as benchmark yield curves, benchmarking of like investment securities, sector groupings, and matrix pricing. In addition, model processes, such as an option adjusted spread model, are used to develop prepayment estimates and interest rate scenarios for investment securities with prepayment features.

Management uses a recognized third-party pricing service to obtain fair values for the Company's fixed income securities portfolio. Documentation is maintained as to the methodology and summary of inputs used by the pricing service for the various types of securities, and management notes that the servicer maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Management does not have access to all of the individual specific assumptions and inputs used for each security. The significant observable inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications.

Based on management's review of the methodology and summary of inputs used, management has concluded these assets are properly classified as Level 2 assets.

The following tables set forth the Company's financial and non-financial assets by level within the fair value hierarchy that were measured at fair value on a non-recurring basis at December 31:

2012

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 5,099,238	\$ —	\$ —	\$ 5,099,238
Other real estate owned	207,774	—	—	207,774

2011

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 4,996,623	\$ —	\$ —	\$ 4,996,623
Other real estate owned	643,191	—	—	643,191

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

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.

The following table sets forth quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements at December 31, 2012:

	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Averages)
Impaired loans (collateral-dependent)	\$ 5,099,238	Appraisal of collateral (1)	Appraisal of adjustments (2)	0% - 9% (7.66%)
Other real estate owned	207,774	Appraisal of collateral (1), (3)	Appraisal of adjustments (2)	9%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include various Level III inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions, aging, and/or estimated liquidation expenses incurred when selling collateral. The range and weighted average of appraisal adjustments and liquidation expenses are presented as a percentage of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expense.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

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

2012

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:				
Cash and cash equivalents	\$ 12,211,441	\$12,211,441	\$	\$
Investment securities available for sale	56,028,665		56,028,665	
Loans held for sale	1,027,867	1,027,867		
Net loans	189,512,445			197,396,000
Bank-owned life insurance	5,601,489	5,601,489		
Regulatory stock	1,233,550	1,233,550		
Accrued interest receivable	768,478	768,478		
Financial liabilities:				
Deposits	\$227,914,506	\$140,803,670	\$	\$ 87,944,000
Federal Home Loan Bank advances	17,021,134			17,831,045
Subordinated debentures	2,450,000			1,625,000
Accrued interest payable	126,979	126,979		

2011

	Carrying Value	Fair Value
Financial assets:		
Cash and cash equivalents	\$ 22,462,096	\$ 22,462,096
Investment securities available for sale	55,788,183	55,788,183
Loans held for sale	266,016	266,016
Net loans	175,354,243	180,046,000
Bank-owned life insurance	5,412,848	5,412,848
Regulatory stock	1,199,150	1,199,150
Accrued interest receivable	802,003	802,003
Financial liabilities:		
Deposits	\$ 227,455,215	\$ 227,978,000
Federal Home Loan Bank advances	15,636,902	16,484,029
Subordinated debentures	2,450,000	2,133,947
Accrued interest payable	154,623	154,623

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 Held for Sale

The carrying amount of loans held for sale is the amount funded and approximates fair value due to the insignificant time between origination and date of sale.

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: SUBSCRIPTION AND SHARE PURCHASE AGREEMENT

The Company offered shares of no par common stock for purchase through the terms of the Agreement entered into on June 18, 2012 and ending on June 28, 2012. The Agreement allowed the Company to sell up to 10,000 shares of common stock at an offering price of \$70.15 per share to a limited number of offerees. The minimum purchase by a subscriber was 500 shares. Through the Agreement, the Company sold 4,700 shares of its common stock and received proceeds of \$326,398, net of offering expenses of \$3,307.

The Company offered shares of no par common 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 16: SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2012, through April 16, 2013, 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 April 16, 2013.

