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HEARTLAND BANCCORP
2012 FINANCIAL STATEMENTS

Heartland BancCorp

Auditor's Report and Consolidated Financial Statements

December 31, 2012 and 2011

Heartland BancCorp
December 31, 2012 and 2011

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BKD LLP
CPAs & Advisors

312 Walnut Street, Suite 3000
Cincinnati, OH 45202-4025
513.621.8300 Fax 513.621.8345 www.bkd.com

Independent Auditor's Report

Board of Directors
Heartland BancCorp
Gahanna, Ohio

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heartland BancCorp and its subsidiaries 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.

BKD, LLP

Cincinnati, Ohio
March 14, 2013

experience BKD

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Heartland BancCorp
Consolidated Balance Sheets
December 31, 2012 and 2011

Assets	**2012**	**2011**
Cash and cash equivalents	$ 22,196,209	$ 25,478,749
Available-for-sale securities	133,165,503	130,740,499
Held-to-maturity securities	6,865,393	8,522,755
Loans, net of allowance for loan losses of $5,425,761 and $4,016,082 at December 31, 2012 and 2011, respectively	395,597,738	387,390,610
Premises and equipment	11,292,861	10,033,014
Federal Reserve and Federal Home Loan Bank stock	1,889,050	1,230,650
Foreclosed assets held for sale	2,606,427	2,029,957
Interest receivable	1,878,136	1,866,830
Goodwill	417,353	417,353
Prepaid FDIC insurance premium	873,214	1,305,828
Other	1,834,649	2,022,439
Total assets	$ 578,616,533	$ 571,038,684

Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Demand	$ 74,237,342	$ 62,561,713
Savings, NOW and money market	183,228,633	173,901,359
Time	229,579,340	252,815,732
Total deposits	487,045,315	489,278,804
Short-term borrowings	29,897,750	24,725,158
Long-term debt	3,093,000	3,093,000
Interest payable and other liabilities	2,855,547	3,186,227
Total liabilities	522,891,612	520,283,189
Shareholders' Equity		
Common stock, without par value; authorized 5,000,000 shares; issued 2012 - 1,541,507 shares, 2011 - 1,537,832 shares	23,131,730	23,071,097
Retained earnings	29,086,743	24,370,699
Accumulated other comprehensive income	3,506,448	3,313,699
Total shareholders' equity	55,724,921	50,755,495
Total liabilities and shareholders' equity	$ 578,616,533	$ 571,038,684

Heartland BancCorp
Consolidated Statements of Income
Years Ended December 31, 2012 and 2011

	2012	2011
Interest Income		
Loans	$ 22,032,899	$ 22,823,350
Securities		
Taxable	2,129,644	2,284,007
Tax-exempt	1,786,602	1,677,482
Other	41,400	36,961
Total interest income	25,990,545	26,821,800
Interest Expense		
Deposits	3,900,074	5,305,838
Borrowings	353,244	388,194
Total interest expense	4,253,318	5,694,032
Net Interest Income	21,737,227	21,127,768
Provision for Loan Losses	3,386,100	2,589,000
Net Interest Income After Provision for Loan Losses	18,351,127	18,538,768
Noninterest Income		
Service charges	1,957,488	2,119,528
Net gains and commissions on loan sales	53,134	52,746
Net realized gains on sales of available-for-sale securities	459,201	10,265
Net realized gains on sales of foreclosed assets	21,359	37,117
(Loss) gain on sale of premises and equipment	(5,568)	93,446
Benefit in excess of life insurance cash value	1,983,025	-
Other	909,471	713,915
Total noninterest income	5,378,110	3,027,017
Noninterest Expense		
Salaries and employee benefits	8,503,139	8,297,597
Net occupancy and equipment expense	1,784,499	1,612,632
Data processing fees	849,418	806,668
Professional fees	754,361	621,853
Marketing expense	395,228	394,054
Printing and office supplies	188,775	207,272
State franchise taxes	586,829	550,335
FDIC Insurance premiums	466,849	493,000
Other	1,976,430	1,666,890
Total noninterest expense	15,505,528	14,650,301
Income Before Income Tax	8,223,709	6,915,484
Provision for Income Taxes	1,524,985	1,846,799
Net Income	$ 6,698,724	$ 5,068,685
Basic Earnings Per Share	$ 4.35	$ 3.30
Diluted Earnings Per Share	$ 4.32	$ 3.27

Heartland BancCorp

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2012 and 2011

	2012	2011
Net Income	$ 6,698,724	$ 5,068,685
Other Comprehensive Income:		
Unrealized gains on available-for-sale securities	$ 751,245	$ 3,647,018
Reclassification adjustment for realized gains on available-for-sale securities included in income	(459,201)	(10,265)
Other comprehensive income, before tax effect	292,044	3,636,753
Tax expense	99,295	1,236,496
Other comprehensive income	192,749	2,400,257
Comprehensive Income	$ 6,891,473	$ 7,468,942

Heartland BancCorp
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2012 and 2011

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, January 1, 2011	1,535,832	$ 23,047,347	$ 21,282,467	$ 913,442	$ -	$ 45,243,256
Net income			5,068,685			5,068,685
Other comprehensvie income				2,400,257		2,400,257
Dividends on common stock, $1.29 per share			(1,980,453)			(1,980,453)
Stock options exercised	3,000	49,500				49,500
Purchase and retirement of stock	(1,000)	(25,750)				(25,750)
Balance, December 31, 2011	1,537,832	23,071,097	24,370,699	3,313,699	-	50,755,495
Net income			6,698,724			6,698,724
Other comprehensvie income				192,749		192,749
Dividends on common stock, $1.29 per share			(1,982,680)			(1,982,680)
Stock option expense		30,839				30,839
Stock options exercised	6,300	103,950				103,950
Purchase and retirement of stock	(2,625)	(74,156)				(74,156)
Balance, December 31, 2012	1,541,507	$ 23,131,730	$ 29,086,743	$ 3,506,448	$ -	$ 55,724,921

Heartland BancCorp

Consolidated Statements of Cash Flows

Years Ended December 31, 2012 and 2011

	2012	2011
Operating Activities		
Net income	$ 6,698,724	$ 5,068,685
Items not requiring (providing) cash		
Depreciation and amortization	667,389	663,064
Provision for loan losses	3,386,100	2,589,000
Amortization of premiums and discounts on securities	715,015	241,275
Amortization of loan fees, net	(328,613)	(258,792)
Deferred income taxes	(1,008,000)	(145,523)
Net realized gains on sale of available-for-sale securities	(459,201)	(10,265)
Net gains on sales of foreclosed assets	(21,359)	(37,117)
Impairment of foreclosed assets	151,656	-
Federal Home Loan Bank stock dividends	-	(200)
Stock option expense	30,839	-
Loss (gain) on sale of premises and equipment	5,568	(93,446)
Gain on sale of loans	(53,134)	(52,746)
Changes in		
Interest receivable	(11,306)	(62,194)
Other assets	(453,916)	108,276
Interest payable and other liabilities	163,397	(949)
Net cash provided by operating activities	9,483,159	8,009,068
Investing Activities		
Purchase of available-for-sale securities	(76,474,138)	(65,681,945)
Purchase of held-to-maturity securities	(1,360,000)	(2,920,009)
Proceeds from maturities of available-for-sale securities	53,631,846	53,090,041
Proceeds from sales of available-for-sale securities	20,459,338	485,895
Proceeds from maturities of held-to-maturity securities	3,011,542	148,643
Purchase of Federal Home Loan Bank Stock	(658,400)	-
Net change in loans	(12,041,037)	(2,081,599)
Purchase of premises and equipment	(1,982,304)	(1,070,144)
Proceeds from sale of premises and equipment	49,500	293,898
Proceeds from sale of foreclosed assets	122,789	556,277
Proceeds from benefit in excess of life insurance cash value	1,983,025	-
Net cash used in investing activities	(13,257,839)	(17,178,943)

Heartland BancCorp

Consolidated Statements of Cash Flows (Continued)

Years Ended December 31, 2012 and 2011

	2012	2011
Financing Activities		
Net increase in demand deposits, money market, NOW and savings accounts	$ 21,002,903	$ 26,222,666
Net (decrease) increase in certificates of deposit	(23,236,392)	1,330,959
Net increase in short-term borrowings	5,172,592	1,224,728
Proceeds from stock options exercised	103,950	49,500
Purchase of common stock	(74,156)	(25,750)
Dividends paid	(2,476,757)	(1,979,206)
Net cash provided by financing activities	492,140	26,822,897
(Decrease) Increase in Cash and Cash Equivalents	(3,282,540)	17,653,022
Cash and Cash Equivalents, Beginning of Year	25,478,749	7,825,727
Cash and Cash Equivalents, End of Year	$ 22,196,209	$ 25,478,749
Supplemental Cash Flows Information		
Interest paid	$ 4,337,723	$ 5,743,276
Income taxes paid (net of refunds)	$ 2,106,458	$ 1,932,921
Supplemental disclosure of noncash investing and financing activities		
Transfers from loans to foreclosed assets held for sale	$ 1,435,364	$ 797,057
Loans to faciliate the sale of foreclosed assets	$ 605,808	$ 516,515
Unrealized gains (losses) on available-for-sale securities	$ 292,044	$ 3,634,753
Dividends payable	$ -	$ 495,324

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Heartland BancCorp ("Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Heartland Bank (the "Bank") and the Bank's wholly-owned subsidiaries, Heartland Mortgage Corporation (inactive), Heartland Investments, Inc. (inactive) and Heartland Insurance, LLC. The Bank is primarily engaged in providing a full range of banking and financial services to individual and corporate customers in Franklin and Licking counties of central Ohio. The Bank is subject to competition from other financial institutions. The Bank is subject to the regulation of certain federal and state agencies and undergoes annual examinations by those regulatory authorities.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of deferred tax assets, and other-than-temporary impairments (OTTI) and fair values of financial instruments.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents.

Pursuant to legislation enacted in 2010, the FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010, through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the $250,000 limit on FDIC insurance per covered institution.

From time to time, the Company's cash accounts may exceed the FDIC's insured limit of $250,000. The Company believes the risk of loss to be very low.

Securities

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses are recorded, net of related income tax effects, in other comprehensive income.

Held-to-maturity securities, which include any security for which the Company has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

For debt securities with fair value below carrying value when the Company does not intend to sell a debt security, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections. The Company recognized no other-than temporary impairment in 2012 and 2011.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

For all loan classes, the accrual of interest is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. For all loan classes, past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

For all loan classes, all interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status

Discounts and premiums on purchased commercial real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

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 income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established if the discounted cash flows, underlying collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default rates derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when 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 construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is recognized on a cash basis after all past due and current principal payments have been made.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Premises and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets.

Federal Reserve and Federal Home Loan Bank Stock

Federal Reserve and Federal Home Loan Bank stock are required investments for institutions that are members of the Federal Reserve and Federal Home Loan Bank systems. The required investment in the common stock is based on a predetermined formula, carried at cost and evaluated for impairment.

Foreclosed Assets Held for Sale

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets.

Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements. There were no changes in the carrying amount of goodwill.

Stock Options

At December 31, 2012, the Company has a share-based employee compensation plan, which is described more fully in Note 13.

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—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

If necessary, the Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries in the U.S. federal jurisdiction. With a few exceptions, the Company is no longer subject to tax authorities for years before 2011. As of December 31, 2012, the Company had no uncertain income tax positions.

Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during each period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized appreciation (depreciation) on available-for-sale securities.

Marketing Costs

Marketing costs are expensed as incurred.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Restriction on Cash and Due From Banks

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2012 was $7,053,000.

Note 3: Securities

The amortized cost and approximate fair values, together with gross unrealized gains and losses, of securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available-for-sale Securities:				
December 31, 2012:				
U.S. government agencies	$ 24,829	$ 77	$ (8)	$ 24,898
Mortgage-backed securities of U.S. Government sponsored enterprises	54,827	1,351	(351)	55,827
State and political subdivisions	48,197	4,292	(48)	52,441
	$ 127,853	$ 5,720	$ (407)	$ 133,166
December 31, 2011:				
U.S. government agencies	$ 32,807	$ 120	$ (1)	$ 32,926
Mortgage-backed securities of U.S. Government sponsored enterprises	51,010	1,746	(43)	52,713
State and political subdivisions	41,903	3,218	(20)	45,101
	$ 125,720	$ 5,084	$ (64)	$ 130,740

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Held-to-maturity Securities:				
December 31, 2012:				
State and political subdivisions	$ 6,865	$ 838	$ (18)	$ 7,685
December 31, 2011:				
State and political subdivisions	$ 8,523	$ 642	$ (3)	$ 9,162

The amortized cost and fair value of available-for-sale securities and held-to-maturity securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$ 382	$ 382	$ 258	$ 257
One to five years	12,516	12,803	1,199	1,281
Five to ten years	23,043	24,731	4,408	4,926
After ten years	37,085	39,423	1,000	1,221
	73,026	77,339	6,865	7,685
Mortgage-backed securities of U.S. Government sponsored entities	54,827	55,827	-	-
Totals	$ 127,853	$ 133,166	$ 6,865	$ 7,685

The carrying value, which equals fair value, of securities pledged as collateral, to secure public deposits and for other purposes, was $58,577,000 at December 31, 2012 and $48,560,000 at December 31, 2011.

Gross gains of $459,000 and $10,000 resulting from sales of available-for-sale securities were realized for 2012 and 2011, respectively. There were no losses resulting from the sale of available-for-sale securities for 2012 and 2011.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2012 and 2011 was $35,057,000 and $13,245,000, which is approximately 25% and 9%, respectively, of the Company's available-for-sale and held-to-maturity investment portfolio. These declines primarily resulted from changes in market interest rates. Management believes the declines in fair value for these securities are temporary.

The following tables show the Company's investments' gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011:

December 31, 2012

Description of Securities	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
U.S. Government agencies	$ 4,206	$ (8)	$ -	$ -	$ 4,206	$ (8)
Mortgage-backed securities of U.S. Government sponsored enterprises	26,253	(351)	-	-	26,253	(351)
State and political subdivisions	4,308	(65)	290	(1)	4,598	(66)
Total temporarily impaired securities	$ 34,767	$ (424)	$ 290	$ (1)	$ 35,057	$ (425)

December 31, 2011

Description of Securities	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
U.S. Government agencies	$ 1,999	$ (1)	$ -	$ -	$ 1,999	$ (1)
Mortgage-backed securities of U.S. Government sponsored enterprises	8,547	(43)	-	-	8,547	(43)
State and political subdivisions	1,766	(5)	933	(18)	2,699	(23)
Total temporarily impaired securities	$ 12,312	$ (49)	$ 933	$ (18)	$ 13,245	$ (67)

The unrealized losses on the Company's investments in U.S. Government agencies, Mortgage-backed securities of U.S. Government sponsored enterprises and securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2012.

Note 4: Loans and Allowance for Loan Losses

Classes of loans at December 31, include:

	2012	2011
Commercial	$ 36,823	$ 30,640
Commercial real estate	252,598	259,357
Residential real estate	98,302	86,937
Consumer	13,468	14,644
Total loans	401,191	391,578
Less		
Net deferred loan fees, premiums and discounts	(167)	(171)
Allowance for loan losses	(5,426)	(4,016)
Net loans	$ 395,598	$ 387,391

The risk characteristics of each loan portfolio segment are as follows:

Commercial (Non-Real Estate)

Commercial loans are based on the identified cash flows of the borrower and on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate

These loans are viewed as cash flow loans with a significant emphasis on the value of real estate securing the loan. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type within the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, market area, risk grade criteria, and concentrations. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus higher risk non-owner occupied loans.

Residential Real Estate and Consumer

With respect to residential loans that are secured by one- to four-family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio of 80% and requires private mortgage insurance of 35% coverage if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in one- to four-family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. The security value can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2012 and 2011.

	2012					
	Commercial	Commercial Real Estate	Residential 1-4 family	Residential Home Equity	Consumer	Total
December 31, 2012:						
Allowance for loan losses:						
Balance, beginning of year	$ 433	$ 3,028	$ 146	$ 187	$ 222	$ 4,016
Provision charged to expense	253	2,466	313	72	282	3,386
Losses charged off	(120)	(1,465)	(100)	(87)	(264)	(2,036)
Recoveries	7	8	7	7	31	60
Balance, end of year	$ 573	$ 4,037	$ 366	$ 179	$ 271	$ 5,426
Ending balance: individually evaluated for impairment	$ 320	$ 1,824	$ 95	$ 44	$ 50	$ 2,333
Ending balance: collectively evaluated for impairment	$ 253	$ 2,213	$ 271	$ 135	$ 221	$ 3,093
Loans:						
Ending balance	$ 36,823	$ 252,598	$ 79,540	$ 18,762	$ 13,468	$ 401,191
Ending balance: individually evaluated for impairment	$ 3,833	$ 15,232	$ 1,000	$ 227	$ 527	$ 20,819
Ending balance: collectively evaluated for impairment	$ 32,990	$ 237,366	$ 78,540	$ 18,535	$ 12,941	$ 380,372

	2011					
	Commercial	Commercial Real Estate	Residential 1-4 family	Residential Home Equity	Consumer	Total
December 31, 2011:						
Allowance for loan losses:						
Balance, beginning of year	$ 450	$ 2,800	$ 111	$ 229	$ 282	$ 3,872
Provision charged to expense	191	2,137	46	54	161	2,589
Losses charged off	(219)	(1,922)	(11)	(98)	(255)	(2,505)
Recoveries	11	13	-	2	34	60
Balance, end of year	$ 433	$ 3,028	$ 146	$ 187	$ 222	$ 4,016
Ending balance: individually evaluated for impairment	$ 225	$ 826	$ -	$ -	$ -	$ 1,051
Ending balance: collectively evaluated for impairment	$ 208	$ 2,202	$ 146	$ 187	$ 222	$ 2,965
Loans:						
Ending balance	$ 30,640	$ 259,357	$ 66,325	$ 20,612	$ 14,644	$ 391,578
Ending balance: individually evaluated for impairment	$ 1,835	$ 10,446	$ -	$ -	$ -	$ 12,281
Ending balance: collectively evaluated for impairment	$ 28,805	$ 248,911	$ 66,325	$ 20,612	$ 14,644	$ 379,297

Internal Risk Categories

Loan grades are numbered 1 through 8. Grades 1 through 4 are considered satisfactory grades. The grade of 5, or Special Mention, represents loans of lower quality and signs of potential weakness. The grades of 6, or Substandard, and 7, or Doubtful, refer to assets that are classified. The use and application of these grades by the Company will be uniform and shall conform to the Company's policy.

Excellent (1) loans are of superior quality with excellent credit strength and repayment ability proving a nominal credit risk.

Good (2) loans are of above average credit strength and repayment ability proving only a minimal credit risk.

Satisfactory (3) loans are of reasonable credit strength and repayment ability proving an average credit risk due to one or more underlying weaknesses.

Special Mention (5) assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6) loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful (7) loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (8) loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off even though partial recovery may be affected in the future.

The following tables present the credit risk profile of the Company's loan portfolio based on the Company's internal rating categories as of December 31, 2012 and 2011:

2012	Commercial	Commercial Real Estate	Residential 1-4 Family	Residential Home Equity	Consumer	Total
Pass	$ 30,702	$ 231,328	$ 78,321	$ 18,400	$ 13,238	$ 371,989
Special mention	2,187	7,298	166	135	11	9,797
Substandard	3,934	13,972	1,053	227	198	19,384
Doubtful	-	-	-	-	21	21
Loss	-	-	-	-	-	-
Total	$ 36,823	$ 252,598	$ 79,540	$ 18,762	$ 13,468	$ 401,191

2011	Commercial	Commercial Real Estate	Residential 1-4 Family	Residential Home Equity	Consumer	Total
Pass	$ 25,063	$ 238,681	$ 64,018	$ 20,432	$ 14,453	$ 362,647
Special mention	1,544	7,440	784	103	18	9,889
Substandard	4,033	13,236	1,523	77	173	19,042
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	$ 30,640	$ 259,357	$ 66,325	$ 20,612	$ 14,644	$ 391,578

Approximately $141,236,000 in 2012 and $148,533,000 in 2011 of commercial real estate is owner occupied.

The following tables present the Company's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2012 and 2011:

2012	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Commercial	$ 495	$ 95	$ 1,615	$ 2,205	$ 34,618	$ 36,823	$ 57
Commercial real estate	1,526	98	10,220	11,844	240,754	252,598	2,086
Residential 1-4 family	688	211	1,000	1,899	77,641	79,540	418
Residential home equity	69	61	213	343	18,419	18,762	129
Consumer	61	-	158	219	13,249	13,468	17
Total	$ 2,839	$ 465	$ 13,206	$ 16,510	$ 384,681	$ 401,191	$ 2,707

	2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Commercial	$ 104	$ 25	$ 2,003	$ 2,132	$ 28,508	$ 30,640	$ 1,733
Commercial real estate	3,187	3,691	7,857	14,735	244,622	259,357	2,153
Residential 1-4 family	2,404	45	1,058	3,507	62,818	66,325	482
Residential home equity	118	74	62	254	20,358	20,612	-
Consumer	144	77	97	318	14,326	14,644	12
Total	$ 5,957	$ 3,912	$ 11,077	$ 20,946	$ 370,632	$ 391,578	$ 4,380

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings.

The following tables present impaired loans for the years ended December 31, 2012 and 2011:

	2012				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Commercial	$ 2,643	$ 2,718	$ -	$ 2,886	$ 123
Commercial real estate	8,371	8,621	-	10,222	472
Residential 1-4 family	482	481	-	482	-
Residential home equity	84	95	-	96	-
Consumer	422	422	-	481	11
Loans with a specific valuation allowance:					
Commercial	1,190	1,243	320	1,266	-
Commercial real estate	6,861	7,477	1,824	7,977	84
Residential 1-4 family	518	518	95	518	23
Residential home equity	143	143	44	145	4
Consumer	105	105	50	110	-
Total:					
Commercial	3,833	3,961	320	4,152	123
Commercial real estate	15,232	16,098	1,824	18,199	556
Residential 1-4 family	1,000	999	95	1,000	23
Residential home equity	227	238	44	241	4
Consumer	527	527	50	591	11
Totals	$ 20,819	$ 21,823	$ 2,333	$ 24,183	$ 717

	2011				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Commercial	$ 1,168	$ 1,240	$ -	$ 1,287	$ 80
Commercial real estate	7,605	8,162	-	8,584	327
Residential 1-4 family	-	-	-	-	-
Residential home equity	-	-	-	-	-
Consumer	-	-	-	-	-
Loans with a specific valuation allowance:					
Commercial	667	671	225	699	40
Commercial real estate	2,841	3,950	826	3,403	21
Residential 1-4 family	-	-	-	-	-
Residential home equity	-	-	-	-	-
Consumer	-	-	-	-	-
Total:					
Commercial	1,835	1,911	225	1,986	120
Commercial real estate	10,446	12,112	826	11,987	348
Residential	-	-	-	-	-
Consumer	-	-	-	-	-
Totals	$ 12,281	$ 14,023	$ 1,051	$ 13,973	$ 468

Interest income recognized is not materially different than interest income that would have been recognized on a cash basis.

The following table presents the Company’s nonaccrual loans at December 31, 2012 and 2011. This table excludes performing troubled debt restructurings.

	2012	2011
Commercial	$ 1,756	$ 270
Commercial real estate	8,113	5,747
Residential 1-4 family	582	576
Residential home equity	99	62
Consumer	145	85
Total nonaccrual	$ 10,695	$ 6,740

As a result of adopting the amendments in Accounting Standards Update No. 2011-02 (the ASU), the Company assessed all restructurings that occurred on or after the beginning of its current fiscal year for identification as troubled debt restructurings. At December 31, 2012 and 2011, the Company had a number of loans that were modified in troubled debt restructurings and impaired. The modification of terms of such loans included one or a combination of the following: an extension of maturity, interest only terms or a combination of both.

The following table presents information regarding troubled debt restructurings by class for the year ended December 31, 2012 and 2011:

Newly classified troubled debt restructurings:

	2012		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial	5	$ 725	$ 725
Commercial Real Estate	8	3,627	3,627
Residential 1-4 faimly	-	-	-
Residential home equity	-	-	-
Consumer	7	388	388
	20	$ 4,740	$ 4,740

	2011		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial	-	$ -	$ -
Commercial Real Estate	1	196	196
Residential 1-4 faimly	-	-	-
Residential home equity	-	-	-
Consumer	-	-	-
	1	$ 196	$ 196

The troubled debt restructurings described above did not increase the allowance for loan losses and did not result in charge offs during the years ended December 31, 2012 and 2011.

Newly restructured loans by type of modification:

2012

	Interest Only Terms	Extension of Maturity	Combination	Total Modification
Commercial	$ 89	$ 539	$ 97	$ 725
Commercial Real Estate	985	2,642	-	3,627
Residential 1-4 faimly	-	-	-	-
Residential home equity	-	-	-	-
Consumer	-	109	279	388
	$ 1,074	$ 3,290	$ 376	$ 4,740

2011

	Interest Only Terms	Extension of Maturity	Combination	Total Modification
Commercial	$ -	$ -	$ -	$ -
Commercial Real Estate	-	196	-	196
Residential 1-4 faimly	-	-	-	-
Residential home equity	-	-	-	-
Consumer	-	-	-	-
	$ -	$ 196	$ -	$ 196

There were two troubled debt restructurings modified in 2012 that subsequently defaulted and were commercial real estate loans totaling $317,000. There were no loans modified in 2011 that subsequently defaulted.

Note 5: Premises and Equipment

Major classifications of premises and equipment, stated at cost, are as follows:

	2012	2011
Land and improvements	$ 3,989	$ 3,871
Building and improvements	8,873	7,506
Equipment	6,905	6,492
	19,767	17,869
Less accumulated depreciation	(8,474)	(7,836)
Net premises and equipment	$ 11,293	$ 10,033

Note 6: Interest-bearing Time Deposits

Interest-bearing time deposits in denominations of $100,000 or more were $95,985,095 on December 31, 2012 and $106,196,000 on December 31, 2011.

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

2013	$ 102,789
2014	65,143
2015	30,025
2016	25,710
2017	5,912
Total time deposits	$ 229,579

Note 7: Short-term Borrowings

Short-term borrowings consisted of the following at December 31:

	2012	2011
Securities sold under repurchase agreements	$ 29,898	$ 19,725
Federal Home Loan Bank advances - fixed at 0.40% and maturing in 2012	-	5,000
	$ 29,898	$ 24,725

Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by U. S. Government Agency, FHLB, FHLMC, FNMA and municipal securities and such collateral is held in safekeeping with a third party. The maximum amount of outstanding agreements at any month end during 2012 and 2011 totaled $29,898,000 and $26,816,000, respectively, and the daily average of such agreements totaled $24,663,000 and $22,786,000 for 2012 and 2011, respectively. These agreements mature daily.

The Company has a Federal Funds Borrowing Line Agreement with US Bank and PNC Bank that allows the Company to purchase up to $10,000,000 and $5,000,000 in Federal Funds, respectively.

The Company has a cash management advance (CMA) line of credit with the Federal Home Loan Bank (FHLB). FHLB borrowings are collateralized by all shares of FHLB stock owned by the Bank and by the Bank's qualified residential mortgage loans.

At December 31, 2012 and 2011, the Company has $45,000,000 and $40,000,000, respectively, available on its CMA line of credit. The CMA application expires on February 22, 2013. The Company has the option of selecting a variable interest rate set daily for 90 days or a fixed interest rate for a maximum of thirty days. Variable interest rates are set daily based upon the FHLB's published interest rates. Variable interest rate advances are prepayable with no fee. The fixed rate is not prepayable prior to maturity.

Note 8: Long-term Debt

The Company issued $3,000,000 of 10.60% capital securities through a special purpose entity as part of a pooled offering. The Company's obligated mandatory redeemable capital securities may be redeemed by the Company prior to their mandatory September 7, 2030 redemption date commencing September 7, 2010 at a redemption price of 105.30% of the face value of the capital securities and thereafter at a premium that declines annually. On or after September 7, 2020, the capital securities may be redeemed at face value. The Company's mandatory redeemable capital securities are considered to be Tier I capital for regulatory reporting purposes. Debt issuance costs have been capitalized and are being amortized over the term of the securities. See footnote 18.

Note 9: Income Taxes

The provision for income taxes includes these components:

	2012	2011
Taxes currently payable	$ 2,533	$ 1,992
Deferred income taxes	(1,008)	(145)
Income tax expense	$ 1,525	$ 1,847

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is shown below:

	2012	2011
Computed at the statutory rate (34%)	$ 2,797	$ 2,351
Increase (decrease) resulting from		
Tax exempt interest	(619)	(549)
Nondeductible expenses	-	15
Cash surrender value, net of premiums	(695)	(7)
Other	42	37
Actual tax expense	$ 1,525	$ 1,847

The tax effects of temporary differences related to deferred taxes shown on the balance sheets were:

	2012	2011
Deferred tax assets		
Allowance for loan losses	$ 1,845	$ 1,305
Deferred compensation	607	592
Nonaccrual of loan interest	437	34
Stock option expense	24	-
Foreclosed assets held for sale	72	63
Other	6	30
	2,991	2,024
Deferred tax liabilities		
Depreciation	(210)	(203)
Purchase accounting adjustments	(37)	(42)
FHLB stock dividends	(152)	(152)
Prepaid expenses	(29)	(72)
Unrealized gains on available-for-sale securities	(1,806)	(1,707)
	(2,234)	(2,176)
Net deferred tax asset (liability)	$ 757	$ (152)

Note 10: Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting guidelines. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Furthermore, the Company's regulators could require adjustments to regulatory capital not reflected in these financial statements.

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

As of December 31, 2012, the most recent notification from the Federal Reserve categorized the Company and Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Company and Bank must maintain capital ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Company or Bank's category.

The Company's and Bank's actual capital amounts and ratios are also presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	$ 59,770	15.3%	$ 31,197	8.0%	$ 38,997	10.0%
Bank	54,360	14.1%	31,748	8.0%	39,685	10.0%
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	54,895	14.1%	15,599	4.0%	23,398	6.0%
Bank	50,854	12.8%	15,874	4.0%	23,811	6.0%
Tier I Capital						
(to Average Assets)						
Consolidated	54,895	9.5%	23,066	4.0%	28,833	5.0%
Bank	50,854	8.8%	23,048	4.0%	28,810	5.0%
As of December 31, 2011						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	$ 54,134	14.4%	$ 30,111	8.0%	$ 37,639	10.0%
Bank	50,763	13.5%	30,083	8.0%	37,604	10.0%
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	50,118	13.3%	15,055	4.0%	22,583	6.0%
Bank	46,747	12.4%	15,042	4.0%	22,562	6.0%
Tier I Capital						
(to Average Assets)						
Consolidated	50,118	8.9%	22,599	4.0%	28,248	5.0%
Bank	46,747	8.2%	22,582	4.0%	28,228	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Generally, the Bank's payment of dividends is limited to net income for the current year plus the two preceding calendar years, less capital distributions paid over the comparable time period.

Note 11: Related Party Transactions

At December 31, 2012 and 2011, the Bank had loans outstanding and lines of credit available to executive officers, directors, significant shareholders and their affiliates (related parties), in the amount of $16,848,000 and $19,479,000, respectively.

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons.

Further, in management's opinion, these loans did not involve more than normal risk of collectibility or present other unfavorable features.

Deposits from related parties held by the Bank at December 31, 2012 and 2011 totaled $8,838,000 and $6,818,000, respectively.

Note 12: Employee Benefits

The Company has a retirement savings 401(k) plan covering substantially all employees. Employees may contribute up to the maximum amount allowable by the Internal Revenue Service with the Company matching 50% of the employee's contribution not to exceed 3% of the employee's compensation. In addition, the Company may make additional discretionary contributions allocated to all eligible participants based on compensation. Employee contributions are always 100% vested. Employer contributions vest 20% annually until the employee becomes fully vested after five years of participation in the plan. Employer contributions charged to expense for 2012 and 2011 were $121,000 and $120,000, respectively.

The Company has supplemental retirement plans for certain senior officers. Officers in the plans, upon retirement, will receive annually for fifteen years 50% of their final annual payroll amount exclusive of incentive and bonus amounts and reduced by 401(k) or 401(k) and social security retirement benefits. The plans are uniquely designed for each participant. The charge to expense for 2012 and 2011 were $180,000 and $192,000, respectively. Such charges reflect the straight-line accrual over the period until full eligibility of the present value of benefits due each participant on the full eligibility date, using a 6% discount factor. The resulting liability at December 31, 2012 and 2011 was $1,785,000 and $1,740,000, respectively. The Company purchased life insurance on the participants. The cash surrender value of such insurance was $995,000 and $1,537,000 at December 31, 2012 and 2011, respectively and is included in other assets.

The Bank has employment agreements with two officers of the Bank. Under these agreements, the officers are employed for rolling two or three-year periods. Unless the Bank serves a termination notice to the officers before December 31 of each year, the agreements are automatically extended for one additional year. The Bank's Board of Directors approve the officers' base salaries annually. The agreements prohibit the officers from soliciting banking business from customers of the Bank for a period of two years following the termination of the employment agreements.

Note 13: Stock Option Plan

The Company has a fixed option plan under which the Company may grant options to selected directors, Advisory Board Members and employees for up to 249,738 shares of common stock that vest over two years or immediately if the recipient is 65 years old or older. The Company believes that such awards better align the interests of its employees with those of its shareholders. The exercise price of each option is intended to equal the fair value of the Company's stock on the date of grant. An option's maximum term is ten years. The compensation cost for the stock option expense recognized in 2012 totaled $31,000 with a related tax benefit in 2012 of $11,000. The Company deemed the compensation cost and related tax benefit for stock options granted in 2011 to be immaterial to the financial statements. As of December 31, 2012, there was $10,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan.

A summary of the status of the plan at December 31, 2012 and changes during the year then ended is presented below:

	2012			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Instrinsic Value
Outstanding, beginning of year	148,649	$ 27.74		
Granted	-	-		
Exercised	(6,300)	16.50		
Forfeited or expired	(28,877)	28.47		
Outstanding, end of year	113,472	$ 28.17	4.95	$ 602,550
Exercisable, end of year	96,947	$ 28.24	4.33	$ 532,319

There were no options granted in 2012. The total intrinsic value of options exercised during the year ended December 31, 2012 and 2011 was $59,000 and $34,000, respectively. The weighted-average grant-date fair value of options granted during year 2011 was $1.22.

The fair value of each option award granted is estimated on the date of the grant using a Black-Scholes valuation model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses the simplified method to estimate option exercise and employee termination within the valuation model due to lack of historical data. The expected term of options granted represents the period of time that options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2012	2011
Dividend yields	N/A	4.80%
Volatility factors of expected market price of common stock	N/A	12.90%
Risk-free interest rate	N/A	2.17%
Expected life of options	N/A	7.00
Weighted-average fair value of options granted during the year	N/A	$ 1.22

Note 14: Earnings Per Share

Earnings per share (EPS) were computed as follows:

	Year Ended December 31, 2012		
	Income	Weighted-Average Shares	Per Share Amount
Basic earnings per share			
Income available to common stockholders	$ 6,699	1,540,519	$ 4.35
Effect of dilutive securities			
Stock options		11,253	
Diluted earnings per share			
assumed conversions			
stockholders and assumed conversions	$ 6,699	1,551,772	$ 4.32

Options to purchase 76,050 shares of common stock at a weighted-average exercise price of $32.37 per share were outstanding at December 31, 2012, but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares.

	Year Ended December 31, 2011		
	Income	Weighted-Average Shares	Per Share Amount
Basic earnings per share			
Income available to common stockholders	$ 5,069	1,537,231	$ 3.30
Effect of dilutive securities			
Stock options		14,736	
Diluted earnings per share			
assumed conversions			
stockholders and assumed conversions	$ 5,069	1,551,967	$ 3.27

Options to purchase 93,591 shares of common stock at a weighted-average exercise price of $32.67 per share were outstanding at December 31, 2011, but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares.

Note 15: Disclosures about Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Recurring Measurements

The following tables present the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012 and 2011:

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012:				
U.S. government agencies	$ 24,898	$ -	$ 24,898	$ -
Mortgage-backed securities of U.S. government sponsored enterprises	55,827	-	55,827	-
State and political subdivisions	52,441	-	52,441	-
December 31, 2011:				
U.S. government agencies	$ 32,926	$ -	$ 32,926	$ -
Mortgage-backed securities of U.S. Government sponsored enterprises	52,713	-	52,713	-
State and political subdivisions	45,101	-	45,101	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets. There have been no significant changes in the valuation techniques during the year-ended December 31, 2012.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Level 2 securities include U.S. government agencies, Mortgage-backed securities of U.S. government sponsored enterprises, and State and political subdivisions. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

Nonrecurring Measurements

The following tables present the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012 and 2011:

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012:				
Impaired Loans	$ 6,484	$ -	$ -	$ 6,484
December 31, 2011:				
Impaired Loans	$ 3,430	$ -	$ -	$ 3,430

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets.

Collateral-dependent Impaired Loans, Net of ALLL

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by management. Appraisals are reviewed for accuracy and consistency. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by comparison to historical results.

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements.

	Fair Value at 12/31/2012	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Collateral-dependent impaired loans	$ 6,484	Market comparable properties	Selling Cost	10%

Fair Value of Financial Instruments

The following table presents estimated fair values of the Company's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012 and 2011.

		Fair Value Measurements Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservabl e Inputs (Level 3)
December 31, 2012				
Financial assets				
Cash and cash equivalents	$ 22,196	$ 22,196	$ -	$ -
Available-for-sale securities	133,166	-	133,166	-
Held-to-maturity securities	6,865	-	7,685	-
Loans, net of allowance for loan losses	395,598	-	-	414,024
Federal Reserve and Federal Home Loan Bank stock	1,889	-	1,889	-
Interest receivable	1,878	-	1,878	-
Financial liabilities				
Deposits	487,045	-	489,931	-
Short-term borrowings	29,898	-	29,898	-
Long-term debt	3,093	-	3,224	-
Interest payable	220	-	220	-
December 31, 2011				
Financial assets				
Cash and cash equivalents	25,479	25,479	-	-
Available-for-sale securities	130,740	-	130,740	-
Held-to-maturity securities	8,523	-	9,162	-
Loans, net of allowance for loan losses	387,391	-	-	408,502
Federal Reserve and Federal Home Loan Bank stock	1,231	-	1,231	-
Interest receivable	1,867	-	1,867	-
Financial liabilities				
Deposits	489,279	-	493,313	-
Short-term borrowings	24,725	-	24,725	-
Long-term debt	3,093	-	3,765	-
Interest payable	305	-	305	-

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheet at amounts other than fair value.

Cash and Cash Equivalents and Federal Reserve and Federal Home Loan Bank Stock

The carrying amount approximates fair value.

Held-to-maturity Securities

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

Fair value is estimated by discounting the future cash flows using the market rates at which similar notes would be made to borrowers with similar credit ratings and for the same remaining maturities. The market rates used are based on current rates the Bank would impose for similar loans and reflect a market participant assumption about risks associated with nonperformance, illiquidity, and the structure and term of the loans along with local economic and market conditions.

Deposits

Fair value of term deposits is estimated by discounting the future cash flows using rates of similar deposits with similar maturities. The market rates used were obtained from a knowledgeable independent third party and reviewed by the Company. The rates were the average of current rates offered by local competitors of the bank subsidiaries.

The estimated fair value of demand, NOW, savings and money market deposits is the book value since rates are regularly adjusted to market rates and amounts are payable on demand at the reporting date.

Short-term Borrowings and Interest Receivable/Payable

The carrying amount approximates fair value.

FHLB Advances

Fair value is estimated by discounting the future cash flows using rates of similar advances with similar maturities. These rates were obtained from current rates offered by FHLB.

Long-term Debt

The fair value is based on the redemption price pursuant to redemption provisions relating to optional redemption at a price equal to 104.240% of carrying value.

Commitments to Originate Loans, Forward Sale Commitments, Letters of Credit and Lines of Credit

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The fair value of forward sale commitments is estimated based on current market prices for loans of similar terms and credit quality. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair values of commitments were not material at December 31, 2012 and 2011.

Note 16: Commitments and Credit Risk

As of December 31, 2012, the Bank had $59,068,000 in outstanding loan balances to churches within the Bank's lending area with an additional $223,000 available to be drawn.

Letters of Credit

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank had total outstanding letters of credit amounting to $2,022,000 and $961,000 at December 31, 2012 and 2011, respectively, with maturities within the next 12 months.

Lines of Credit

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Since a portion of the line may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2012, the Bank had granted unused lines of credit to borrowers aggregating approximately $15,167,000 and $37,706,000 for commercial lines and open-end consumer lines, respectively. At December 31, 2011, unused lines of credit to borrowers aggregated approximately $12,700,000 for commercial lines and $24,728,000 for open-end consumer lines.

Commitments to Originate Loans

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate.

At December 31, 2012, and 2011, the Bank had outstanding commitments to originate variable rate loans aggregating approximately $28,051,000 and $12,409,000, respectively. The commitments extended over varying periods of time with the majority being disbursed within a one-year period.

Note 17: Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to financial position, results of operations and cash flows of the Company:

Condensed Balance Sheets

	December 31, 2012	December 31, 2011
Assets		
Cash and cash equivalents	$ 3,802	$ 3,714
Investment in common stock of subsidiaries	54,359	50,061
Other assets	658	729
Total assets	$ 58,819	$ 54,504
Liabilities		
Long-term debt	$ 3,093	$ 3,093
Other liabilities	1	656
Total liabilities	3,094	3,749
Shareholders' Equity	55,725	50,755
Total liabilities and shareholders' equity	$ 58,819	$ 54,504

Condensed Statements of Income and Comprehensive Income

	Year Ending December 31, 2012	Year Ending December 31, 2011
Income		
Interest income	$ 6	$ 7
Dividends from subsidiaries	2,483	3,480
Benefit in excess of life insurance cash value	453	-
Total income	2,942	3,487
Expenses		
Interest expense	323	323
Other expenses	156	92
Total expenses	479	415
Income Before Income Tax and Equity in Undistributed Income of Subsidiaries	2,463	3,072
Income Tax Benefit	(161)	(139)
Income Before Equity in Undistributed Income of Subsidiaries	2,624	3,211
Equity in Undistributed Income of Subsidiaries	4,075	1,858
Net Income	$ 6,699	$ 5,069
Comprehensive Income	$ 6,891	$ 7,469

Condensed Statements of Cash Flows

	Year Ending December 31, 2012	2011
Operating Activities		
Net income	$ 6,699	$ 5,069
Items not providing cash	(4,164)	(1,841)
Net cash provided by operating activities	2,535	3,228
Financing Activities		
Cash dividends paid	(2,477)	(1,979)
Proceeds from stock options exercised	104	50
Purchase of common stock	(74)	(26)
Net cash used in financing activities	(2,447)	(1,955)
Net Change in Cash and Cash Equivalents	88	1,273
Cash and Cash Equivalents at Beginning of Year	3,714	2,441
Cash and Cash Equivalents at End of Year	$ 3,802	$ 3,714

Note 18: Subsequent Events

The Company redeemed the outstanding long-term debt with a total carrying value of $3,093,000, on March 7, 2013. The long-term debt was redeemed pursuant to redemption provisions relating to optional redemption at a price equal to 104.240% of carrying value.

Subsequent events have been evaluated through the March 14, 2013, which is the date the financial statements were available to be issued.

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Board of Directors

As of December 31, 2012
(*Not pictured: I. Robert Amerine*)

Heartland BancCorp and Bank Directors

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Chairman, ISCO, Inc.

Arthur G.H. Bing M.D.
Plastic & Reconstructive Surgeon

William A. Dodson, Jr.
EVP/Community Relations Director,
Rhema Christian Center

Jay B. Eggspuehler, Esq.
Wiles, Boyle, Burkholder & Bringardner Co., L.P.A.

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Osteopathic Heritage Foundation of Nelsonville

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Jennifer L. Eckert
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Ashley A. Trout
Assistant Vice President, Branch Operations Manager

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VP, Director of Investment Services
Heartland Investment Executive, Infinex

Heartland Insurance Services, LLC.

Courtney L. Wagner
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