TRI CITY BANKSHARES CORPORATION

2012 Annual Report
Audited Consolidated Financial Statements

Directors and Officers of the Corporation

Directors

Frank J. Bauer	President of Frank Bauer Construction Company, Inc.
William N. Beres	Vice President of Structured Finance for the Global Energy Solutions division of Johnson Controls, Inc. since March 2010. Independent business and financial consultant from January 2009 through March 2010. Former Chief Financial Officer of Wisvest LLC and Vice President of Minergy LLC, both wholly owned subsidiaries of Wisconsin Energy Corporation, from January 1999 through December 2008
Sanford Fedderly	Retired Registered Pharmacist
Rebecca Ferguson	Attorney at the Estate Planning Resource Center in Elmhurst, IL from 2006 to 2009. Prior to that Mrs. Ferguson held various professional positions, including serving as an Assistant Vice President at Tri City National Bank.
Scott D. Gerardin	Senior Vice President and General Counsel of Tri City Bankshares Corporation and Senior Vice President and General Counsel of Tri City National Bank
William Gravitter	Retired President of Hy-View Mobile Home Court, Inc.
Brian T. McGarry	Retired Vice President of Tri City National Bank and Director of NDC LLC
Robert W. Orth	Executive Vice President of Tri City Bankshares Corporation and President of Tri City National Bank
Ronald K. Puetz	Chairman of the Board, President and Chief Executive Officer of Tri City Bankshares Corporation and Chairman of the Board and Chief Executive Officer of Tri City National Bank and Treasurer of NDC LLC
Agatha T. Ulrich	Chairman and Director of NDC LLC, President and Director of the David A. and Agatha T. Ulrich Foundation, Inc.
David A. Ulrich, Jr.	Independent Investor, Retired Vice President and Director of Mega Marts, Inc., Retired Vice President and Director of NDC, Inc., Director of NDC LLC and Director of the David A. and Agatha T. Ulrich Foundation, Inc.
Scott A. Wilson	Executive Vice President, Treasurer and Secretary of Tri City Bankshares Corporation, and Executive Vice President, CFO, Treasurer and Secretary of Tri City National Bank

Officers

Ronald K. Puetz	President, Chairman and Chief Executive Officer
Robert W. Orth	Executive Vice President
Scott A. Wilson	Executive Vice President, Treasurer and Secretary
Scott D. Gerardin	Senior Vice President and General Counsel
Frederick R. Klug	Senior Vice President and Chief Financial Officer
Thomas W. Vierthaler	Vice President and Comptroller
George E. Mikolajczak	Vice President – Human Resources
Gary J. Hafemann	Vice President and Auditor

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides management's analysis of the audited consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") and should be read in conjunction with those financial statements. This discussion focuses on significant factors that affected the Corporation's financial performance in 2012 with comparisons to 2011 and to 2010 where applicable. For all periods presented, the operations of Tri City National Bank (the "Bank") contributed substantially all of the Corporation's revenue and expense for the year. Included in the operations of the Bank are the activities of its wholly-owned subsidiaries, Tri City Capital Corporation, Inc. and Title Service of Southeast Wisconsin, Inc.

This report contains statements that may constitute forward-looking statements that speak of the Corporation's plans, goals, beliefs or expectations, refer to estimates or use similar terms. Forward-looking statements are subject to significant risks and uncertainties. The Corporation's actual results may differ materially from the results discussed in such forward-looking statements.

On August 8, 2012 the Corporations shareholders were notified that recently-enacted legislation allowed the Corporation, and other banking companies with fewer than 1,200 shareholders, to remove their stock from registration under the Securities Exchange Act of 1934 and thereby terminate their obligation to file financial and other reports with the Securities and Exchange Commission ("SEC"). The Board of Directors approved the filing of Form 15 with the SEC to voluntarily deregister which officially ended the Corporation's SEC-reporting obligations as of November 6th, 2012. As a result, there are two audit opinions provided by Baker Tilly included in the audited financial statements. The first opinion states that the audit as of December 31, 2012 was done in accordance with auditing standards generally accepted in the United States of America. The second opinion indicates that audits completed in periods prior to 2012 were conducted in accordance with the standards of the Public Company Accounting Oversight Board as required by the SEC.

Performance Summary

While the economy continued to struggle and interest rates declined to historical lows in 2012, the Corporation posted after tax earnings of $8.2 million, a decrease of $1.3 million or 14.3% compared to earnings of $9.5 million in 2011 and earnings of $14.3 million in 2010. Operating earnings in 2012 were negatively affected by a substantial decline in net interest income which was partially offset by a lower provision for loan losses, an increase in non-interest income and a decline in non-interest expenses. The decrease from 2010 to 2011 was due to a decline in net interest income, a higher provision for loan losses and a decrease in non-interest income which was partially offset by a decline in non-interest expenses. Basic earnings per share for 2012 were $0.92, a 14.0% decrease from 2011 basic earnings per share of $1.07, while basic earnings per share in 2010 were $1.61. Return on average assets and return on equity for 2012 were 0.69% and 6.56%, respectively, compared to 0.85% and 8.10%, respectively, for 2011 and 1.32% and 11.69%, respectively, for 2010. Cash dividends of $2.54 per share were paid in 2012, which included a prepayment of future dividends of $1.70 per share. No dividends were paid in 2011. However, a quarterly dividend of $0.21 per share was declared in December of 2011 and paid in January of 2012. Cash dividends of $2.40 per share were paid in 2010, which included a prepayment of 2011 dividends of $1.20 per share. Total assets increased $16.6 million or 1.4% to $1.23 billion in 2012 as the decline in total loans during 2010 and 2011 began to stabilize in 2012 while core deposits continued to grow during the year.

On October 23, 2009, the Bank was the successful bidder for the Bank of Elmwood ("Acquired Bank") through an FDIC-assisted purchase (the "Acquisition"). The Acquisition was the result of a competitive bidding process facilitated by the FDIC. The Bank bid negative $110.9 million and the FDIC estimated the net cost of the transaction to be $101.1 million, deemed to be the "least costly" resolution for the FDIC. Earnings performance at the Bank as a result of the Acquisition has been positively impacted.

INCOME STATEMENT ANALYSIS

Table 1 provides average balances of interest-earning assets and interest-bearing liabilities, the interest income and expense resulting from each, and the calculated interest rates earned and paid. The table further shows net interest income, interest rate spread, and the net interest margin on a tax-equivalent basis for the years ended December 31, 2012, 2011 and 2010.

Table 1

AVERAGE BALANCES AND INTEREST RATES
(Interest rates on a tax-equivalent basis)
(Dollars in Thousands)

	2012			2011			2010		
	Average Balance	Interest	Yield or Cost	Average Balance	Interest	Yield or Cost	Average Balance	Interest	Yield or Cost
ASSETS									
Interest earning assets:									
Loans[1]	$ 695,408	$ 40,870	5.88%	$ 722,719	$ 46,958	6.50%	$ 771,428	$ 56,722	7.35 %
Taxable investment securities[2]	307,775	3,250	1.06%	256,707	4,824	1.88%	158,365	3,663	2.31 %
Non taxable investment securities	47,922	1,983	4.14%	47,050	2,102	4.47%	44,452	2,246	5.05 %
Fed funds sold	48,593	43	0.09%	25,268	28	0.11%	40,732	61	0.15 %
Total interest earning assets	1,099,698	46,146	4.20%	1,051,744	53,912	5.13%	1,014,977	62,692	6.18 %
Noninterest-earning assets:									
Other assets	77,681			66,907			71,890		
TOTAL ASSETS	$ 1,177,379			$ 1,118,651			$ 1,086,867		
LIABILITIES AND EQUITY									
Interest-bearing liabilities:									
Transaction accounts	$ 276,010	371	0.13%	$ 256,241	485	0.19%	$ 247,950	860	0.35 %
Money market	214,817	721	0.34%	199,816	1,011	0.51%	155,195	1,313	0.85 %
Savings deposits	198,957	283	0.14%	182,093	379	0.21%	164,378	508	0.31 %
Other time deposits	179,323	1,829	1.02%	193,147	2,696	1.40%	229,011	3,030	1.32 %
Short-term borrowing	1,256	10	0.80%	3,027	13	0.43%	1,583	1	0.06 %
Total interest bearing liabilities	870,363	3,214	0.37%	834,324	4,584	0.55%	798,117	5,712	0.72 %
Noninterest bearing liabilities:									
Demand deposits	171,994			161,355			156,011		
Other	10,674			5,523			10,346		
Stockholders' equity	124,348			117,449			122,393		
Total liabilities and stockholders' equity	$ 1,177,379			$ 1,118,651			$ 1,086,867		
Net interest earnings and interest rate spread[3]		$ 42,932	3.83%		$ 49,328	4.58%		$ 56,980	5.46 %
Net interest margin[4]			3.90%			4.69%			5.61 %

1. The average loan balances and rates include non-accrual loans.
2. The interest income on tax exempt securities is computed on a tax-equivalent basis using a tax rate of 34% for all periods presented.
3. Interest rate spread represents the difference between the average yield earned on average interest-earning assets for the period and the average rate accrued on average interest-bearing liabilities for the period and is represented on a tax-equivalent basis.
4. Net interest margin represents net interest income for a period divided by average interest-earning assets for the period and is represented on a tax-equivalent basis.

The following table sets forth, for the periods indicated, a summary of the changes in interest earned on a fully tax-equivalent basis and interest paid resulting from changes in volume and rates:

Table 2

NET INTEREST INCOME AND EXPENSE VOLUME AND RATE CHANGE
(Dollars in Thousands)

	2012 Compared to 2011 Increase (Decrease) Due to			2011 Compared to 2010 Increase (Decrease) Due to		
	Volume	Rate(1)	Net	Volume	Rate(1)	Net
Interest earned on:						
Loans	$ (1,775)	$ (4,313)	(6,088)	$ (3,582)	$ (6,182)	(9,764)
Taxable investment securities	960	(2,534)	(1,574)	2,275	(1,114)	1,161
Non-taxable investment	39	(158)	(119)	131	(274)	(143)
Fed funds sold	26	(11)	15	(23)	(10)	(33)
Total interest-earning assets	$ (750)	$ (7,016)	$ (7,766)	$ (1,199)	$ (7,580)	$ (8,779)
Interest paid on:						
Transaction accounts	$ 37	$ (151)	$ (114)	$ 29	$ (404)	$ (375)
Money market	76	(366)	(290)	378	(680)	(302
Savings deposits	35	(131)	(96)	55	(184)	(129)
Time deposits	(193)	(674)	(867)	(480)	146	(334)
Short-term borrowings	(8)	5	(3)	1	11	12
Total interest-bearing liabilities	$ (53)	$ (1,317)	$ (1,370)	$ (17)	$ (1,111)	$ (1,128)
Increase (decrease) in net interest income			$ (6,396)			$ (7,651)

(1) The change in interest due to both rate and volume has been allocated to rate changes.

Net Interest Income

Total interest income on loans decreased $6.1 million, or 13.0%, during 2012 compared to the same period in 2011. The decrease was due to both a reduction in loan volume and the low interest rate environment. Average loans decreased $47.3 million, or 3.8%, during 2012 due primarily to the run-off of acquired loans. In addition to a decrease in loan volume, loan yields decreased 62 basis points to 5.88% during 2012 compared to 6.50% in 2011, as new and renewed loans were booked at lower interest rates than the existing portfolio. The decrease in interest income on loans was also due to a decrease in the purchase accounting income related to the Acquisition of $1.7 million from $5.8 million during 2011 to $4.1 million during 2012. Loan discount accretion is realized as the Acquired Bank's loan portfolio continues to amortize, mature, renew or pay off. Interest income on loans during 2012, excluding loan discount accretion, decreased by $4.4 million compared to same period in 2011.

Interest income on investment securities on a tax-equivalent basis decreased $1.7 million, or 24.4%, during 2012 compared to the same period in 2011. This change reflects an increase in volume which was offset by a decrease in yield. Total average investment securities increased $51.9 million to $355.7 million as of December 31, 2012 as loan volume continued to decrease and deposit balances continued to increase. The average tax equivalent yield on the investment securities decreased 81 basis points to 1.47% during 2012 compared to 2.24% for the same period in 2011. The decrease in the average tax equivalent yield was due to securities with higher coupon rates being called and reinvested in securities with lower coupon rates as the interest rate environment continues at historic lows. In addition, the high level of mortgage refinance activity has caused prepayment speeds on our investments in CMO and MBS securities to increase which has resulted in a decrease in interest income due to accelerated levels of premium amortization.

Interest expense during 2012 decreased $1.4 million or 29.9%, compared to the same period in 2011. The average yield on interest-bearing liabilities decreased 18 basis points to 0.37% during 2012 compared to 0.55% in 2011. The decrease in average yields was partially offset by an increase in average interest-bearing liabilities of $36.0 million to $870.3 million for 2012 from $834.3 million during 2011, primarily due to an increase in core deposits.

Net interest income in the consolidated statements of operations (which excludes the tax-equivalent adjustment) was $42.3 million during 2012, compared to $48.6 million for the same period in 2011. The tax equivalent adjustments (adjustments needed to bring tax-exempt interest to a level that would yield the same after-tax income had that income been subject to taxation using a 34% tax rate) of $0.6 million for 2012 and $0.7 million for 2011 resulted in a tax-equivalent net interest income of $42.9 million and $49.3 million, respectively. The tax-equivalent net interest margin for 2012 was 3.90% compared to 4.69% during 2011.

Total interest income on loans decreased $9.8 million, or 17.2%, during 2011 compared to the same period in 2010. The decrease was due to both a reduction in loan volume and the continued low interest rate environment. The decrease in interest income on loans was also due to a decrease in the purchase accounting income related to the Acquisition of $3.6 million from $9.8 million during 2010 to $5.8 million during 2011. Interest income on investment securities on a tax-equivalent basis increased $1.0 million, or 17.2%, during 2011 compared to the same period in 2010. This change reflects an increase in volume which was partially offset by a decrease in yield. Interest expense during 2011 decreased $1.1 million or 19.7%, compared to the same period in 2010. The decrease was due to a decrease in yield which was partially offset by an increase in volume. In addition, interest expense was positively impacted by $1.4 million in 2010 due to purchase accounting related to the Acquisition. Net interest income on a tax-equivalent basis was of $49.3 million in 2011 and $56.9 million in 2010. The tax-equivalent net interest margin for 2011 was 4.69% compared to 5.61% during 2010.

Provision for Loan Losses

The PLL results from the assessment of qualitative and quantitative factors to determine the required ALL. Factors considered are the size of the portfolio, levels of nonperforming loans, historical losses, risk inherent in certain categories of loans, concentrations of loans to certain borrowers or certain industry segments, economic trends, collateral pledged, and other factors that could affect loan losses as discussed in the paragraphs following Table 8.

The PLL represents the amount periodically added to the Bank's ALL and charged to earnings in the relevant period. The PLL for 2012 was $7.2 million, a decrease from $8.4 million in 2011 but still higher than $6.9 million in 2010. The fluctuations in the PLL reflect the charge-off activity net of recoveries on loans previously charged off. Net charge-offs were $6.0 million in 2012, $6.9 million in 2011 and $3.4 million in 2010. Charge-offs are expected to remain at relatively high levels as we continue to work through the acquired loans and non-performing legacy loans in a weak economy.

Non-interest Income

A summary of non-interest income for the years ended December 31, 2010, 2011 and 2012 appears in Table 3 below:

Table 3

NON-INTEREST INCOME
(Dollars in Thousands)

	For the Years Ended December 31,		
	2012	2011	2010
Service charges on deposits	$ 10,108	$ 9,987	$ 10,181
Loan servicing income	133	318	350
Net gain on sale of loans	2,569	1,249	1,421
Increase in cash surrender value of life insurance	837	467	472
Non-accretable loan discount	1,974	2,247	2,269
Other income	1,571	522	1,784
Total non-interest income	$ 17,192	$ 14,790	$ 16,477

Total non-interest income was $17.2 million for 2012, an increase of $2.4 million or 16.2% from $14.8 million in 2011. The increase was primarily due to three factors. Interest rates on mortgage loans continued to decline to record low levels in 2012 resulting in a record year in mortgage loan origination. The net gain on sale of loans increased $1.3 million during 2012 compared to 2011 due to strong refinance activity in the secondary mortgage market. In addition, the Bank purchased an additional $15.0 million of bank owned life insurance during 2012 which resulted in a $0.4 million increase in the cash surrender value of life insurance. Finally, there was a $1.0 million increase in other non-interest income that was driven by two factors. There was an increase in the gain on the sale of OREO, net of carrying costs, of $0.7 million in 2012 compared to 2011. In addition, there was one-time income of $0.3 million on the sale of excess land at one of the Bank's branches. Loan servicing income decreased $0.2 million due to an acceleration of the Banks mortgage serving rights amortization due to an increased level of refinancing activity. Non-accretable income, which is part of the Acquisition related purchase accounting, decreased $0.3 million in 2012 compared to 2011. This is income related to loans acquired in the Acquisition that were specifically identified as credit impaired which were paid or charged off during the year. In future years, non-accretable income will be dependent on the difference between future contractual payments expected to be received and the carrying amount of the loans specifically impaired.

Total non-interest income was $14.8 million for 2011, a decrease of $1.7 million or 10.2% from $16.5 million in 2010. The decrease was primarily due to a $1.3 million decrease in other non-interest income resulting from lower gains on the sale of OREO, net of carrying costs, in 2011 compared to 2010. In addition, revenue from service charges and fees on business and retail deposit accounts decreased $0.2 million primarily driven by the number of accounts and the activity within those accounts. Net gain on sale of loans decreased $0.2 million to $1.2 million for 2011 as refinance activity in the secondary mortgage market was not as strong as in 2010.

Non-interest Expense

A summary of non-interest expense for the years ended December 31, 2010, 2011 and 2012 appears in Table 4 below:

Table 4

NON-INTEREST EXPENSE
(Dollars in Thousands)

	For the Years Ended December 31,		
	2012	2011	2010
Salaries and employee benefits	$ 21,407	$ 22,037	$ 22,739
Occupancy	3,733	4,067	3,959
Furniture and equipment	1,966	1,887	2,201
Computer services	4,075	3,679	3,504
Advertising and promotional	953	1,033	1,173
Regulatory agency assessments	1,286	1,317	2,459
Office supplies	833	790	834
Acquisition expense	-	-	370
Core deposit intangible amortization	310	418	568
Other expenses	5,518	5,597	5,272
Total non-interest expense	$ 40,081	$ 40,825	$ 43,079

Total non-interest expense for 2012 was $40.1 million, a decrease of $0.7 million or 1.8% over 2011 as management continues to make expense control a priority. Salaries and employee benefits decreased $0.6 million due to retirements, regular attrition and the closure of one in-store branch locations while total benefit costs remained stable. Occupancy expense decreased $0.3 million in 2012 compared to 2011 due to a decrease in maintenance and repair expenses, a decrease in rent expense and an increase in rental income. Furniture and equipment decreased slightly by $0.1 million in 2012 while computer services increased by $0.4 million. The increase in computer services was due to one time charges related to a change in our telephone and data communications provider. This increase was partially offset by a decrease in data processing costs due to the negotiation of a new contract with our current provider. As a result of these two changes, management expects computer services expense to decline by approximately $1.2 million in 2013 compared to 2012. Advertising expense decreased $0.1 million to $0.9 million in 2012 as the Bank focused on larger, higher exposure advertising opportunities and discontinued several outlets that produced lower returns. Office supply expenses remained stable while the Bank incurred core deposit amortization expense of $0.3 million in 2012 compared to $0.4 million in 2011. The core deposit amortization expense will decrease annually until it is fully amortized in 2017. Finally, other non-interest expenses remained stable at $5.5 million in 2012.

Total non-interest expense for 2011 was $40.8 million, a decrease of $2.3 million or 5.2% over 2010, primarily resulting from a $1.1 million decrease in regulatory assessments resulting from lower FDIC premiums due to a change in the assessment methodology that took full effect during 2011. In addition, salaries and employee benefits decreased $0.7 million due to a decrease in bonus payments that was partially offset by both normal wage and salary increases as well as an increase in health insurance costs. Advertising expense decreased $0.1 million to $1.0 million in 2011 due to a reduction in special advertising during 2010 related to the integration of the Acquisition in October of 2009. The Bank did not have any Acquisition-related expense during 2011 compared to $0.4 million incurred during 2010. The Bank had core deposit amortization expense of $0.4 million in 2011 compared to $0.6 million in 2010. These decreases were partially offset by a $0.1 million increase in occupancy expenses and a $0.3 million decrease in equipment expenses in 2011 compared to 2010. In addition, computer service expense increased $0.2 million due to enhanced services for the Bank and additional new account volume. Finally, other non-interest expenses increased $0.3 million in 2011.

Income Taxes

Income tax expense was $4.0 million in 2012 compared to $4.7 million in 2011 and $8.4 million in 2010. The Corporation's effective tax rate (income tax expense divided by income before income taxes) was 33.0% in both 2012 and 2011 compared to 36.9% in 2010. The decrease in the effective tax rate in 2011 and 2012 compared to 2010 was due to a decrease in pre-tax income, which increases the effect of permanent non-taxable items on the effective tax rate.

BALANCE SHEET ANALYSIS

Investment Securities Portfolio

The investment securities portfolio is intended to provide the Bank with liquidity, a source of stable income, and is structured to minimize the Corporation's credit exposure. It is the practice of the Corporation to hold securities to maturity.

Table 5

INVESTMENT SECURITIES PORTFOLIO
(Dollars in Thousands)

	December 31,					
	2012		2011		2010	
	Amortized Cost	Percentage of Total	Amortized Cost	Percentage of Total	Amortized Cost	Percentage of Total
Obligations of:						
States and political subdivisions (tax exempt)	$ 44,008	12.5%	$ 51,028	14.2%	$ 41,292	18.1%
States and political subdivisions (taxable)	16,510	4.7%	12,118	3.4%	10,023	4.4%
U.S. government sponsored entities	151,781	43.2%	261,602	72.6%	176,389	77.4%
Collateralized mortgage obligations	43,812	12.5%	17,069	4.7%	-	-%
Mortgage-backed securities	95,413	27.1%	18,699	5.1%	-	-%
Other	-	0.0%	50	-%	100	0.1%
Total investment securities	$ 351,524	100.0%	$ 360,566	100.0%	$ 227,804	100.0%

The total investment securities portfolio decreased $9.1 million or 2.5% to $351.5 million at December 31, 2012 compared to $360.6 million at December 31, 2011. At December 31, 2011, the total carrying value of investment securities represented 29.3% of total assets, compared to 29.7% at December 31, 2011. The decrease in the investment securities portfolio was related to the timing of purchasing suitable investments for the portfolio.

States and political subdivisions (tax-exempt) investment securities decreased $7.0 million or 13.8% to $44.0 million at December 31, 2012 compared to $51.0 million at December 31, 2011. States and political subdivisions (taxable) investment securities increased $4.4 million or 36.2% to $16.5 million at December 31, 2012 compared to $12.1 million at year end 2011. Municipal investments (tax-exempt and taxable) represent 17.2% of total investment securities at December 31, 2012 compared to 17.6% at December 31, 2011. Management maintains overall quality as well as addresses its asset/liability management concerns by limiting purchases to rated investments of high quality or, on a limited basis, to well known local non-rated issues. Diversity in the securities portfolio is maintained by limiting the amount of investment to any single debtor in the municipal category. At December 31, 2012, the Bank's securities portfolio did not contain any obligations of any single issuer that were payable by the same source of revenue or taxing authority where the aggregate carrying value of such securities exceeded 2.2% of stockholders' equity.

Investments in GSE securities decreased $85.2 million to $151.8 million at December 31, 2012 compared to $261.6 million at year end 2011. Investments include four GSEs; the Federal Farm Credit Bank, the Federal Home Loan Bank, the Federal National Mortgage Association ("Fannie Mae"), and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Investments in GSE securities represented 43.2% of total investment securities at December 31, 2012 compared to 72.6% in 2011. Many of the GSE securities purchased during 2012 contained relatively attractive yields initially and step-up features in which the yields are scheduled to increase in future periods. Step-up features provide the Bank the advantage of increasing yields in a rising rate environment. However, the issuer receives the advantage of a call option in return and therefore the ability to reprice the security in a falling rate environment. In 2012 the Bank's portfolio experienced numerous calls as rates continued to decline during the year largely due to actions taken by the Federal Reserve. GSEs such as Fannie Mae and Freddie Mac are not explicitly guaranteed by the U.S. government. The U.S. government has, however, provided unlimited support to both entities since 2009. The Federal Home Loan Bank and the Federal Farm Credit Bank are also GSEs. To date neither of these GSEs has required support from the U.S. Government.

The Corporation continued to diversify the investment portfolio in 2012 as investments in CMO and MBS securities increased from $35.8 million at December 31, 2011 to $139.2 million at December 31, 2012. As GSE securities were called during the first four months of 2012 the available funds were reinvested into CMO and MBS securities. The mortgages underlying these securities are guaranteed by Fannie Mae, Freddie Mac and the Government National Mortgage Association ("Ginnie Mae"). Investments in collateralized mortgage obligations and mortgage-backed securities represented 39.6% of total investment securities at December 31, 2012 compared to 9.8% in 2011. These bonds are structured to return principal in a principal window significantly shorter than the maturity of the underlying mortgages. The Weighted Average Life ("WAL") of the investments purchased was 3 to 5 years. During 2012, these investment securities pre-paid at a rate much higher than anticipated amid strong refinance activity of the underlying mortgages. As a result the

WAL decreased significantly. The faster repayment was due to actions by the Federal Reserve to push interest rates even lower as well as the implementation of another wave of the Home Affordable Refinance Program ("HARP 2.0"). HARP 2.0 expanded the ability for homeowners with high loan to value ratios ("LTV") to refinance. The Bank's CMO and MBS investments were seasoned with relatively low LTVs of 80% or less. However, the investments were purchased at a premium as all carried higher coupons of 4.5% to 5.5%. National servicers have become very aggressive about refinancing higher coupon MBSs as a result of the HARP 2.0 The resulting impact of the premium amortization due to the faster repayment had a negative impact on the investment yield in the second half of 2012.

Loans

Total loans were $704.6 million at December 31, 2012, a decrease of $3.1 million, or 0.4%, from $707.8 million at December 31, 2011. Loans decreased in the first six months of 2012 by $10.7 million and increased by $7.6 million during the second half of the year. Loan growth during the final six months of 2012 reversed a two and a half year trend of declining loan balances as total loans decreased $35.0 million during 2010 and $39.0 million in 2011. The increase in the loan portfolio during the second half of 2012 was attributable to new business production offsetting the continued reduction of the Acquired Bank's loan portfolio. The strategy for acquired loans involves three options: renewal of loans conforming to the underwriting guidelines of the Bank, pay-out of loans not meeting those guidelines or final resolution of impaired loans through a short sale with a cooperative borrower or a foreclosure when other options fail. Renewals neither increase nor decrease the portfolio while the other two options reduce total loans. Management expects that new loan business will offset both amortization of performing loans and the continued planned elimination of substandard acquired loan balances resulting in growth of the loan portfolio during 2013.

Loans originated by the Bank are generally loans to small businesses and individuals in the communities served in the Southeastern Wisconsin market. Although the legal lending limit of the Bank was $17.9 million per borrower as of December 31, 2012, the Bank's larger customers are borrowers with credit needs of $10 million and less and, in fact, most borrowers' credit relationships total less than $1 million. At December 31, 2012, there were six relationships in excess of $10 million with aggregate exposure totaling $71.5 million, ten relationships between $5.0 and $10 million with aggregate exposure totaling $68.1 million and thirty-three relationships between $2.0 and $5.0 million with aggregate exposure totaling $99.9 million. Of these forty-nine relationships with $239.5 million committed the balance outstanding at December 31, 2012 was $211.0 million. The remaining $28.5 million represented unfunded liability on lines of credit to 27 of the borrowers.

As of October 23, 2009, (the "Acquisition Date") the Acquired Bank's loan portfolio was discounted $85.1 million to reflect the estimated fair value of the acquired loans. Between the Acquisition Date and December 31, 2012, the discount has been significantly reduced as a result of activity in the Acquired Bank's loan portfolio including renewals, amortization, pay-offs and charge-offs. Thus, the Bank's total loans of $704.6 million at December 31, 2012 include a discount of $27.7 million reflecting the difference between cash flows expected to be received and contractually required payments on the acquired loans. Management continues to try and improve the credit quality of the acquired loans as they are renewed and integrated into the Bank's portfolio. The aforementioned $85.1 million loan portfolio discount was originally allocated to $279.2 million of acquired (undiscounted) loans at the time of purchase. At December 31, 2012, the undiscounted loan total has been reduced by $141.9 million as a result of payment, foreclosure or charge-off. Of the remaining undiscounted $137.3 million, $42.9 million has been restructured or renewed into the Bank's portfolio. Therefore, to completely transition the acquired portfolio into the Bank's portfolio requires resolving $101.1 million of undiscounted loans with $27.7 of remaining discount or $72.4 million of the Bank's $704.7 portfolio. Management believes the remaining discount will be sufficient to cover the remaining credit losses related to the acquired loans that have not yet been paid off, renewed or restructured since the Acquisition.

The following table presents information concerning the composition of the loans held for investment by the Bank at the dates indicated.

Table 6

LOAN PORTFOLIO COMPOSITION
(Dollars in Thousands)
December 31,

	2012		2011		2010	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commercial	$ 20,286	2.89%	$ 19,956	2.82%	$ 25,451	3.41%
Real estate						
Construction	40,790	5.79%	46,600	6.58%	55,974	7.49%
Commercial	325,335	46.17%	298,043	42.11%	285,863	38.28%
Residential	258,548	36.69%	288,609	40.78%	319,789	42.82%
Multifamily	47,526	6.74%	39,799	5.62%	41,074	5.50%
Installment and other	12,151	1.72%	14,790	2.09%	18,678	2.50%
Total loans	$ 704,636	100.00%	$ 707,797	100.00%	$ 746,829	100.00%

As Table 6 indicates, commercial loans were $20.3 million at December 31, 2012, an increase of 0.3 million or 1.6% from December 31, 2011 and comprised 2.9% of the total loan portfolio compared to $20.0 million comprising 2.8% of the loan portfolio at December 31, 2011. Historically, commercial lending has been a small part of the Bank's portfolio which continues to be the case in 2012. Commercial balances have leveled off in conjunction with the overall portfolio despite continued difficult economic conditions. Commercial loans are collateralized by general business assets such as accounts receivable, inventory and equipment and have no real estate component. During difficult economic periods the Bank can be exposed to heightened risk if a business is out of compliance with debtor covenants supporting commercial loans. The Bank was active in policing such requirements and this segment of loans presents minimal risk going forward.

Real estate construction loans decreased $5.8 million, or 14.2% to $40.8 million, representing 5.8% of the total loan portfolio at December 31, 2012, compared to $46.6 million or 6.6% of the total loan portfolio at December 31, 2011. The decrease from 2011 to 2012 was due primarily to continued repayment of the Bank's construction loan portfolio. Construction financing by definition is classified as such only during the development phase. When the project is complete, the outstanding balance is paid in one of several ways. In the case of residential real estate development, the sale of the spec home or lot results in payment. In the case of a commercial project, the completed building is refinanced to term debt for the developer or in some cases a new buyer. This activity reduces the real estate construction portfolio and resulted in an $11.0 million decrease in 2012. New loans to individuals for construction of owner-occupied single family residences and loans to developers that provide financing for the acquisition or development of commercial real estate and residential subdivisions improved slightly in 2012 as several large commercial projects increased real estate construction lending by $4.0 million during 2012. Loans to residential real estate developers for spec home financing also experienced $1.0 million growth in 2012 after several years of no activity. Historically, real estate construction loans have been made to developers who are well known to the Bank, have prior successful project experience and are well capitalized. Loans are made to customers in the Bank's Southeastern Wisconsin market with experience and knowledge of the local economy. Most of the Bank's real estate development loans for residential subdivisions are performing despite the economic downturn and these borrowers' lot inventories continue to decrease thereby decreasing the portfolio balances. The greatest risk to the Bank within this segment are loans secured by raw land and condominium development loans. These two groups have been most severely affected by the prolonged economic downturn. In the case of loans secured by undeveloped acreage, the price per acre has decreased dramatically as other lenders liquidate the collateral on these raw land or "dirt" loans. The Bank has a few customers continuing to service the debt from free cash flow, but this becomes more problematic as the housing market continues a slow recovery. In the case of condominium loans, risk factors the Bank inherits upon the failure of a developer include the existence and/or control of the condo association, the availability of term financing to initial buyers of units and partial project completion for common use areas.

Commercial real estate loans increased $27.3 million or 8.4% to $325.3 million at December 31, 2012, compared to $298.0 million at December 31, 2011. The increase is due to new business exceeding the portfolio amortization, pay-offs and elimination of nonperforming loans from the Acquisition. This category of loans made up the largest component of the total loan portfolio at 46.2% at December 31 2012 and 42.1% at December 31, 2011. The increase is attributable to new relationships as well as new projects with current customers which outpaced run-off from the Acquired loan portfolio. The Bank's commercial real estate lending efforts are focused on owner occupied, improved property such as office buildings, warehouses, small manufacturing operations and retail facilities. The most significant risk factor is occupancy. The fact that the Bank prefers owner occupied commercial real estate reduces that risk, provided of course, the owner's business survives. The Bank's $17.9 million per-borrower legal lending limit would permit it to compete for activity in the middle market, but management prefers to seek small businesses as its target borrowers. Loans to such businesses are approved based on the creditworthiness, economic feasibility and cash flow abilities of the borrower.

Residential real estate loans which include single family, 2-4 family dwellings and home equity lines of credit or "HELOCs" secured by real estate decreased $30.1 million or 11.6% to $258.5 million comprising 36.7% of the Bank's total loan portfolio at December 31, 2012 compared to $288.6 million comprising 40.8% of the Bank's total loan portfolio at December 31, 2011. The decrease is primarily due to the elimination of nonperforming acquired loans. Loans in this segment of the portfolio have historically represented the lowest risk due to the large number of individual loans with relatively small average balances. The Bank considers owner-occupied one-to-four family loans to be low risk because underwriting has always required 20% equity and qualified borrowers with proper debt service coverage ratios. These loans provide a foundation for the sale of all other retail banking products and have always been a staple of the Bank's portfolio. However, the Acquired Bank's loan portfolio included a number of residential real estate loans that do not meet the Bank's underwriting standards and these borrowers were encouraged to bring loans current, pay delinquent taxes, and comply with the Bank's underwriting standards, refinance at another financial institution or face foreclosure. The greatest risks to the Bank in this segment are those one-to-four family residential real estate loans that are not owner occupied. Many of these scattered site owner's loans were generated by the Acquired Bank through its "Rehab and Go" and "Equity is Cash" programs. Often rehab dollars were not invested in the property, the properties were over-appraised and rental property damage was prevalent but no replacement reserves were required, as would be the case in a commercial real estate loan. The Bank is working to eliminate this group of acquired loans. As a result, the significant portfolio decreases experienced in 2010, 2011 and 2012 will likely continue into 2013 but probably at a reduced rate. Despite the fact that these loans were deeply discounted in the Bank's bid to the FDIC, the Bank has experienced losses from scattered-site owners both on acquired loans and legacy loans.

Residential real estate loans in the portfolio have historically been originated with maturities of one, two or three years. In 2012, the Bank also began to offer a 5 year balloon loan to encourage portfolio growth. Amortization periods offered to customers are 20-25 years depending on equity and loan-to-value ratios. Customers seeking long term rate locks choose the secondary market products offered by the Bank where rates can be fixed for 15, 20 or 30 years. These loans are then sold and as a result, do not impact the portfolio yields nor are they a factor in interest rate risk. Loans from the Acquisition are either one-, two- or three-year balloons or Adjustable Rate Mortgages ("ARMs"). While ARMs have not been the Bank's vehicle of choice for rate management, they serve the purpose of providing annual rate adjustments after an initial fixed rate period of three to five years. ARM loans from the Acquired Bank residential real estate loan portfolio have been repriced since they were acquired at the margin (2.625%) prescribed by Freddie Mac over their assigned indices. A typical ARM index is the one year US Treasury note rate, which continued near historic lows during 2012. This rate hovered between 0.10% and 0.20% for most of the year resulting in adjusted rates below 3.0% for ARM mortgage customers. Of the variable rate mortgage loans repricable, total ARM portfolio yields decreased 42 basis points to 4.36% at December 31, 2012 from 4.78% at December 31, 2011 as a result of these rate decreases.

Multi-family real estate loans increased $7.7 million or 16.3% to $47.5 million, representing 6.7% of the total loan portfolio at December 31, 2012 compared to $39.8 million comprising 5.6% of the total loan portfolio at December 31, 2011. New loans in this category accounted for an increase of $16.1 million which was offset by $8.4 million of payoffs and principle amortization. Of the $16.1 million in new relationships, $8.6 million was loaned to four customers. The loans in this category are collateralized by properties with more than four family dwelling units. The Bank has always been conservative in requiring borrowers to be well-qualified and to provide their personal guaranty, as well as insisting on proper debt service coverage ratios and equity sufficient to sustain reasonable debt service in the event of interest rate pressure. Loans in this category typically have maturities of 3, 4 or 5 years and are amortized over 15 to 20 years. While any loan presents risk to the Bank, loans in this segment are performing quite well in the downturn because of the Bank's underwriting criteria and with significant foreclosure activity in the market, many former homeowners are back in the rental market.

Installment loans decreased $2.6 million, or 21.7%, to $12.2 million at December 31, 2012 compared to $14.8 million at December 31, 2011 due to the elimination of acquired loans outpacing new business. These loans consist of auto loans, mobile home loans and unsecured consumer loans which have been decreasing at the Bank for several years. Auto loan volume decreased despite improved new car sales in 2012 because dealer incentive financing makes this non-competitive. The Bank has historically limited its exposure to mobile home loans and unsecured consumer loans. However, the Bank acquired a number of such consumer loans in the Acquisition, many of which continue to perform, despite not meeting the Bank's historical underwriting standards.

To ensure credit quality, overall credit management of portfolio loans in the Bank requires sound loan underwriting and administration, systematic monitoring of existing loans, effective loan review, early identification of problem loans, an adequate ALL and valid non-accrual and charge-off policies. As the economy weakened, loan underwriting was strengthened at the Bank by reducing delegated authority for lenders in the branch locations to ensure that appropriate standards would be met on every credit request. These precautions were extended through 2012 and deemed necessary as management believed many marketing opportunities were the result of marginally qualified borrowers, both commercial and consumer, attempting to leave their existing bank due to rate pressure and new requirements such as additional collateral or other restrictive terms.

Other Real Estate Owned

Real estate acquired by foreclosure or by deed in lieu of foreclosure is held for sale and is initially recorded at the lesser of carrying value or fair value at the date of foreclosure less estimated selling expenses, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed and any excess of carrying value over fair value is recorded as a valuation allowance. At the date of foreclosure any write down to fair value less estimated selling costs is charged to the ALL. Costs relating to the development and improvement of the property may be capitalized; holding period costs and subsequent changes to the valuation allowance are charged to expense.

A summary of the activity in other real estate owned ("OREO") is as follows:

Table 7

	For the Year Ended December 31,					
	2012		2011		2010	
	Dollar Balance	Number of Properties	Dollar Balance	Number of Properties	Dollar Balance	Number of Properties
Beginning Balance	$ 7,351	67	$ 5,407	49	$ 4,681	46
Additions	10,167	79	10,256	118	8,668	78
Sales	(8,973)	(115)	(8,313)	(100)	(7,942)	(75)
Ending Balance	$ 8,545	31	$ 7,351	67	$ 5,407	49

As of December 31, 2012, the Bank had 31 properties in OREO with a total balance of $8.5 million compared to 67 properties with a total balance of $7.4 million as of December 31, 2011. While the number of properties declined substantially during 2012, the total balance increased by $1.1 million. The increase in OREO during 2012 is primarily due to one large property that represented $3.6 million of the $8.5 million outstanding. Management expects a decrease in OREO activity during 2013 as the foreclosure pipeline, a precursor to OREO, has begun to substantially decline.

The collection practices for the Bank are centralized in order to efficiently handle the increased levels of past dues, foreclosures and repossessions from both legacy loans and acquired loans. The Bank has three collection divisions reporting to an executive vice president; commercial loan workouts, retail loan collection and collection of the secondary market real estate loan portfolio serviced by the Bank. The Bank's goal is to minimize the delay in liquidation. The Bank has used its own officers as the best source for identifying buyers for OREO as they know which of the Bank's existing customers are in the market for real estate. This strategy has proven successful as Bank officers have been responsible for identifying the buyers for 127 of the 290 properties sold over the last three years.

Allowance for Loan Losses

The loan portfolio is the primary asset subject to credit risk. Credit risk is controlled and monitored through the use of lending standards, management's strict underwriting of potential borrowers and on-going review of loan payment performance. Managing credit risk and minimizing loan losses is a high priority for management. Active asset quality administration, including early problem loan identification and timely resolution, aids in the management of credit risk and minimization of loan losses.

Table 8 summarizes the ALL balances at the beginning and end of each year from 2010 through 2012, changes in the ALL arising from loans charged-off and recoveries on loans previously charged-off, additions to the allowance that have been charged to expense and selected performance ratios.

Table 8

SUMMARY OF ALLOWANCE FOR LOAN LOSSES
(Dollars in Thousands)

	For the Year Ended December 31,		
	2012	2011	2010
Balance of allowance for loan losses at beginning of period	$ 11,012	$ 9,527	$ 6,034
Total loans charged-off	(6,715)	(7,128)	(4,551)
Total recoveries	700	243	1,114
Net loans charged-off	(6,015)	(6,885)	(3,437)
Additions to allowance charged to expense	7,200	8,370	6,930
Balance of allowance for loan losses at end of period	$ 12,197	$ 11,012	$ 9,527
Total loans	$ 704,636	$ 707,798	$ 746,829
Total nonperforming loans[1]	$ 22,374	$ 22,405	$ 24,615
Ratio of allowance for loan losses to total nonperforming loans	54.51%	49.15%	38.70%
Ratio of nonperforming loans to total loans	3.18%	3.17%	3.30%
Ratio of nonperforming assets to total assets	2.51%	2.49%	2.63%
Ratio of net loans charged-off during the period to average loans outstanding	0.86%	0.95%	0.45%
Ratio of allowance at end of year to total loans	1.73%	1.56%	1.28%

[1]This amount excludes purchased credit-impaired loans. Purchased credit-impaired loans have evidence of pre-Acquisition deterioration in credit quality. Fair value of these loans as of the Acquisition Date includes estimates of credit losses.

The ALL represents management's estimate of an amount adequate to provide for probable and inherent credit losses in the loan portfolio. To assess the adequacy of the ALL, management uses significant judgment focusing on specific reserves applied to loans that are identified for evaluation on an individual loan basis. In addition, loans are analyzed on a group basis using risk characteristics that are common to groups of similar loans. The factors that are considered include changes in the size and character of the loan portfolio, changes in the levels of impaired and nonperforming loans, historical losses in each category, the risk inherent in specific loans, concentrations of loans to specific borrowers or industries, existing economic conditions, and the fair value of underlying collateral as well as changes to the fair value of underlying collateral.

At December 31, 2012, the ALL was $12.2 million, compared to $11.0 million at December 31, 2011. As of December 31, 2012, the ratio of the ALL to total loans was 1.73% and covered 54.5% of nonperforming loans, compared to a ratio of 1.56% covering 49.2% of nonperforming loans at December 31, 2011. The increase in the ratio of ALL to total loans during 2012 was primarily due to an increase in the ALL. Nonperforming loans, not including the acquired credit impaired nonperforming loans, were $22.4 million, or 3.2% of total loans as of both December 31, 2012 and December 31, 2011. Net charge-offs were $6.0 million and $6.9 million for 2012 and 2011, respectively. Loans charged-off are subject to continuous review and specific efforts are taken to achieve maximum recovery of principal, accrued interest and related expenses.

Potential Problem Loans

Management uses an internal asset classification system as a means of reporting problem and potential problem assets. At the quarterly meetings, the Board of Directors of the Bank reviews trends for loans classified as "Special Mention," "Substandard" and "Doubtful" for the previous thirteen months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and viewed as non-bankable assets, worthy of charge-off. Assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses that may or may not be within the control of the customer are deemed to be Watch.

The determination as to the classification of assets and the amount of valuation allowance is subject to review by the Bank's regulator, the Office of the Comptroller of the Currency (the "OCC") ,which can order the establishment of additional general or specific loss allowances. There can be no assurance that regulators, in reviewing the Bank's loan portfolio, will not request the Bank to materially adjust its allowance for loan losses. The OCC, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the ALLs. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that (1) institutions have effective systems and controls to identify, monitor and address asset quality problems; (2) management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and (3) management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Management believes it has established an adequate ALL. The Bank analyzes its process regularly, with modifications made if needed, and reports those results four times per year at meetings of the Board of Directors. Although management believes that adequate specific and general loan loss allowances have been established, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary.

Deposits

Deposits are the Bank's largest source of funds. The Bank competes in Southeastern Wisconsin with other financial institutions such as banks, thrifts and credit unions, as well as non-bank institutions, for retail and commercial deposits. The Bank continues to market its checking accounts and had continued success in 2012 with completely free checking (non-interest-bearing), several options for interest-bearing checking and for Investor Checking, a tiered product. The interest-bearing checking options offered are desirable to the Bank as low cost core deposit growth. Depositors earn interest, but the yields paid on these products are low compared to other funding costs.

Table 9

AVERAGE DAILY BALANCE OF DEPOSITS AND AVERAGE RATE PAID ON DEPOSITS
(Dollars in Thousands)

	2012		2011		2010	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing demand deposits	$ 171,994	-%	$ 161,355	-%	$ 156,011	-%
Transaction Accounts	276,010	0.13%	256,241	0.19%	247,950	0.35%
Money Market Accounts	214,817	0.34%	199,816	0.51%	155,195	0.85%
Savings	198,957	0.14%	182,093	0.21%	164,378	0.31%
Time deposits (excluding time certificates of deposit of $100,000 or more)	103,806	0.96%	120,793	1.41%	124,966	1.35%
Time deposits ($100,000 or more)	75,517	1.10%	72,354	1.38%	104,045	1.30%
	$ 1,041,101		$ 992,652		$ 952,545	

For the year ended December 31, 2012, average daily deposits were $1.04 billion, an increase of $48.4 million or 4.88% over $992.7 million at December 31, 2011. The Bank continued to have substantial organic deposit growth across most of the branches, including those that it acquired, due to a strong product line, convenient hours and locations, and successful marketing campaigns.

Average non-interest-bearing demand deposits increased $10.6 million or 6.6% to $172.0 million at December 31, 2012 compared to $161.4 million at December 31, 2011 which mirrors the overall growth of our deposit base. These core deposits are very valuable to the Bank given their non-interest bearing status.

Transaction accounts consist of interest-bearing checking held by individuals, municipalities, non-profit organizations and sole proprietorships. Average transaction accounts increased $19.8 million or 7.7% to $276.0 million at December 31, 2012 compared to $256.2 million on December 31, 2011. The blended rate for all transaction accounts in 2012 was 0.13%, a decrease of 6 bp from 0.19% in 2011.

The daily average balance of money market deposit accounts increased $15.0 million or 7.5% to $214.8 million for 2012 compared to $199.8 million in 2011. The increase in money market accounts during 2012 is due to the relatively attractive interest rates paid on this product compared to certain transaction accounts and longer term certificates of deposits. The yield on money market deposits decreased 17 bp to 0.34% for 2012 from 0.51% in 2011.

The daily average balance of savings accounts increased $16.9 million or 9.3% to $199.0 million for the year ended December 31, 2012 from $182.1 million at December 31, 2011. The yield on basic savings was 0.14% in 2012 and 0.21% in 2011. Savings include savings sweep accounts for businesses in the amount of $12.0 million with rates that are tied to the Fed funds rate and vary as that index moves.

The daily average balance of time deposits decreased by $13.8 million, or 7.2% to $179.3 million at December 31, 2012, from $193.1 million at December 31, 2011. The decline was primarily due to deposits moving from fixed rate products with longer terms into floating interest rate products, such as money market accounts given the very low rates available in 2012. Within that total, time deposits less than $100,000 decreased $17.0 million or 14.1% to $103.8 million at year-end 2012 from $120.8 million at December 31, 2011. The yield on time deposits less than $100,000 was 0.96% in 2012, down from 1.45% in 2011. The decrease in time deposits less than $100,000 was partially offset by an increase in time deposits $100,000 or more of $3.2 million or 4.4% to $75.5 million at year-end 2012 from $72.4 million at December 31, 2011. The yield on time deposits $100,000 or more was 1.10% in 2012, down from 1.38% in 2011.

Capital

The adequacy of the Corporation's capital is regularly reviewed to ensure that sufficient capital is available for current and future needs and is in compliance with regulatory guidelines. The assessment of overall capital adequacy depends on a variety of factors, including asset quality, liquidity, earnings stability, changing competitive forces, economic condition in markets served, and strength of management.

Table 10

CAPITAL
(Dollars and Share Numbers in Thousands)

	December 31,		
	2012	2011	2010
Total stockholders' equity	$ 109,384	$ 121,980	$ 114,335
Tier 1 capital	$ 108,689	$ 120,816	$ 112,741
Total capital	$ 118,312	$ 130,371	$ 122,268
Book value per common share	$ 12.28	$ 13.70	$ 12.84
Cash dividends declared per common share	$ 2.33	$ 0.21	$ 2.40
Tier 1 leverage ratio	9.10%	10.63%	10.37%
Tier 1 risk-based capital ratio	14.16%	15.84%	14.52%
Total risk-based capital ratio	15.41%	17.08%	15.75%
Shares outstanding (period end)	8,905	8,905	8,905
Basic shares outstanding (average)	8,905	8,905	8,905
Diluted shares outstanding (average)	8,905	8,905	8,905

Total stockholders' equity at December 31, 2012 decreased $12.6 million to $109.4 million, or $12.28 book value per common share compared with $122.0 million, or $13.70 book value per common share at December 31, 2011.

The decrease in stockholders' equity during 2012 was the result of three regular quarterly dividends of $0.21 per share being declared in April, July and October of 2012. In addition, the Corporation paid a special dividend of $1.70 per share in December of 2012. The dividend was intended to be a prepayment of future dividends in anticipation of potential changes in the tax code related to dividend income. Management and the Board are committed to rebuilding the Corporation's capital to offset this prepayment and therefore do not anticipate making additional dividends payments until at least 2015. In December of 2011, the Board resumed quarterly dividends following a special dividend payment in December of 2010 by declaring a dividend of $0.21 per share payable in January 2012.

As previously discussed, cash dividends of $2.54 per share were paid in 2012 which consisted of regular dividends of $0.84 per share and a special pre-paid dividend of $1.70 per share compared to no cash dividends paid during 2011.

As of December 31, 2012, the Corporation's Tier 1 leverage ratio was 9.10% compared to 10.63% at December 31, 2011. Tier 1 risk-based capital ratios were 14.16% and 15.84% at December 31, 2012 and 2011, respectively, and total risk-based capital ratios were 15.41% and 17.08% at December 31, 2012 and 2011, respectively. All of the ratios declined due to the special dividend paid in December of 2012. In anticipation of the decline in the Corporation's regulatory capital ratios, management did ask for and receive regulatory approval to pay the special dividend. After the payment of the dividend, all of the Corporation's ratios remain significantly in excess of minimum regulatory requirements. A bank is "well capitalized" if it maintains a minimum Tier 1 leverage ratio of 5.0% and a minimum Tier 1 risk based capital ratio of 6.0%. Earnings continue to be stable and provide sufficient capital retention for anticipated growth. Management actively reviews capital strategies for the Corporation and each of its subsidiaries in light of perceived business risks, future growth opportunities, industry standards and regulatory requirements.

Interest Rate Risk

Financial institutions derive their income primarily from the excess of interest collected over interest paid. The rates of interest an institution earns on its assets and pays on its liabilities generally are established contractually for a period of time. Since market interest rates change over time, an institution is exposed to changes in profit margins (or losses) if it cannot adapt to interest rate changes. Interest Rate Risk ("IRR") is the exposure of an organization's financial condition to adverse movements in interest rates. Accepting this risk can be an important source of profitability and stockholder value. However, excessive levels of IRR could pose a significant threat to the Bank's earnings and capital base. Accordingly, effective risk management that maintains IRR at prudent levels is essential to the Bank's safety and soundness.

When assessing IRR, the Bank seeks to ensure that appropriate policies, procedures, management information systems and internal controls are in place to maintain IRR at prudent levels with consistency and continuity. Evaluating the quantitative level of IRR exposure requires the Bank to assess the existing and potential future effects of changes in interest rates on its consolidated financial condition, including capital adequacy, earnings, liquidity and, where appropriate, asset quality.

Financial institutions are also subject to prepayment risk in falling rate environments. For example, mortgage loans and other financial assets may be prepaid by a debtor so that the debtor may refinance its obligations at new, lower rates. Prepayments of assets carrying higher rates reduce the Bank's interest income and overall asset yields. Certain portions of an institution's liabilities may be short-term or due on demand, while most of its assets may be invested in long-term loans or investments. Accordingly, the Bank seeks to have in place sources of cash to meet short-term demands. These funds can be obtained by increasing deposits, borrowing or selling assets. Also, short-term borrowings provide additional sources of liquidity for the Bank.

Several ways an institution can manage IRR include selling existing assets or repaying certain liabilities and matching repricing periods for new assets and liabilities by shortening terms of new loans or investments. The Bank has employed all these strategies in varying degrees. An institution might also invest in more complex financial instruments intended to hedge or otherwise mitigate IRR. Interest rate swaps, futures contracts, options on futures and other such derivative financial instruments are often used for this purpose. The Bank has never purchased any of these types of derivative financial instruments.

In order to measure earnings sensitivity to changing rates, the Bank uses two different measurement tools: static gap analysis and simulation of earnings. The static gap analysis starts with contractual repricing information for assets and liabilities. These items are then combined with repricing estimations for administered rate (interest-bearing demand deposits, savings, and money market accounts) and non-rate related products (demand deposit accounts, other assets and other liabilities) to create a baseline repricing balance sheet.

At December 31, 2012, the Bank's balance sheet was asset sensitive to interest rate movements for principal amounts maturing in one year. Asset sensitive means that interest-bearing assets will reprice faster than interest-bearing liabilities. In a rising rate environment, an asset sensitive bank will generally be beneficial. Liability sensitive means interest-bearing deposits will reprice faster than interest-bearing assets. In a rising rate environment a liability sensitive bank will generally not be beneficial.

Table 11

STATIC GAP ANALYSIS
December 31, 2012
(Dollars in Thousands)

	Principal Amount Maturing in:						
	Immediate	2013	2014	2015	2016	Thereafter	Total
Rate-sensitive assets:							
I/B Due From Banks	$ 726	$ -	$ -	$ -	$ -	$ -	$ 726
Fed Funds Sold	63,060	-	-	-	-	-	63,060
U. S. Agencies	-	101,432	24,301	-	-	26,047	151,780
Mortgage-Backed Securities	-	29,517	20,525	15,349	11,804	62,030	139,225
Municipal Securities	-	16,230	8,828	7,336	4,196	23,739	60,329
FRB Stock	322	-	-	-	-	-	322
Commercial	1,003	49,044	12,786	10,836	1,755	3,655	79,079
Real Estate	70,755	265,552	118,458	100,459	16,185	34,206	605,615
Consumer	850	2,020	1,217	668	197	119	5,071
Other Loans	114	635	523	566	567	3,186	5,591
Total RS Assets	$ 136,830	$ 464,430	$ 186,638	$ 135,214	$ 34,704	$ 152,982	$ 1,110,798
Rate-sensitive liabilities:							
NOW Accounts	$ -	$ 99,460	$ 99,459	$ 99,459	$ 33,153	$ -	$ 331,531
Money Market Accounts	-	67,732	67,730	67,730	22,577	-	225,769
Savings	-	33,140	33,140	33,140	33,140	60,757	193,317
Time Deposits	-	122,388	23,221	9,977	6,706	7,535	169,827
Total RS Liabilities	$ -	$ 322,720	$ 223,550	$ 210,306	$ 95,576	$ 68,292	$ 920,444

The Corporation's funding acquisition and deployment strategy, management reporting and board approved limits target a cumulative ratio of 1.0 for Rate Sensitive Assets vs. Rate Sensitive Liabilities ("RSA/RSL") at one year. The Bank RSA/RSL ratio is 1.73 at December 31, 2012 (where a cumulative ratio of 1.0 is balanced and neither asset nor liability sensitive after one year). The asset sensitive difference of 0.73 means that $253.7 million more interest-earning assets will be rate adjusted than interest bearing liabilities over the next 12 months. The ratio and analysis includes assumptions that closely follow the Bank's techniques for managing risk: lagged interest rate adjustments, administered rate products, rate adjustment of cash flow from amortization and prepayment of loans through reinvestment, and the reinvestment of maturing assets and liabilities. In this case, management has positioned the Bank to benefit from rising interest rates as the Bank has more assets that will reprice in the next 12 months than liabilities which would positively impact net interest income.

Along with the static gap analysis, determining the sensitivity of short-term future earnings to a hypothetical plus or minus 100 bp and 200 bp parallel rate shock can be accomplished through the use of simulation modeling. In addition to the assumptions used to create the static gap, simulation of earnings includes the modeling of the balance sheet as an ongoing entity. The model projects net interest income based on a hypothetical change in interest rates. The resulting net interest income for the next 12-month period is compared to the net interest income amount calculated using flat rates. Table 12 below represents the Corporation's earnings sensitivity to a plus or minus 100 and 200 bp parallel rate shock.

Table 12

NET INTEREST INCOME OVER ONE YEAR HORIZON
(Dollars in Thousands)

	Amount	Dollar Change	Percentage Change
+200 bps	$ 41,451	$ 2,743	$ 7.09 %
+100 bps	40,399	1,692	4.37 %
Base	38,707	-	- %
-100 bps	37,559	(1,162)	(3.00) %
-200 bps	35,759	(2,949)	(7.62) %

These results are based solely on the modeled changes in market rates, and do not reflect the earnings sensitivity that may arise from other factors such as the shape of the yield curve and changes in spread between key market rates. These actions also do not include any action management may take to mitigate potential income variances. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies.

Liquidity

The ability to provide the necessary funds for the Bank's day-to-day operations depends on a sound liquidity position. Management monitors the Bank's liquidity by reviewing the maturity distribution between interest-earning assets and interest-bearing liabilities. Fluctuations in interest rates can be the primary cause for the flow of funds into or out of a financial institution. The Bank continues to offer products that are competitive and encourages depositors to invest their funds in these products. Management believes that these efforts will help the Bank to not only retain these deposits, but to encourage continued deposit growth. As of December 31, 2012, the Bank has the ability to borrow up to $55.0 million in federal funds purchased, $55.4 million through repurchase agreements and $33.5 million available for short-term liquidity through the Federal Reserve Bank Discount window.

During the year, the Bank manages its overall liquidity, taking into consideration funded and unfunded commitments as a percentage of its liquidity sources. The Bank's liquidity sources have been and are expected to continue to be sufficient to meet the cash requirements of its lending activities.

Off-Balance Sheet Arrangements

The Bank uses certain derivative financial instruments to meet the ongoing credit needs of its customers and to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit and forward loan sale commitments. The Bank does not use interest rate contracts (e.g. swaps, caps or floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2012 or 2011. The Bank, through its normal operations, does have loan commitments and standby letters of credit outstanding as of December 31, 2012 and December 31, 2011 in the amount of $101.5 million and $109.9 million, respectively. These items are further explained in Note 18 of Notes to Consolidated Financial Statements.

Tri City Bankshares Corporation
Selected Financial Data

	2012	2011	2010	2009	2008
Results of Operations:					
Total interest income	$ 45,472,669	$ 53,196,793	$ 61,928,649	$ 44,386,514	$ 43,451,436
Total interest expense	3,213,143	4,583,358	5,712,618	6,953,466	9,517,508
Net interest income	42,259,526	48,613,435	56,216,031	37,433,048	33,933,928
Provision for loan losses	7,200,000	8,370,000	6,930,000	3,705,555	1,300,000
Net interest income after PLL	35,059,526	40,243,435	49,286,031	33,727,493	32,633,928
Non-interest income	17,191,751	14,790,163	16,476,536	14,597,386	12,885,068
Non-interest expense	40,081,136	40,824,792	43,078,525	34,086,548	29,202,122
Acquisition-related gain	-	-	-	21,474,123	-
Provision for income tax	4,018,157	4,692,601	8,374,000	13,635,000	5,292,500
Net income	$ 8,151,984	$ 9,516,205	$ 14,310,042	$ 22,077,454	$ 11,024,374
Per Share Data:					
Basic earnings per share	$ 0.92	$ 1.07	$ 1.61	$ 2.48	$ 1.24
Cash dividends declared per share	$ 2.33	$ 0.21	$ 2.40	$ 1.08	$ 1.04
Selected Financial Condition Data (at December 31): (Dollars in Thousands)					
Total assets	$ 1,231,752	$ 1,215,143	$ 1,141,687	$ 1,125,709	$ 792,933
Total net loans	692,440	696,786	737,302	781,846	593,701
Held to maturity investment securities	351,523	360,566	227,804	189,789	106,651
Total deposits	1,119,207	1,070,480	1,018,447	987,984	677,678
Total stockholders' equity	109,384	121,981	114,335	121,396	108,936

Market for Corporation's Common Stock

The Corporation's stock is quoted over-the-counter on the OTCQB bulletin board under the trading symbol "TRCY" and on the Pink Sheets under the trading symbol "TRCY.PK." Over-the-counter quotations do not reflect retail mark-up, mark-down or commission and may not necessarily reflect actual transactions. Trading in the Corporation's stock is limited and sporadic and the Corporation believes that no established trading market exists for its stock. The following table sets forth the high and low bid quotations as quoted on the OTCQB for the Corporation's stock for the past two years.

	OTCQB Pink Quote Bid Quotations	
Fiscal Quarter Ended	**High**	**Low**
March 31, 2011	$ 18.85	$ 17.50
June 30, 2011	18.00	17.25
September 30, 2011	17.25	15.35
December 31, 2011	18.45	16.60
March 31, 2012	17.90	16.05
June 30, 2012	16.99	13.00
September 30, 2012	17.00	15.15
December 31, 2012	17.25	13.51

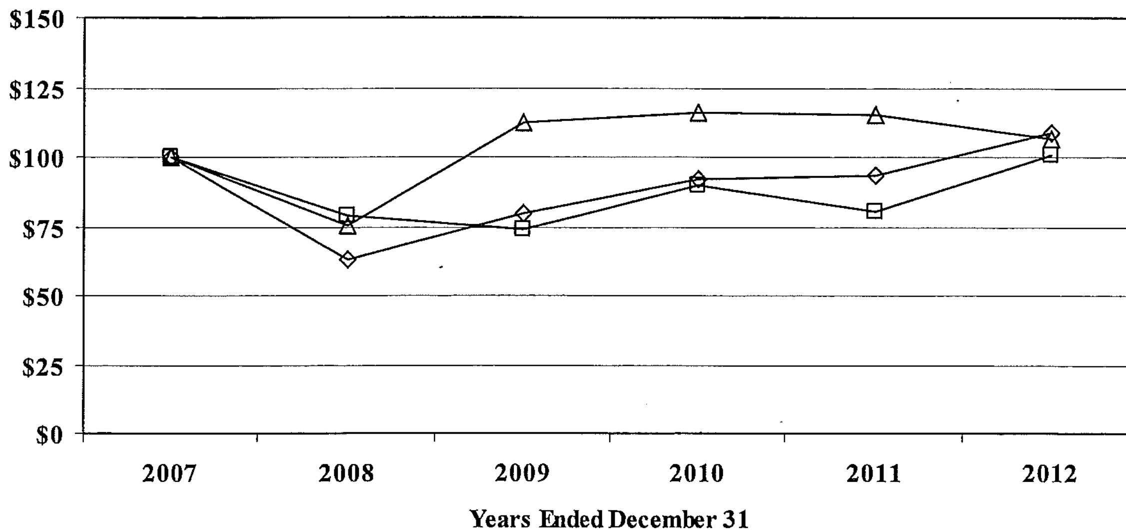
As of December 31, 2012, the number of holders of record of the Corporation's common stock was 559.

The Corporation declared three $0.21 per share quarterly cash dividends in 2012. These dividends were declared on April 11, July 11 and October 10, 2012 payable on May 3, August 2 and November 1, 2012, respectively. The Corporation declared one quarterly cash dividend in 2011 in the amount of $0.21 per share. An additional prepaid dividend for 2013 and 2014 was declared of $1.70 per share on December 5, 2012, payable on December 21, 2012, in anticipation of potential tax law changes that occurred in 2012.

The Corporation is not party to any loan agreement, indenture or other agreement which restricts its ability to pay dividends; however, the Wisconsin Business Corporation Law authorizes directors to declare and pay cash dividends only out of the Corporation's unreserved and unrestricted earned surplus. The prepaid dividend payment resulted in the Corporation paying more dividends than net income generated during the current year and the preceding two years combined. Thus, the Corporation did ask for and receive regulatory approval to pay the special dividend. See Note 19 to the consolidated financial statements for restrictions imposed by regulatory agencies upon the subsidiary bank's ability to transfer funds to the parent corporation.

STOCK PERFORMANCE GRAPH

The following graph shows the cumulative total stockholder return on the Corporation's common stock over the last five fiscal years compared to the returns of the Standard & Poor's 500 Stock Index and S&P 500 Commercial Banks Index compiled by Standard & Poor's and consisting of 13 regional banks, assuming that $100 is invested on December 31, 2007 with dividends reinvested.



PERIOD (FISCAL YEAR COVERED)	S&P 500	S&P 500 COMMERCIAL BANKS	TRI CITY BANKSHARES
2007	$ 100.00	$ 100.00	$ 100.00
2008	$ 63.00	$ 78.94	$ 75.43
2009	$ 79.67	$ 74.20	$ 112.36
2010	$ 91.67	$ 89.89	$ 115.82
2011	$ 93.61	$ 80.77	$ 115.03
2012	$ 102.59	$ 100.61	$ 106.72

Prior to January 2008, the Corporation maintained an automatic Dividend Reinvestment Plan ("DRIP"). For purposes of the DRIP, the Board of Directors was required to establish the "Fair Market Value" of the Corporation's stock on a quarterly basis based on factors set forth in the DRIP. The Corporation common stock values above through 2007 are based on the Fair Market Value established under the DRIP over the periods indicated. From January 2008 forward the values are based on the closing bid quotations for the Corporation's common stock on the last trading day of each fiscal year.

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Tri City Bankshares Corporation
Oak Creek, Wisconsin

We have audited the accompanying consolidated financial statements of Tri City Bankshares Coproation and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statement of income, stockholders' equity, and cash flow for the year 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 controls relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 auditors' 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 controls relevant to the entities' 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 entities' internal controls. 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 Tri City Bankshares Corporation and its subsidiaries as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 6, 2013

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Tri City Bankshares Corporation

We have audited the accompanying consolidated balance sheets of Tri City Bankshares Corporation and subsidiaries (the "Corporation") as of December 31, 2011, and the related consolidated statements of income, stockholders' equity and cash flows for each of the two years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of its internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tri City Bankshares Corporation and subsidiaries as of December 31, 2011 and the results of their operations and cash flows for each of the two years ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 6, 2013

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2012 and 2011

ASSETS

	2012	2011
Cash and due from banks	$ 59,719,085	$ 52,942,095
Federal funds sold	63,060,224	55,121,113
Cash and cash equivalents	122,779,309	108,063,208
Held to maturity securities, fair value of $355,987,948 and $363,252,684 as of 2012 and 2011, respectively	351,523,150	360,566,062
Loans held for investment, less allowance for loan losses of $12,197,012 and $11,012,088 as of 2012 and 2011, respectively	692,439,668	696,785,798
Premises and equipment - net	18,005,267	19,146,870
Cash surrender value of life insurance	28,328,926	12,491,722
Mortgage servicing rights - net	1,685,893	1,598,802
Core deposit intangible	694,922	1,005,135
Other real estate owned	8,544,665	7,350,678
Accrued interest receivable and other assets	7,750,512	8,134,624
TOTAL ASSETS	$ 1,231,752,312	$ 1,215,142,899

LIABILITIES AND STOCKHOLDERS' EQUITY

	2012	2011
LIABILITIES		
Deposits		
Demand	$ 199,261,784	$ 176,767,314
Savings and NOW	750,122,506	714,052,479
Other time	169,822,847	179,660,109
Total Deposits	1,119,207,137	1,070,479,902
Payable for investments purchased	-	17,165,797
Other liabilities	3,160,910	5,516,471
Total Liabilities	1,122,368,047	1,093,162,170
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Cumulative preferred stock, $1 par value, 200,000 shares authorized, no shares issued	-	-
Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2012 and 2011	8,904,915	8,904,915
Additional paid-in capital	26,543,470	26,543,470
Retained earnings	73,935,880	86,532,344
Total Stockholders' Equity	109,384,265	121,980,729
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,231,752,312	$ 1,215,142,899

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

For theYears Ended December 31, 2012, 2011 and 2010

	2012	2011	2010
INTEREST INCOME			
Loans	$ 40,870,501	$ 46,957,702	$ 56,721,563
Investment securities			
Taxable	3,230,957	4,804,949	3,643,942
Tax exempt	1,309,326	1,386,998	1,482,349
Federal funds sold	42,559	27,818	61,469
Other	19,326	19,326	19,326
Total Interest Income	45,472,669	53,196,793	61,928,649
INTEREST EXPENSE			
Deposits	3,203,426	4,570,769	5,711,774
Other borrowings	9,717	12,589	844
Total Interest Expense	3,213,143	4,583,358	5,712,618
Net Interest Income before Provision for Loan Losses	42,259,526	48,613,435	56,216,031
Provision for loan losses	7,200,000	8,370,000	6,930,000
Net Interest Income after Provision for Loan Losses	35,059,526	40,243,435	49,286,031
NONINTEREST INCOME			
Service charges on deposits	10,108,357	9,986,812	10,180,904
Loan servicing income	132,600	317,687	349,842
Net gain on sale of loans	2,568,443	1,248,797	1,421,550
Increase in cash surrender value of life insurance	837,204	467,458	471,581
Non-accretable loan discount	1,974,071	2,247,167	2,268,873
Other income	1,571,076	522,242	1,783,786
Total Noninterest Income	17,191,751	14,790,163	16,476,536
NONINTEREST EXPENSES			
Salaries and employee benefits	21,407,022	22,037,202	22,738,774
Net occupancy costs	3,732,617	4,067,094	3,958,806
Furniture and equipment expenses	1,965,881	1,886,925	2,200,688
Computer services	4,075,449	3,678,813	3,504,256
Advertising and promotional	952,789	1,033,215	1,173,330
FDIC and other regulatory assessments	1,286,408	1,316,754	2,459,307
Office supplies	832,921	790,283	834,013
Acquisition expenses	-	-	370,214
Core deposit intangible amortization	310,212	418,219	567,713
Other expenses	5,517,837	5,596,287	5,271,424
Total Noninterest Expenses	40,081,136	40,824,792	43,078,525
Total Income before Taxes	12,170,141	14,208,806	22,684,042
Less: Income tax expense	4,018,157	4,692,601	8,374,000
NET INCOME	$ 8,151,984	$ 9,516,205	$ 14,310,042
Basic earnings per share	$ 0.92	$ 1.07	$ 1.61
Dividends per share	$ 2.33	$ 0.21	$ 2.40
Weighted average shares outstanding	8,904,915	8,904,915	8,904,915

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2012, 2011 and 2010

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total
BALANCES – January 1, 2010	$ 8,904,915	$ 26,543,470	$ 85,947,919	$ 121,396,304
Net income	-	-	14,310,042	14,310,042
Cash dividends - $2.40 per share	-	-	(21,371,793)	(21,371,793)
BALANCES – December 31, 2010	8,904,915	26,543,470	78,886,168	114,334,553
Net income	-	-	9,516,205	9,516,205
Cash dividends - $0.21 per share	-	-	(1,870,029)	(1,870,029)
BALANCES – December 31, 2011	8,904,915	26,543,470	86,532,344	121,980,729
Net income	-	-	8,151,984	8,151,984
Cash dividends - $2.23 per share	-	-	(20,748,448)	(20,748,448)
BALANCES – December 31, 2012	$ 8,904,915	$ 26,543,470	$ 73,935,880	$ 109,384,265

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2012, 2011 and 2010

	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 8,151,984	$ 9,516,205	$ 14,310,042
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Depreciation	2,059,240	2,149,444	2,250,653
(Accretion) amortization of servicing rights, premiums and discounts	1,564,957	(6,696,585)	(10,373,438)
Gain on sale of loans	(2,568,443)	(1,248,797)	(1,421,550)
Amortization of other intangibles	310,212	418,219	567,713
Provision for loan losses	7,200,000	8,370,000	6,930,000
Benefit for deferred income taxes	(1,560,287)	(1,170,614)	(4,685,335)
Proceeds from sales of loans held for sale	97,997,995	56,224,575	66,009,353
Originations of loans held for sale	(96,155,402)	(55,365,375)	(64,983,128)
Increase in cash surrender value of life insurance	(837,204)	(467,458)	(471,581)
Gain on other real estate owned	(623,936)	(700,534)	(1,376,007)
Gain on disposal of premises and equipment	(256,057)	(26,250)	(72,109)
Net change in:			
Accrued interest receivable and other assets	384,114	(503,139)	6,298,979
Payable for investments purchased	(17,165,797)	17,165,797	-
Accrued interest payable and other liabilities	(795,274)	727,108	(5,742,165)
Net Cash Flows Provided by (Used) in Operating Activities	(2,293,898)	28,393,210	7,241,427
CASH FLOWS FROM INVESTING ACTIVITIES			
Activity in held to maturity securities:			
Maturities, prepayments and calls	391,116,342	246,482,676	182,949,588
Purchases	(389,080,745)	(380,118,180)	(221,817,712)
Net decrease (increase) in loans	(6,939,472)	29,953,612	40,659,828
Purchase of life insurance	(15,000,000)	-	-
Purchases of premises and equipment – net	(1,081,214)	(987,490)	(2,858,680)
Proceeds from sale of other real estate owned	9,596,668	9,013,104	9,317,897
Proceeds from sales of premises and equipment	419,633	38,900	380,090
Net Cash Flows Provided by (Used) in Investing Activities	(10,968,788)	(95,617,378)	8,631,011
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in deposits	48,727,235	52,032,610	30,463,595
Net change in other borrowings	-	(4,815,964)	3,003,948
Dividends paid	(20,748,448)	-	(21,371,793)
Net Cash Flows Provided by in Financing Activities	27,978,787	47,216,646	12,095,750
Net Change in Cash and Cash Equivalents	14,716,101	(20,007,522)	27,968,188
CASH AND CASH EQUIVALENTS – BEGINNING OF YEAR	108,063,208	128,070,730	100,102,542
CASH AND CASH EQUIVALENTS – END OF YEAR	$ 122,779,309	$ 108,063,208	$ 128,070,730

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2012, 2011 and 2010

(continued)

	2012	2011	2010
SUPPLEMENTAL CASH FLOW DISCLOSURES			
Cash paid for interest	$ 3,285,817	$ 4,692,288	$ 5,911,953
Cash paid for income taxes	5,410,000	5,480,000	13,835,860
Loans receivable transferred to other real estate owned	10,166,719	10,256,043	8,667,614
Mortgage servicing rights resulting from sales of loans	725,850	389,597	395,325
Dividends accrued not paid	-	1,870,029	-

See accompanying notes to consolidated financial statements

NOTE 1 - Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, and Title Service of Southeast Wisconsin, Inc., a title company subsidiary. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. The Corporation has evaluated the consolidated financial statements for subsequent events through the report issue date.

Nature of Banking Activities

The consolidated income of the Corporation is principally from the income of its wholly owned subsidiary. The Bank grants commercial, residential and consumer loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation and the Bank are subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation and the Bank are subject to the regulations of certain regulatory agencies and undergo periodic examination by those regulatory agencies.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and 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 in the near term relate to the determination of the allowance for loan losses and valuation of other real estate owned.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. The Bank maintains amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Held to Maturity Securities

Securities classified as held to maturity are those securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. Interest and dividends are included in interest income from the related securities as earned. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. The sale of a security within three months of its maturity date or after collection of at least 85 percent of the principal outstanding at the time the security was acquired is considered a maturity for purposes of classification and disclosure. Realized gains and losses are computed on a specific identification basis and declines in value determined to be other than temporary due to credit issues are included in gains (losses) on sale of securities. In the event that a security is called, the Bank would expect to receive 100% of the principle.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal, reduced by an allowance for loan losses and any deferred fees or costs in originating loans. Interest income is accrued and credited to income on a daily basis based on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the loan yield using an effective interest method. The accrual of interest income on impaired loans is discontinued when, in the opinion of management, there is reasonable doubt as to the borrower's ability to meet payment of interest or principal when they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are credited to the loan receivable balance and no interest income is recognized on those loans until the principal balance is current. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. A troubled debt restructuring includes a loan modification where a borrower is experiencing financial difficulty and the Bank grants a concession to that borrower that the Bank would not otherwise consider except for the borrower's financial difficulties. All troubled debt restructurings are classified as impaired loans. Troubled debt restructurings may be on accrual or non-accrual status based upon the performance of the borrower and management's assessment of collectability. Loans deemed non-accrual may return to accrued status based on performance in accordance with terms of the restructuring.

Consistent with regulatory guidance, charge-offs are taken when specific loans, or portions thereof, are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. The Bank's policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Bank promptly charges-off commercial and real estate loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. All consumer loans 120 days past due and all other loans with principal and interest 180 days or more past due will be reviewed for potential charge-off at least quarterly.

Loans Acquired Through Purchase

Loans acquired through the completion of a purchase, including loans that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Bank will be unable to collect all contractually- required payments receivable, are initially recorded at fair value with no valuation allowance. Loans are evaluated individually at the date of acquisition to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Contractually-required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "nonaccretable difference," are not recognized as a yield adjustment, a loss accrual or a valuation allowance. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the difference from non-accretable discount to accretable discount with a positive impact on interest income. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as provision for loan losses. If the Bank does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized gains or losses are recognized through a valuation allowance by charges to income. All sales are made without recourse.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable and inherent losses incurred in the loan portfolio. Management maintains allowances for loan losses at levels that we believe to be adequate to absorb estimated probable credit losses inherent in the loan portfolio. The adequacy of the allowances is determined based on periodic evaluations of the loan portfolios and other relevant factors. The allowance is comprised of both a specific component and a general component. Even though the entire allowance is available to cover losses on any loan, specific allowances are provided on impaired loans pursuant to accounting standards. The general allowance is based on historical loss experience, adjusted for qualitative and environmental factors. Management reviews the assumptions and methodology related to the general allowance in an effort to update and refine the estimate on a quarterly basis.

In determining the general allowance management has segregated the loan portfolio by loan segment. For each class of loan, we compute a historical loss factor. In determining the appropriate period of activity to use in computing the historical loss factor we look at trends in net charge-off ratios. It is management's intention to utilize a period of activity that is most reflective of current experience. Changes in the historical period are made when there is a distinct change in the trend of net charge-off experience. Management adjusts the historical loss factors for the impact of the following qualitative factors: asset quality, changes in volume and terms, policy changes, ability of management, economic trends, industry conditions, changes in credit concentrations and competitive/legal factors. In determining the impact, if any, of an individual qualitative factor, management compares the current underlying facts and circumstances surrounding a particular factor with those in the historical periods, adjusting the historical loss factor in a directionally consistent manner with changes in the qualitative factor. Management separately evaluates both the Bank's historical portfolio as well as Acquired loans that have renewed and are eligible to be considered as part of the general allowance. Management will continue to analyze the qualitative factors on a quarterly basis, adjusting the historical loss factor both up and down, to a factor we believe is appropriate for the probable and inherent risk of loss in its portfolio.

Specific allowances are determined as a result of our impairment process. When a loan is identified as impaired it is evaluated for loss using either the fair value of collateral method or the present value of cash flows method. If the present value of expected cash flows or the fair value of collateral exceeds the Bank's carrying value of the loan no loss is anticipated and no specific reserve is established. However, if the Bank's carrying value of the loan is greater than the present value of expected cash flows or fair value of collateral a specific reserve is established. In either situation, loans identified as impaired are excluded from the calculation of the general reserve.

The allowance for loan losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries. The adequacy of the allowance for loan losses is reviewed and approved by the Bank's Board of Directors on a quarterly basis. The allowance for loan losses reflects management's best estimate of the probable and inherent losses on loans and is based on a risk model developed and implemented by management and approved by the Bank's Board of Directors.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may suggest additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

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 Bank, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

The Bank records a mortgage servicing right asset ("MSR") when it continues to service borrower payments and perform maintenance activities on loans in which the loan has been sold to secondary market investors. The servicing rights are initially capitalized at fair value on an individual loan level basis. In the period in which the loan is sold to the secondary market investors, the gain on sale of the loan is increased by the value of the initial MSR. Amortization of MSRs is calculated based on actual payment activity on a per loan basis.

Quarterly impairment testing is performed by the Bank to determine that MSRs are recorded as the lower of fair value or amortized cost. Annually the Bank engages a third party specialist to calculate the fair value using significant inputs/assumptions such as prepayment speed, default rates, cost to service and discount rates. A valuation allowance is recorded when the fair value of the MSRs is less than its amortized cost.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Premises and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Provisions for depreciation are computed on straight-line methods over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and 15 to 40 years for buildings and lease-hold improvements. Repairs and maintenance costs are expensed as incurred.

Other Real Estate Owned

Other real estate owned ("OREO") comprises real estate acquired in partial or full satisfaction of loans. OREO is recorded at the lower of carrying value or its estimated fair value less estimated selling costs at the date of transfer, establishing a new cost basis, with any excess of the related loan balance over the fair value less expected selling costs charged to the allowance for loan losses. Subsequently, properties are evaluated and any additional declines in value are recorded in current period earnings. The amount the Bank ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Bank's control.

Intangible Assets

The Bank's intangible assets include the value of ongoing customer relationships (core deposit intangible) arising from the purchase of certain assets and the assumption of certain liabilities from unrelated entities. Core deposit intangibles are amortized over an eight year period. Any impairment in the intangibles would be recorded against income in the period of impairment.

Federal Reserve Bank Stock

The Bank's investment in Federal Reserve Bank stock meets the minimum amount required by current regulations and is carried at cost, which approximates fair value.

Off-Balance Sheet Financial Instruments

In the ordinary course of business the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Derivative Financial Instruments

The Bank utilizes derivative financial instruments to meet the ongoing credit needs of its customers and in order to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit. The Bank does not use interest rate contracts (e.g. swaps, caps, floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2012 or 2011.

Advertising Costs

All advertising costs incurred by the Bank are expensed in the period in which they are incurred.

Income Taxes

The Corporation files a consolidated federal income tax return and combined state income tax returns. Income tax expense is recorded based on the liability method. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The differences relate principally to the allowance for loan losses, mortgage servicing rights, deferred loan fees, and premises and equipment. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized. The Corporation also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position taken or expected to be taken in an income tax return. The Corporation follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to the uncertainty in these income tax positions. It is the Corporation's policy to include interest and penalties in tax expense.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Earnings Per Share

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during any of the three years in the period ended December 31, 2012.

Segment Reporting

The Corporation has determined that it has one reportable segment - community banking. The Bank offers a range of financial products and services to external customers, including: accepting deposits and originating residential, consumer and commercial loans. Revenues for each of these products and services are disclosed in the consolidated statements of income.

Employee Benefit Plan

The Bank has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Bank's policy is to fund contributions as accrued.

Reclassifications

Certain 2011 and 2010 amounts have been reclassified to conform to the 2012 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

Recent Accounting Pronouncements

In May 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): *Reconsideration of Effective Control for Repurchase Agreements*. The ASU is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments to the codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU was effective for the first interim or annual period beginning on or after December 15, 2011. The provisions of this guidance had no significant impact on our consolidated financial condition, results of operations or liquidity.

In June 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification (Codification) in this ASU are to be applied prospectively. For public entities, the amendments were effective during interim and annual periods beginning after December 15, 2011. The provisions of this guidance had no significant impact on the consolidated financial condition, results of operations or liquidity.

NOTE 2 - Fair Value of Financial Instruments

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if a Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Corporation can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

The Corporation has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves and option volatilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, creditworthiness, liquidity and unobservable parameters that are applied consistently over time. Any changes to the valuation methodology are reviewed by management to determine appropriateness of the changes.

Loans held for investment - The Bank does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. At December 31, 2012 and 2011, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with relevant accounting guidance, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as a nonrecurring Level 2 valuation. Valuations based on management estimates are recorded as nonrecurring Level 3. Mortgage loans available for sale and held for investment are valued using fair values attributable to similar mortgage loans. The fair value of the other loans is based on the fair value of obligations with similar credit characteristics.

Other real estate owned - Loans on which the underlying collateral has been repossessed are recorded at the lesser of (i) carrying value or (ii) at fair value less estimated costs to sell upon transfer to OREO. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the OREO as a nonrecurring Level 2 valuation. Valuations based on management estimates are recorded as nonrecurring Level 3.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Further, while the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments at the reporting date.

As of December 30, 2012 and December 31, 2011 the Bank did not carry any assets that were measured at fair value on a recurring basis.

NOTE 2 - Fair Value of Financial Instruments – (cont.)

Assets measured at fair value on a nonrecurring basis

The Bank has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market and had a fair value below cost at the end of the period as summarized below.

	Balance at 12/31/12	Level 1	Level 2	Level 3
Loans held for investment	$ 18,189,649	$ -	$ -	$ 18,189,649
Other real estate owned	8,544,665	-	-	8,544,665
Totals	$ 26,734,314	$ -	$ -	$ 26,734,314

	Balance at 12/31/11	Level 1	Level 2	Level 3
Loans held for investment	$ 17,902,323	$ -	$ -	$ 17,902,323
Other real estate owned	7,350,678	-	-	7,350,678
Totals	$ 25,253,001	$ -	$ -	$ 25,253,001

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Corporation.

The following is a description of the valuation methodologies used by the Corporation to estimate fair value, as well as the general classification of financial instruments pursuant to the valuation hierarchy:

Cash and due from banks – Due to their short-term nature, the carrying amount of cash and due from banks approximates fair value.

Fed funds sold – Due to their short-term nature, the carrying amount of Fed funds sold approximates fair value.

Held to maturity securities – The fair value is estimated using quoted market prices.

Federal Reserve Bank Stock – It is not practical to determine the fair value of Federal Reserve Bank ("FRB") Stock due to restrictions placed on its transferability. No secondary market exists for FRB stock. The stock is bought and sold at par by the FRB. Management believes the recorded value is the fair value.

Loans held for investment – The fair value of loans held for investment is estimated using the rates currently offered for loans held for investment segregated by loan purpose and term.

Cash surrender value of life insurance – Fair value is based on the cash surrender value of the individual policies as provided by the insurance agency.

NOTE 2 - Fair Value of Financial Instruments – (cont.)

Mortgage servicing rights - The fair value of MSRs is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Bank's portfolio of serviced loans.

Deposit Accounts - The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.

Other borrowings – The carrying value of other borrowings, including federal funds purchased and repurchase agreements, approximates fair value.

The estimated fair values of financial instruments at December 31, 2012 and 2011 are as follows:

	December 31, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS				
Cash and due from banks	$ 59,179,085	$ 59,179,085	$ 52,942,095	$ 52,942,095
Federal funds sold	63,060,224	63,060,224	55,121,113	55,121,113
Held to maturity securities	351,523,150	355,987,948	360,566,062	363,252,684
Federal reserve stock	322,100	322,100	322,100	322,100
Loans held for investment, net	692,439,668	700,335,974	696,785,798	700,264,487
Cash surrender value of life insurance	28,328,926	28,328,926	12,491,722	12,491,722
Mortgage servicing rights	1,685,893	1,750,724	1,598,802	1,884,447
Accrued interest receivable	4,164,716	4,164,716	4,650,828	4,650,828
FINANCIAL LIABILITIES				
Deposits	$ 1,119,207,137	$ 1,118,005,211	$ 1,070,479,902	$ 1,069,056,674
Accrued interest payable	178,569	178,569	251,243	251,243

The estimated fair value of fee income on letters of credit outstanding at December 31, 2012 and December 31, 2011 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2012 and December 31, 2011.

NOTE 3 - Cash and Due From Banks

The Bank is required to maintain vault cash and reserve balances with Federal Reserve Banks based upon a percentage of deposits. These requirements approximated $13,596,000 and $12,308,000 at December 31, 2012 and 2011, respectively.

NOTE 4 - Held to Maturity Securities

Amortized costs and fair values of held to maturity securities as of December 31, 2012 and 2011 are summarized as follows:

	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of:				
States and political subdivisions	$ 60,517,328	$ 1,719,818	$ (23,164)	$ 62,213,982
U.S. government sponsored entities	151,781,160	119,198	(34,378)	151,865,980
Collateralized mortgage obligations	43,811,778	889,223	(21,931)	44,679,070
Mortgage-backed securities	95,412,884	1,816,032	-	97,228,916
Totals	$ 351,523,150	$ 4,544,271	$ (79,473)	$ 355,987,948

	December 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of:				
States and political subdivisions	$ 63,145,630	$ 1,897,676	$ (3,892)	$ 65,039,414
U.S. government sponsored entities	261,601,680	810,407	(5,000)	262,407,087
Collateralized mortgage obligations	17,069,071	25,702	(81,226)	17,013,547
Mortgage-backed securities	18,699,681	52,067	(9,112)	18,742,636
Other	50,000	-	-	50,000
Totals	$ 360,566,062	$ 2,785,852	$ (99,230)	$ 363,252,684

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

NOTE 4 - Held to Maturity Securities (cont.)

	December 31, 2012	
	Amortized Cost	Fair Value
Due in one year or less	$ 14,947,397	$ 15,016,635
Due after one year less than 5 years	146,234,702	149,080,075
Due after 5 years less than 10 years	154,261,563	155,805,238
Due over 10 years	36,079,488	36,086,000
Totals	$ 351,523,150	$ 355,987,948

Held to maturity securities with an amortized cost of $130,560,317 and $114,469,144 at December 31, 2012 and 2011, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following tables summarize the portion of the Bank's held to maturity securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011.

	December 31, 2012					
	Continuous unrealized losses existing for less than 12 Months		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of:						
States and political Subdivisions	$ 4,053,173	$ 23,164	$ -	$ -	$ 4,053,173	$ 23,164
U.S. government sponsored entities	17,993,200	34,378	-	-	17,993,200	34,378
Collateralized mortgage obligations	4,570,727	21,931	-	-	4,570,727	21,931
Totals	$ 26,617,100	$ 79,473	$ -	$ -	$ 26,617,100	$ 79,473

	December 31, 2011					
	Continuous unrealized losses existing for less than 12 Months		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of:						
States and political Subdivisions	$ 979,394	$ 3,892	$ -	$ -	$ 979,394	$ 3,892
U.S. government sponsored entities	9,995,000	5,000	-	-	9,995,000	5,000
Collateralized mortgage Obligations	11,163,181	81,226	-	-	11,163,181	81,226
Mortgage-backed securities	5,403,167	9,112	-	-	5,403,167	9,112
Totals	$ 27,540,742	$ 99,230	$ -	$ -	$ 27,540,742	$ 99,230

NOTE 4 - Held to Maturity Securities (cont.)

Management does not believe any individual unrealized loss as of December 31, 2012 and 2011 represents other than temporary impairment. The Bank held no investment securities at December 31, 2012 and 2011 that had unrealized losses existing for greater than 12 months.

NOTE 5 - Loans

Major classification of loans are as follows at December 31:

	2012	2011
Commercial	$ 20,286,468	$ 19,956,000
Real Estate		
Construction	40,790,486	46,600,467
Commercial	325,335,181	298,042,808
Residential	258,548,191	288,609,383
Multifamily	47,525,720	39,798,866
Installment and other	12,150,634	14,790,362
	$ 704,636,680	$ 707,797,886
Less: Allowance for loan losses	(12,197,012)	(11,012,088)
Net Loans	$ 692,439,668	$ 696,785,798

Commercial loans - Historically commercial lending has been a small part of the Bank's portfolio which continues to be the case in 2012. Commercial balances have decreased during these difficult economic times. Reductions of outstanding balances on lines of credit have occurred as well as the demand for term financing as businesses made little, if any, investment in new equipment. Commercial loans are collateralized by general business assets such as accounts receivable, inventory and equipment and have no real estate component. During weak economic periods the Bank can be exposed to heightened risk if a business is out of compliance with debtor covenants supporting commercial loans.

Real estate construction loans - Loans to residential real estate developers comprise most of the dollars outstanding in real estate construction loans. Historically, real estate construction loans have been made to developers who are well known to the Bank, have prior successful project experience and are well capitalized. Loans are made to customers in the Bank's Southeastern Wisconsin market. Real estate construction loans of this type are generally larger in size and involve greater risks than residential mortgage loans because payments depend on the success of the project or in the case of commercial development, successful management of the property. The Bank will generally make credit extensions to borrowers with adequate outside liquidity to support the project in the event the actual performance is less than projected. Developers with which the Bank does business have the ability to service the development debt personally or through their companies, however, these individuals are not immune to a prolonged weak economy such as the Bank has experienced. Most of the Bank's real estate development loans are performing even four years into the economic downturn and the Bank's borrowers' inventories are decreasing. The greatest risk to the Bank within this segment are loans secured by raw land and condominium development loans. These two groups have been most severely affected by the prolonged economic downturn. In the case of loans secured by undeveloped acreage, the price per acre has decreased dramatically as other lenders liquidate the collateral on these raw land or "dirt" loans. The Bank has a few customers continuing to service the debt from free cash flow, but this becomes more problematic as the housing market continues a slow recovery. In the case of condominium loans, risk factors the Bank inherits upon the failure of a developer include the existence and/or control of the condo association, the availability of term financing to initial buyers of units and partial project completion for common use areas.

NOTE 5 – Loans (cont.)

Commercial real estate loans - The Bank's commercial real estate lending efforts are focused on owner occupied, improved property such as office buildings, warehouses, small manufacturing operations and retail facilities. The most significant risk factor is occupancy. The fact that the Bank prefers owner occupied commercial real estate reduces that risk, provided of course, the owner's business survives. The Bank's $17.9 million per-borrower legal lending limit would permit it to compete for activity in the middle market, but management prefers to seek small businesses as its target borrowers. Loans to such businesses are approved based on the creditworthiness, economic feasibility and cash flow abilities of the borrower.

Residential real estate loans - Loans in this segment of the portfolio have historically represented the lowest risk due to the large number of individual loans with relatively small average balances. The Bank considers owner-occupied one-to-four family loans to be low risk because underwriting has always required 20% equity and qualified borrowers with proper debt service coverage ratios. These loans provide a foundation for the sale of all other retail banking products and have always been a staple of the Bank's portfolio. However, in the acquisition of the Bank of Elmwood in October of 2009, the Bank acquired a number of residential real estate loans that do not meet the Bank's underwriting standards and these borrowers were encouraged to bring loans current, pay delinquent taxes, refinance at another financial institution and comply with the Bank's underwriting standards or face foreclosure. The greatest risks to the Bank in this segment are those one-to-four family residential real estate loans that are not owner occupied.

Multi-family real estate loans - The loans in this category are collateralized by properties with more than four family dwelling units. The Bank requires borrowers to provide their personal guaranty, as well as insisting on proper debt service coverage ratios and equity sufficient to sustain reasonable debt service in the event of interest rate pressure. Loans in this category typically have maturities of 3, 4 or 5 years and are amortized over 15 to 20 years. While any loan presents risk to the Bank, loans in this segment have performed quite well because of the Bank's underwriting criteria and with significant foreclosure activity in the market, many former homeowners are back in the rental market.

Installment and other loans - These loans consist of auto loans, mobile home loans and unsecured consumer loans which have been decreasing at the Bank for several years. Auto loan volume decreased despite improved new car sales in 2012 because dealer incentive financing makes this non-competitive. The Bank has historically limited its exposure to mobile home loans and unsecured consumer loans. However, the Bank acquired a number of such consumer loans, many of which continue to perform, despite not meeting the Bank's historical underwriting standards.

NOTE 5 – Loans (con't)

The following table presents the contractual aging of the recorded investment in loans as of December 31, 2012 and 2011:

	As of December 31, 2012					
	Current	Days Past Due				Total
	Loans	30-59	60-89	Over 90	Total	Loans
Commercial	$ 20,059,355	$ 9,474	$ 13,156	$ 204,483	$ 227,113	$ 20,286,468
Real Estate						
Construction	39,644,388	253,698	-	892,400	1,146,098	40,790,486
Commercial	313,517,308	2,496,491	2,174,469	7,146,913	11,817,873	325,335,181
Residential	237,609,453	4,845,595	1,441,073	14,652,070	20,938,738	258,548,191
Multifamily	46,048,825	-	1,344,570	132,325	1,476,895	47,525,720
Installment and other	11,532,810	33,641	294,914	289,269	617,824	12,150,634
Total loans	668,412,139	7,638,899	5,268,182	23,317,460	36,224,541	704,636,680
Purchase credit-impaired loans	(19,718,246)	(875,837)	(207,330)	(4,823,045)	(5,906,212)	(25,624,458)
Total loans, excluding purchase credit-impaired loans	$ 648,693,893	$ 6,763,062	$ 5,060,852	$ 18,494,415	$ 30,318,329	$ 679,012,222

	As of December 31, 2011					
	Current	Days Past Due				Total
	Loans	30-59	60-89	Over 90	Total	Loans
Commercial	$ 19,443,774	$ 58,506	$ 152,148	$ 301,572	$ 512,226	$ 19,956,000
Real Estate						
Construction	44,707,804	189,794	119,174	1,583,695	1,892,663	46,600,467
Commercial	287,520,615	3,033,167	1,358,887	6,130,139	10,522,193	298,042,808
Residential	268,286,798	3,360,425	2,702,845	14,259,315	20,322,585	288,609,383
Multifamily	37,933,674	415,821	-	1,449,371	1,865,192	39,798,866
Installment and other	14,017,731	283,519	14,331	474,781	772,631	14,790,362
Total loans	671,910,396	7,341,232	4,347,385	24,198,873	35,887,490	707,797,886
Purchase credit-impaired loans	(31,085,630)	(146,855)	(885,441)	(5,037,404)	(6,069,700)	(37,155,330)
Total loans, excluding purchase credit-impaired Loans	$ 640,824,766	$ 7,194,377	$ 3,461,944	$ 19,161,469	$ 29,817,790	$ 670,642,556

Commercial loans deemed to be inadequately collateralized and past due 90 days or more for principal or interest are placed in a non-accrual status. Residential real estate loans are not subject to these guidelines if well-secured, as deemed by the Senior Loan Committee, and in the process of collection.

NOTE 5 – Loans (con't)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31, 2012 and 2011:

	December 31, 2012	
	Nonaccrual	Past due 90 days or more and accruing
Commercial	$ 221,414	$ -
Real estate		
Construction	1,940,043	593,182
Commercial	8,989,870	483,500
Residential	15,039,972	275,602
Multifamily	252,152	-
Installment and other	101,328	241,002
Total Loans	26,544,779	1,593,286
Purchase Credit Impaired Loans:		
Commercial	-	-
Real estate		
Construction	-	-
Commercial	(1,300,890)	-
Residential	(4,463,017)	-
Multifamily	-	-
Installment & Other	-	-
Total Purchased Credit-Impaired Loans	(5,763,907)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 20,780,872	$ 1,593,286

	December 31, 2011	
	Nonaccrual	Past due 90 days or more and accruing
Commercial	$ 393,391	$ 47,156
Real estate		
Construction	1,101,343	732,911
Commercial	7,455,567	426,242
Residential	15,931,722	757,514
Multifamily	1,990,563	-
Installment and other	62,742	412,039
Total Loans	26,935,328	2,375,862
Purchase Credit Impaired Loans:		
Commercial	(2,919)	(12,749
Real estate		
Construction	-	-
Commercial	(1,602,816)	-
Residential	(4,671,780)	(12,914)
Multifamily	(603,395)	-
Installment & Other	-	-
Total Purchased Credit-Impaired Loans	(6,880,910)	(25,663)
Total Loans, excluding Purchase Credit Impaired Loans	$ 20,054,418	$ 2,350,199

NOTE 5 – Loans (con't)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. At the quarterly meetings, the Board of Directors of the Bank reviews trends for loans classified as "Special Mention," "Substandard" and "Doubtful" for the previous twelve months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets 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 currently existing facts, conditions and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and viewed as non-bankable assets, worthy of charge-off. Assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that may or may not be within the control of the customer are classified as "Pass." The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31, 2012 and December 31, 2011:

	December 31, 2012				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 18,747,473	$ 1,021,793	$ 312,719	$ 204,483	$ 20,286,468
Real estate					
Construction	35,448,492	-	5,182,404	159,590	40,790,486
Commercial	296,182,011	7,530,468	21,567,077	55,625	325,335,181
Multifamily	45,766,290	162,708	1,480,274	116,448	47,525,720
Total	$ 396,144,266	$ 8,714,969	$ 28,542,474	$ 536,146	$ 433,937,855
Current	$ 394,025,565	7,946,799	$ 17,137,923	$ 159,590	$ 419,269,877
30-59	908,822	-	1,850,841	-	2,759,663
60-89	726,379	768,170	2,037,646	-	3,532,195
Over 90	483,500	-	7,516,064	376,556	8,376,120
Total	$ 396,144,266	$ 8,714,969	$ 28,542,474	$ 536,146	$ 433,937,855

	December 31, 2011				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 17,834,473	$ 1,192,000	$ 895,121	$ 34,406	$ 19,956,000
Real estate					
Construction	41,739,351	555,665	4,140,419	165,032	46,600,467
Commercial	270,211,863	10,912,130	16,864,133	54,682	298,042,808
Multifamily	34,959,277	2,849,026	1,874,115	116,448	39,798,866
Total	$ 364,744,964	$ 15,508,821	$ 23,773,788	$ 370,568	$ 404,398,141
Current	$ 361,193,743	$ 15,233,112	$ 13,013,980	$ 165,032	$ 389,605,867
30-59	3,052,889	-	644,399	-	3,697,288
60-89	320,762	275,709	1,033,738	-	1,630,209
Over 90	177,570	-	9,081,671	205,536	9,464,777
Total	$ 364,744,964	$ 15,508,821	$ 23,773,788	$ 370,568	$ 404,398,141

NOTE 5 – Loans (con't)

For residential real estate and installment loan classes, the Bank also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in those loan classes based on payment activity as of December 31, 2012 and 2011:

	December 31, 2012		
	Performing	Nonperforming	Total
Residential Real Estate	$ 243,232,617	$ 15,315,574	$ 258,548,191
Installment & Other	11,808,304	342,330	12,150,634
Total	$ 255,040,921	$ 15,657,904	$ 270,698,825

	December 31, 2011		
	Performing	Nonperforming	Total
Residential Real Estate	$ 271,920,147	$ 16,689,236	$ 288,609,383
Installment & Other	14,315,581	474,781	14,790,362
Total	$ 286,235,728	$ 17,164,017	$ 303,399,745

At December 31, 2012, the Corporation has identified $43.7 million of loans as impaired, including $17.2 million of performing troubled debt restructurings. A loan is identified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing troubled debt restructuring consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans follows:

	December 31, 2012	December 31, 2011
Loans for which there was a related allowance for loan loss	$ 25,375,279	$ 24,368,902
Impaired loans with no related allowance	18,364,383	24,144,704
Total Impaired Loans	$ 43,739,662	$ 48,513,606
Average quarterly balance of impaired loans	$ 49,102,343	$ 46,524,919
Related allowance for loan losses	7,185,630	6,466,579
Interest income recognized while impaired	628,270	842,282

NOTE 5 – Loans (con't)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2012 and 2011:

	December 31, 2012			
	Unpaid Principal Balance	Partial Charge-offs	Allowance For Loan Losses Allocation	Recorded Investment
Loans with no related allowance recorded:				
Commercial	$ 22,662	$ 5,730	$ -	$ 16,932
Real estate				
Construction	284,481	-	-	284,481
Commercial	7,775,104	1,147,712	-	6,627,392
Residential	11,152,571	110,510	-	11,042,061
Multifamily	263,204	11,052	-	252,152
Installment & Other	141,788	423	-	141,365
Total	19,639,810	1,275,427	-	18,364,383
Loans with a related allowance recorded:				
Commercial	204,952	469	204,483	-
Real estate				
Construction	1,729,124	43,319	183,104	1,502,701
Commercial	7,821,504	231,976	1,566,027	6,023,501
Residential	16,123,025	317,731	5,156,847	10,648,447
Multifamily	-	-	-	-
Installment & Other	92,245	2,076	75,169	15,000
Total	25,970,850	595,571	7,185,630	18,189,649
Total Impaired Loans	$ 45,610,660	$ 1,870,998	$ 7,185,630	$ 36,554,032

	December 31, 2011			
	Unpaid Principal Balance	Partial Charge-offs	Allowance For Loan Losses Allocation	Recorded Investment
Loans with no related allowance recorded:				
Commercial	$ 366,920	$ 11,218	$ -	$ 355,702
Real estate				
Construction	1,481,875	13,850	-	1,468,025
Commercial	7,968,827	1,034,776	-	6,934,051
Residential	14,640,519	82,953	-	14,557,566
Multifamily	734,274	5,508	-	728,766
Installment & Other	100,594	-	-	100,594
Total	25,293,009	1,148,305	-	24,144,704
Loans with a related allowance recorded:				
Commercial	37,396	-	24,175	13,221
Real estate				
Construction	774,837	14,643	274,218	485,976
Commercial	8,066,785	185,080	1,743,062	6,138,643
Residential	14,715,142	376,919	3,847,056	10,491,167
Multifamily	1,279,699	17,902	523,481	738,316
Installment & Other	89,587	-	54,587	35,000
Total	24,963,446	594,544	6,466,579	17,902,323
Total Impaired Loans	$ 50,256,455	$ 1,742,849	$ 6,466,579	$ 42,047,027

NOTE 5 – Loans (con't)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2012 and 2011:

	December 31, 2012						
	Commercial	Construction	Commercial Real Estate	Residential Real Estate	Multifamily	Consumer	Total
Allowance for loan losses:							
Beginning balance	$ 163,865	$ 583,784	$ 3,748,857	$ 5,569,743	$ 786,919	$ 158,920	$ 11,012,088
Charge-offs	(56,744)	(608,699)	(1,117,451)	(4,008,226)	(720,373)	(203,407)	(6,714,900)
Recoveries	43,933	41,873	210,199	349,285	31,929	22,605	699,824
Provision	209,968	460,028	1,130,056	4,948,074	262,136	189,738	7,200,000
Ending Balance	$ 361,022	$ 476,986	$ 3,971,661	$ 6,858,876	$ 360,611	$ 167,856	$ 12,197,012
Loans:							
Ending balance	$ 20,286,468	$ 40,790,486	$ 325,335,181	$ 258,548,191	$ 47,525,720	$ 12,150,634	$ 704,636,680
Allowance for loan losses;							
Individually evaluated for impairment	204,483	183,104	1,566,027	5,156,847	-	75,169	7,185,630
Collectively evaluated for impairment	156,539	293,882	2,405,634	1,702,029	360,611	92,687	5,011,382
Total allowance for loan losses	361,022	476,986	3,971,661	6,858,876	360,611	167,856	12,197,012
Recorded Investment	$ 19,925,446	$ 40,313,500	$ 321,363,520	$ 251,689,315	$ 47,165,109	$ 11,982,778	$ 692,439,668
Ending Balance:							
Individually evaluated for impairment	$ 221,414	$ 1,970,287	$ 14,216,920	$ 26,847,354	$ 252,152	$ 231,535	$ 43,739,662
Collectively evaluated for impairment	20,053,903	37,756,394	309,063,238	218,668,170	46,329,346	11,907,932	643,778,983
Acquired	11,151	1,063,805	2,055,023	13,032,667	944,222	11,167	17,118,035
Total ending balance	$ 20,286,468	$ 40,790,486	$ 325,335,181	$ 258,548,191	$ 47,525,720	$ 12,150,634	$ 704,636,680

	December 31, 2011						
	Commercial	Construction	Commercial Real Estate	Residential Real Estate	Multifamily	Consumer	Total
Allowance for loan losses:							
Beginning balance	$ 412,745	$ 447,955	$ 2,819,054	$ 4,593,811	$ 1,010,978	$ 242,049	$ 9,526,592
Charge-offs	(299,829)	(256,279)	(1,199,872)	(4,971,619)	(117,115)	(283,184)	(7,127,898)
Recoveries	10,232	36,965	86,453	88,024	-	21,720	243,394
Provision	40,717	355,143	2,043,222	5,859,527	(106,944)	178,335	8,370,000
Ending Balance	$ 163,865	$ 583,784	$ 3,748,857	$ 5,569,743	$ 786,919	$ 158,920	$ 11,012,088
Loans:							
Ending balance	$ 19,956,000	$ 46,600,467	$ 298,042,808	$ 288,609,383	$ 39,798,866	$ 14,790,362	$ 707,797,886
Allowance for loan losses;							
Individually evaluated for impairment	24,176	274,218	1,743.062	3,847,056	523,481	54,586	6,466,579
Collectively evaluated for impairment	139,689	309,566	2,005,795	1,722,687	263,438	104,334	4,545,509
Total allowance for loan losses	163,865	583,784	3,748,857	5,569,743	786,919	158,920	11,012,088
Recorded Investment	$ 19,792,135	$ 46,016,683	$ 294,293,951	$ 283,039,640	$ 39,011,947	$ 14,631,442	$ 696,785,798
Ending Balance:							
Individually evaluated for impairment	$ 393,391	$ 2,227,927	$ 14,815,756	$ 28,895,790	$ 1,990,563	$ 190,179	$ 48,513,606
Collectively evaluated for impairment	19,526,299	43,272,500	280,378,746	240,804,604	36,824,488	14,587,610	635,394,247
Acquired	36,310	1,100,040	2,848,306	18,908,989	983,815	12,573	23,890,033
Total ending balance	$ 19,956,000	$ 46,600,467	$ 298,042,808	$ 288,609,383	$ 39,798,866	$ 14,790,362	$ 707,797,886

NOTE 5 – Loans (cont.)

The Corporation continues to evaluate loans purchased for impairment in accordance with GAAP. The purchased loans were considered impaired at the acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31, 2012 and 2011.

	December 31, 2012		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Commercial	$ 65,751	$ 564,174	$ 462,520
Real Estate			
Construction	1,919,976	41,953	1,104,826
Commercial	7,252,950	3,023,479	6,190,892
Residential	36,990,826	46,380,930	62,174,180
Multifamily	1,243,200	-	944,222
Installment and Consumer	14,192	2,604,422	1,573,922
Total	$ 47,486,895	$ 52,614,958	$ 72,450,562

	December 31, 2011		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Commercial	$ 235,856	$ 972,354	$ 828,188
Real Estate			
Construction	3,676,897	44,697	2,191,129
Commercial	10,509,579	12,485,797	15,459,924
Residential	48,061,689	56,780,596	79,049,005
Multifamily	2,302,782	-	1,587,210
Installment and Consumer	18,223	3,485,572	2,018,806
Total	$ 64,805,026	$ 73,769,016	$ 101,134,262

As of December 31, 2012, the estimated contractually-required payments receivable on credit impaired and non-credit impaired loans was $47.5 million and $52.6 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2012 on all purchased loans is $72.4 million. As a result, there is $27.7 million of remaining discount on the purchased loans. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows at December 31, 2012. The difference between the contractually required payments at acquisition and the cash flow expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows will result in a reversal of the provision for loan losses charged to earnings to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

The change in the carrying amount of accretable yield for purchased loans was as follows for the years ended December 31, 2012 and 2011.

	For Twelve Months Ended December 31,	
	2012	2011
Beginning Balance	$ 9,760,544	$ 14,414,324
Additions	-	-
Accretion[1]	4,107,047	4,653,780
Ending Balance	$ 5,653,497	$ 9,760,544

(1) Accretable yield is recognized in interest income as the purchased loans pay down, mature, renew or pay off.

NOTE 5 – Loans (cont.)

Contractual maturities of loans with accretable yield range from 1 year to 30 years. Actual maturities may differ from contractual maturities because borrowers have the right to prepay or renew their loan prior to maturity or the loan may be charged off.

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of $6.9 million and $8.3 million at December 31, 2012 and 2011, respectively. During 2012 and 2011, $0.2 million and $0.02 million of new loans were made and repayments totaled $1.6 million and $0.1 million, respectively. Management believes these loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectibility or present other unfavorable features.

Residential and commercial real estate loans approximating $109.8 million and $128.4 million at December 31, 2012 and 2011, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 6 – Allowance for Loan Losses

The allowance for loan losses reflected in the accompanying consolidated financial statements represents the allowance available to absorb loan losses that are probable and inherent in the portfolio. An analysis of changes in the allowance is presented in the following tabulation as of December 31:

	2012	2011	2010
Balance at beginning of year	$ 11,012,088	$ 9,526,592	$ 6,034,187
Charge-offs	(6,714,900)	(7,127,898)	(4,551,517)
Recoveries	699,824	243,394	1,113,922
Provision charged to operation	7,200,000	8,370,000	6,930,000
Balance at end of year	$ 12,197,012	$ 11,012,088	$ 9,526,592

NOTE 7 - Other Real Estate Owned

Real estate acquired by foreclosure or by deed in lieu of foreclosure is held for sale and is initially recorded at the lesser of carrying value or fair value at the date of foreclosure less estimated selling expenses, establishing a new cost basis. At the date of foreclosure any write down to fair value less estimated selling costs is charged to the allowance for loan losses. Subsequent to foreclosure, an analysis of the valuation is performed and a valuation allowance is established as needed. Costs relating to the development and improvement of the property may be capitalized; holding period costs and subsequent changes to the valuation allowance are charged to expense.

The following is a summary of the activity in OREO for the years ended December 31, 2012 and 2011:

	2012	2011
Beginning Balance	$ 7,350,678	$ 5,407,205
Additions	10,166,719	10,256,043
Valuation Adjustments	-	-
Sales	(8,972,732)	(8,312,570)
Ending Balance	$ 8,544,665	$ 7,350,678

NOTE 8 - Troubled Debt Restructuring

A troubled debt restructuring ("TDR") includes a loan modification where a borrower is experiencing financial difficulty and the Bank grants a concession to that borrower that the Bank would not otherwise consider except for the borrower's financial difficulties. Modifications include below market interest rate, interest-only terms, forgiveness of principal, or an exceptionally long amortization period. Most of the Bank's modifications are below market interest rates. A TDR may be either on accrual or nonaccrual status based upon the performance of the borrower and management's assessment of collectability. If a TDR is placed on nonaccrual status, it remains there until it performs under the restructured terms for six consecutive months at which time it is returned to accrual status.

A summary of troubled debt restructurings as of December 31, 2012 and December 31, 2011 is noted in the table below. All troubled debt restructurings are considered impaired loans and, as of December 31, 2012, the allowance associated with those loans was $3.0 million.

	December 31, 2012			
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation	Recorded Investment
Commercial	-	$ -	$ -	$ -
Real estate				
Construction	2	189,833	38,043	151,790
Commercial	21	10,440,652	1,013,782	9,426,870
Residential	101	16,320,585	1,949,960	14,370,625
Multifamily	1	119,828	-	119,828
Installment & Other	6	155,506	10,299	145,207
Total Loans	131	$ 27,226,404	$ 3,012,084	$ 24,214,320

	December 31, 2011			
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation	Recorded Investment
Commercial	-	$ -	$ -	$ -
Real estate				
Construction	4	1,291,616	46,081	1,245,535
Commercial	13	7,360,189	790,410	6,569,779
Residential	86	15,950,281	923,937	15,026,344
Multifamily	2	541,192	170,295	370,897
Installment & Other	9	127,437	11,844	115,593
Total Loans	114	$ 25,270,715	$ 1,942,567	$ 23,328,148

NOTE 8 - Troubled Debt Restructuring (cont.)

The following is a summary of troubled debt restructurings as of December 31, 2012 and December 31, 2011 that were in default. Troubled debt restructures in default are past due 90 days or more at the end of the period.

	December 31, 2012		December 31, 2011	
	Number of Modifications	Total in Default	Number of Modifications	Total in Default
Commercial	-	$ -	-	$ -
Real estate				
Construction	-	-	-	-
Commercial	2	4,073,472	-	-
Residential	23	4,532,899	18	2,860,627
Multifamily	-	-	-	-
Installment & Other	1	25,299	-	-
Total Loans	26	$ 8,631,670	18	$ 2,860,627

A summary of the type of modifications made on troubled debt restructurings that occurred during 2012 and 2011is noted in the table below.

For the Year Ended December 31, 2012

	Modification of Terms		Reduction of Interest Rate		Modification to Interest-only Payments		Forgiveness of Debt		Total	
	Count	Balance	Count	Balance	Count	Balance	Count	Balance	Count	Balance
Commercial	-	$ -	-	$ -	-	$ -	-	$ -	-	$ -
Real estate										
Construction	-	-	-	-	-	-	-	-	-	-
Commercial	2	414,129	5	2,472,278	6	2,184,220	-	-	13	5,070,627
Residential	6	1,029,130	31	3,239,121	1	14,023	-	-	38	4,282,274
Multifamily	-	-	-	-	-	-	-	-	-	-
Installment & Other	-	-	2	74,823	-	-	-	-	2	74,823
Total Loans	8	$ 1,443,259	38	5,786,222	7	$ 2,198,243	-	$ -	53	$ 9,427,724

For the Year Ended December 31, 2011

	Modification of Terms		Reduction of Interest Rate		Modification to Interest-only Payments		Forgiveness of Debt		Total	
	Count	Balance	Count	Balance	Count	Balance	Count	Balance	Count	Balance
Commercial	-	$ -	-	$ -	-	$ -	2	$ 85,000	2	$ 85,000
Real estate										
Construction	-	-	1	165,032	-	-	3	3,518,007	4	3,683,039
Commercial	-	-	-	-	4	801,112	1	427,300	5	1,228,412
Residential	4	439,326	47	6,678,519	5	2,486,920	2	2,717,078	58	12,321,843
Multifamily	-	-	1	415,821	-	-	-	-	1	415,821
Installment & Other	2	31,526	7	104,885	-	-	-	-	9	136,411
Total Loans	6	$ 470,852	56	7,364,257	9	$ 3,288,032	8	$ 6,747,385	79	$ 17,870,526

NOTE 9 - Core Deposit Intangible Asset

Estimated future amortization expense as of December 31, 2012 by year is as follows:

2013	$	230,381
2014		172,613
2015		130,381
2016		98,275
2017		63,273
Total	$	694,923

NOTE 10 - Mortgage Servicing Rights

The following is an analysis of the mortgage servicing rights activity for the years ended December 31:

	2012	2011	2010
Balance at beginning of year	$ 1,598,802	$ 1,702,696	$ 1,794,635
Additions of mortgage servicing rights	725,850	389,597	395,325
Amortization	(638,759)	(493,491)	(487,264)
Balance at end of year	$ 1,685,893	$ 1,598,802	$ 1,702,696

The carrying value of MSRs is determined in accordance with relevant accounting guidance. This guidance permits capitalized MSRs to be amortized in proportion to and over the period of estimated net servicing income and to be assessed for impairment. The Bank relies on industry data to estimate the initial fair value of MSRs to be capitalized as a percentage of the principal balance of the loans sold. The Bank adjusts the carrying value monthly for reductions due to normal amortization and actual prepayments, including defaults. The Bank assesses its MSRs for impairment each reporting period by using a third party source. At December 31, 2012 and 2011, the weighted average coupon rates of mortgage loans underlying the MSRs were 4.04% and 4.56%, respectively, and the weighted average remaining maturity of the mortgage loans underlying the MSRs were 208 months and 209 months, respectively. The estimated fair values of MSRs were $1,750,724 and $1,884,447 at December 31, 2012 and 2011, respectively. As the carrying value of the Bank's MSRs was less than the estimated fair value at December 31, 2012 and 2011, no impairment existed.

The carrying value of MSRs was $1,685,893 or 0.55% of loans serviced for others at December 31, 2012 compared with $1,598,802, or 0.50% of loans serviced at December 31, 2011.

NOTE 10 - Mortgage Servicing Rights (cont.)

The projections of amortization expense shown below for mortgage servicing rights are based on existing asset balances and the existing interest rate environment at December 31, 2012. Future amortization may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates and market conditions.

Estimated future amortization by year is as follows:

2013	$	187,345
2014		178,951
2015		170,487
2016		132,135
2017		91,938
Thereafter		925,037
	$	1,685,893

The unpaid principal balance of mortgage loans serviced for others, which is not included in the accompanying consolidated balance sheets, was $307,314,943 and $320,325,961 at December 31, 2012 and 2011, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing and included in demand deposits were $1,002,136 and $1,390,998 at December 31, 2012 and 2011, respectively.

NOTE 11 - Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation at December 31 and are summarized as follows:

		2012		2011
Land	$	6,244,202	$	6,347,851
Buildings and leasehold improvements		30,730,534		30,536,256
Furniture and equipment		13,766,524		13,194,847
Total		50,741,260		50,078,954
Less: Accumulated depreciation		(32,735,993)		(30,932,084)
Net Premises and Equipment	$	18,005,267	$	19,146,870

Depreciation expense amounted to $2,059,240, $2,149,444, and $2,250,653 in 2012, 2011 and 2010, respectively.

NOTE 12 – Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets at December 31 is as follows:

		2012		2011
Accrued interest receivable	$	4,164,716	$	4,650,828
Federal Reserve Stock		322,100		322,100
Prepaid expenses and other assets		3,263,696		3,161,696
Total	$	7,750,512	$	8,134,624

NOTE 13 - Deposits

The aggregate amount of time deposits, each with a minimum denomination of $100,000, was $75,517,308 and $72,353,997 at December 31, 2012 and 2011, respectively.

Scheduled maturities of time deposits at December 31 are:

	2012	2011
Due within one year	$ 120,606,068	$ 134,027,779
After one year but within two years	24,923,474	25,630,007
After two years but within three years	9,769,026	7,374,224
After three years but within four years	6,700,012	6,906,562
After four years but within five years	7,824,267	5,721,537
	$ 169,822,847	$ 179,660,109

The Bank had no customers with a deposit balance in excess of 5% of total deposits at December 31, 2012 and 2011, respectively.

NOTE 14 - Other Borrowings

The Bank has the ability to borrow (purchase) federal funds of up to $55,000,000 under a revolving line-of-credit. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature daily. There were no federal funds purchased outstanding at December 31, 2012 or 2011.

The Bank may also borrow through securities sold under repurchase agreements (reverse repurchase agreements). Reverse repurchase agreements, which are classified as secured borrowings, generally mature within one to four days from the transaction date. They are reflected at the amount of cash received in connection with the transaction. The Bank had no borrowings outstanding under reverse repurchase agreements at December 31, 2012 and 2011, respectively and, accordingly, the Bank did not pledge any U.S. government sponsored entity securities and municipal obligations at December 31, 2012 or 2011 as collateral under the master repurchase agreement. At December 31, 2012, the Bank could pledge up to $167,102,071 of additional securities as collateral under the existing agreements if needed to obtain additional borrowings. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. The Bank may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $33,520,500 and $52,708,500 as of December 31, 2012 and 2011, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $37,245,000 and $58,565,000 as of December 31, 2012 and 2011, respectively.

NOTE 15 - Income Taxes

The provision for income taxes included in the accompanying consolidated financial statements consists of the following components for the year ending December 31:

	2012	2011	2010
Current tax expense			
Federal	$ 4,379,530	$ 4,691,821	$ 10,559,058
State	1,198,914	1,171,394	2,500,277
Total current expense	5,578,444	5,863,215	13,059,335
Deferred income taxes benefit			
Federal	(1,212,727)	(885,799)	(3,731,054)
State	(347,560)	(284,815)	(954,281)
Total deferred benefit	(1,560,287)	(1,170,614)	(4,685,335)
Total income tax expense	$ 4,018,157	$ 4,692,601	$ 8,374,000

The net deferred income tax assets in the accompanying consolidated balance sheets include the following amounts of deferred income tax assets and liabilities at December 31:

	2012	2011
Deferred income tax assets:		
Allowance for loan losses	$ 4,896,911	$ 4,421,342
Reserve for health plan	-	341
Depreciation	70,425	-
Non-accrual interest	916,395	959,819
Loss carryforwards	41,130	43,295
Other	216,694	200,963
Deferred tax assets before valuation allowance	6,141,555	5,625,760
Valuation allowance	-	(43,294)
Net deferred income tax assets	6,141,555	5,582,466
Deferred income tax liabilities		
Loan acquisition fair market valuation	(2,223,162)	(3,198,822)
Other real estate owned	(34,840)	(45,531)
Core deposit intangible asset	(278,907)	(403,411)
Deferred loan fees	(239,892)	(221,156)
Mortgage servicing rights	(673,290)	(638,336)
Reserve for health plan	(38,055)	-
Depreciation	-	(1,184)
Other	(84,507)	(65,411)
Total deferred income tax liabilities	(3,572,653)	(4,573,851)
Net deferred income tax asset	$ 2,568,902	$ 1,008,615

The Corporation has state net business loss carryforwards of approximately $801,000 and $843,000 as of December 31, 2012 and 2011, respectively. The net business loss carryforwards expire in 2031.

Realization of the deferred income tax asset over time is dependent upon the existence of taxable income in carryback periods or the Corporation generating sufficient taxable income in future periods. In determining that realization of the deferred income tax asset recorded was more likely than not, the Corporation gave consideration to a number of factors including its recent earnings history, its expectations for earnings in the future, and where applicable, the expiration dates associated with tax carryforwards.

NOTE 15 - Income Taxes (cont.)

Due to a change in law, the Corporation has released the valuation allowance established against state deferred income taxes for those entities which have state net business loss carryforwards in which management believes that it is now more likely than not that the state deferred income tax assets will be realized. As a result, there is no valuation allowance at December 31, 2012, compared to $43,294 at December 31, 2011 and December 31, 2010, respectively.

A reconciliation of statutory federal income taxes based upon income before taxes to the provision for federal and state income taxes is as follows:

	2012		2011		2010	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income taxes at statutory rate	$ 4,259,549	35.00%	$ 4,973,083	35.00%	$ 7,939,415	35.00%
Adjustments for:						
Tax exempt interest on municipal obligations	(458,264)	(3.77)	(485,449)	(3.41)	(518,822)	(2.29)
Increase in taxes resulting from state income taxes, net of federal tax benefit	596,675	4.90	709,205	4.99	1,004,897	5.07
Increase in cash surrender value of life insurance	(293,021)	(2.41)	(163,610)	(1.15)	(165,053)	(0.73)
Permanent items prior years	-	-	(238,071)	(1.68)	-	-
Other – net	(86,782)	(0.70)	(102,557)	(0.72)	113,563	0.14
Income tax expense	$ 4,018,157	33.02%	$ 4,692,601	33.03%	8,374,000	36.91%

As of December 31, 2012, 2011 and 2010, the Corporation had no uncertain tax positions. The Corporation's policy is to record interest and penalties related to income tax liabilities in income tax expense. The Corporation, along with its subsidiaries, files U.S. Federal and Wisconsin income tax returns. The Corporation's federal tax returns for 2008 and prior and its 2007 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

NOTE 16 - Employee Benefit Plans

The Bank has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21 and completed one year of service. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Bank may make regular and matching contributions to the plan each year. In 2012, 2011and 2010, the Bank provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. Participants direct the investment of their contributions into one or more investment options. The Bank recorded contribution expense of $549,502, $629,577, and $562,593 in 2012, 2011 and 2010, respectively.

The Bank purchased paid-up life insurance as owner and beneficiary on certain officers and executives to provide the Bank with funds in the event of the death of such individuals and to help recover the cost of employee benefits. Included in the consolidated financial statements is $28,328,926 and $12,941,722 of related cash surrender value as of December 31, 2012 and 2011, respectively.

NOTE 17 - Operating Leases

The Corporation leases various banking facilities under operating lease agreements from various companies. Three of these facilities are leased from companies held by a director and major shareholder of the Corporation. All of the agreements include renewal options and one agreement requires the subsidiary Bank to pay insurance, real estate taxes and maintenance costs associated with the lease. Rental amounts are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to $1,184,661, $1,357,715 and $1,239,981 in 2012, 2011 and 2010 respectively, including $470,874, $449,474 and $362,645, respectively, on facilities leased from companies held by a director and major shareholder of the Corporation.

At December 31, 2012, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

2013	$	1,165,949
2014		1,122,436
2015		759,183
2016		376,209
2017		213,175
Thereafter		384,128
	$	4,021,080

Office space at certain facilities is leased to outside parties. Rental income included in net occupancy costs was $964,132, $933,267 and $987,826 for the years ended December 31, 2012, 2011 and 2010, respectively.

NOTE 18 - Commitments and Contingencies

The Corporation and Bank are party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, financial guarantees and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the consolidated balance sheets.

NOTE 18 - Commitments and Contingencies (cont.)

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contract or notional amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2012 and 2011 is as follows:

	2012	2011
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 98,549,862	$ 106,156,733
Standby letters of credit	2,943,530	3,746,445
Forward commitment to sell mortgage loans	2,669,915	3,208,503

Commitments to extend credit 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 many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties. The Bank also enters into forward commitments to sell mortgage loans to a secondary market agency.

NOTE 19 - Stockholders' Equity

Cumulative Preferred Stock

The Corporation's articles of incorporation authorize the issuance of up to 200,000 shares of $1 par value cumulative preferred stock. The Board of Directors is authorized to divide the stock into series and fix and determine the relative rights and preferences of each series. No shares have been issued.

Retained Earnings

The principal source of income and funds of the Corporation are dividends from the Bank. Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies.

In December of 2012, the Corporation paid a special dividend of $1.70 per share. The dividend was intended to be a prepayment of future dividends in anticipation of potential changes in the tax code related to dividend income. This payment resulted in the Corporation paying more dividends than net income generated during the current year and the preceding two years combined. Thus, the Corporation did ask for and receive regulatory approval to pay the special dividend. Management is committed to rebuilding the Bank's capital ratios and therefore, does not anticipate making any additional dividends payments until at least 2015. However, the Board of Directors will continue to review earnings, regulatory requirements and other factors at quarterly board meetings and will resume quarterly dividends when it is appropriate to do so.

Under Federal Reserve regulations, the Bank is limited as to the amount it may lend to its affiliates, including the Corporation. Such loans are required to be collateralized by investments defined in the regulations. In addition, the maximum amount available for transfer from the Bank to the Corporation in the form of loans is limited to 10% of the Bank's stockholders' equity in the case of any one affiliate or 20% in the case of all affiliates.

NOTE 20 - Regulatory Capital Requirements

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal and state 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 Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table that follows) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2012 and 2011 the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2012, the most recent notification from the regulatory agencies categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since these notifications that management believes have changed the institution's category.

Listed below is a comparison of the Corporation's and the Bank's actual capital amounts with the minimum requirements for well capitalized and adequately capitalized banks, as defined by the federal regulatory agencies' Prompt Corrective Action Rules, as of December 31, 2012 and 2011.

NOTE 20 - Regulatory Capital Requirements (cont.)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012						
Total capital (to risk weighted assets)						
Tri City Bankshares Corporation	$ 118,312,000	15.4%	$ 61,427,000	8.0%	$ n/a	n/a
Tri City National Bank	$ 116,536,000	15.2%	$ 61,382,000	8.0%	$ 76,728,000	10.0%
Tier 1 capital (to risk weighted assets)						
Tri City Bankshares Corporation	$ 108,689,000	14.2%	$ 30,713,000	4.0%	$ n/a	n/a
Tri City National Bank	$ 106,913,000	13.9%	$ 30,691,000	4.0%	$ 46,037,000	6.0%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	$ 108,689,000	9.1%	$ 47,765,000	4.0%	$ n/a	n/a
Tri City National Bank	$ 106,913,000	9.0%	$ 47,815,000	4.0%	$ 59,768,000	5.0%
As of December 31, 2011						
Total capital (to risk weighted assets)						
Tri City Bankshares Corporation	$ 130,371,000	17.1%	$ 61,037,000	8.0%	$ n/a	n/a
Tri City National Bank	$ 125,937,000	16.6%	$ 60,783,000	8.0%	$ 75,979,000	10.0%
Tier 1 capital (to risk weighted assets)						
Tri City Bankshares Corporation	$ 120,816,000	15.8%	$ 30,414,000	4.0%	$ n/a	n/a
Tri City National Bank	$ 116,421,000	15.5%	$ 30,392,000	4.0%	$ 45,588,000	6.0%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	$ 120,816,000	10.6%	$ 45,524,000	4.0%	$ n/a	n/a
Tri City National Bank	$ 116,421,000	10.2%	$ 45,515,000	4.0%	$ 56,894,000	5.0%

NOTE 21 - Concentration of Credit Risk

Practically all of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area of Southeastern Wisconsin. Although the Bank has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of the counties surrounding the Bank. The concentration of credit by type of loan is set forth in Note 5.

NOTE 22 - Tri City Bankshares Corporation (Parent Company Only) Financial Information

CONDENSED BALANCE SHEETS

	December 31, 2012	December 31, 2011
ASSETS		
Cash on deposit with subsidiary Bank	$ 529,196	$ 3,186,504
Premises and equipment – net	1,052,544	1,136,526
Investment in subsidiary Bank	106,703,639	116,624,361
Other assets – net	1,098,886	1,033,338
TOTAL ASSETS	$ 109,384,265	$ 121,980,729
STOCKHOLDERS' EQUITY		
Cumulative preferred stock, $1 par value, 200,000 shares authorized, no shares issued	$ -	$ -
Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding as of 2012 and 2011, respectively	8,904,915	8,904,915
Additional paid-in capital	26,543,470	26,543,470
Retained earnings	73,935,880	86,532,344
TOTAL STOCKHOLDERS' EQUITY	$ 109,384,265	$ 121,980,729

CONDENSED STATEMENTS OF INCOME

	Years Ended December 31, 2012	2011	2010
INCOME			
Dividends from subsidiary Bank	$ 18,170,000	$ 1,876,000	$ 21,437,898
Interest income from subsidiary Bank	14,055	20,895	39,416
Management fees from subsidiary Bank	900,000	900,325	720,011
Total income	19,084,055	2,797,220	22,197,325
EXPENSES			
Administrative and general – net	1,034,344	1,100,835	1,146,824
Income before income taxes and equity in undistributed earnings of subsidiary Bank	18,049,711	1,696,385	21,050,501
Plus: Income tax benefit	23,000	66,336	154,500
Income before equity in undistributed earnings (loss) of subsidiary	18,072,711	1,762,721	21,205,001
Equity in undistributed earnings (loss) of subsidiary bank	(9,920,727)	7,753,484	(6,894,959)
NET INCOME	$ 8,151,984	$ 9,516,205	$ 14,310,042

NOTE 22 - Tri City Bankshares Corporation (Parent Company Only) Financial Information (cont.)

CONDENSED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 8,151,984	$ 9,516,205	$ 14,310,042
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation	83,982	85,451	83,112
Equity in undistributed income of subsidiary Bank	9,920,727	(7,753,486)	6,894,959
Other	(65,553)	(71,490)	(144,935)
Net Cash Flows Provided by Operating Activities	18,091,140	1,776,680	21,143,178
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of premises and equipment – net	-	(14,900)	(21,269)
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid	(20,748,448)	(1,870,029)	(21,371,793)
Common stock issued – net	-	-	-
Net Cash Flows Used in Financing Activities	(20,748,448)	(1,870,029)	(21,371,793)
Net Change in Cash	(2,657,308)	(108,249)	(249,884)
CASH – BEGINNING OF YEAR	3,186,504	3,294,753	3,544,637
CASH – END OF YEAR	$ 529,196	$ 3,186,504	$ 3,294,753

NOTE 23 - Quarterly Results of Operations (Unaudited)

The quarterly results of operations is unaudited; however, in management's opinion, the interim data includes all adjustments, consisting only of normal, recurring adjustments necessary for a fair presentation of results for the interim periods.

The following is a summary of the quarterly results of operations for the years ended December 31, 2012 and 2011:

	(Dollars in Thousands, except per share data) Three Months Ended			
2012	December 31	September 30	June 30	March 31
Interest income	$ 10,570	$ 10,581	$ 11,801	$ 12,520
Interest expense	(668)	(772)	(863)	(910)
Net interest income	9,902	9,809	10,938	11,610
Provision for loan losses	(2,200)	(2,000)	(1,500)	(1,500)
Noninterest income	3,676	4,457	4,922	4,137
Noninterest expense	(9,094)	(10,291)	(10,525)	(10,171)
Income before income taxes	2,284	1,975	3,835	4,076
Income taxes	(696)	(495)	(1,321)	(1,506)
Net income	$ 1,588	$ 1,480	$ 2,514	$ 2,570
Basic earnings per share	$ 0.18	$ 0.17	$ 0.28	$ 0.29
2011	December 31	September 30	June 30	March 31
Interest income	$ 13,804	$ 12,955	$ 13,594	$ 12,843
Interest expense	(989)	(1,086)	(1,180)	(1,328)
Net interest income	12,815	11,869	12,414	11,515
Provision for loan losses	(3,000)	(2,050)	(1,920)	(1,400)
Noninterest income	3,548	4,161	3,704	3,376
Noninterest expense	(10,156)	(10,239)	(10,098)	(10,331)
Income before income taxes	3,207	3,741	4,100	3,160
Income taxes	(1,074)	(1,297)	(1,447)	(874)
Net income	$ 2,133	$ 2,444	$ 2,653	$ 2,286
Basic earnings per share	$ 0.24	$ 0.28	$ 0.29	$ 0.26