AMES NATIONAL CORP
Form 10-Q
November 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission File Number 0-32637

AMES NATIONAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

IOWA	42-1039071
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification Number)

405 FIFTH STREET
AMES, IOWA 50010
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (515) 232-6251

NOT APPLICABLE
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

COMMON STOCK, $2.00 PAR VALUE	9,310,913
(Class)	(Shares Outstanding at October 26, 2012)

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(unaudited)

ASSETS	September 30, 2012	December 31, 2011
Cash and due from banks	$23,542,568	$22,829,291
Interest bearing deposits in financial institutions	35,759,545	33,741,406
Securities available-for-sale	573,557,196	508,624,622
Loans receivable, net	488,426,392	438,650,837
Loans held for sale	1,570,621	1,212,620
Bank premises and equipment, net	12,040,379	11,362,626
Accrued income receivable	8,041,189	6,467,509
Other real estate owned	9,939,706	9,538,440
Core deposit intangible, net	1,377,040	-
Goodwill	5,600,749	-
Other assets	8,022,953	3,136,482
Total assets	$1,167,878,338	$1,035,563,833
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$150,811,637	$126,059,239
NOW accounts	276,439,976	229,810,463
Savings and money market	257,844,279	216,768,048
Time, $100,000 and over	99,310,392	107,944,525
Other time	157,815,497	138,123,116
Total deposits	942,221,781	818,705,391
Securities sold under agreements to repurchase	38,974,691	41,696,585
Federal Home Loan Bank (FHLB) advances	14,628,314	15,179,335
Other long-term borrowings	20,000,000	20,000,000
Dividend payable	1,396,637	1,210,419
Deferred income taxes	2,441,988	885,433
Accrued expenses and other liabilities	4,161,343	3,329,285
Total liabilities	1,023,824,754	901,006,448
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; issued 9,432,915 shares; outstanding 9,310,913 shares as of September 30, 2012 and December 31, 2011	18,865,830	18,865,830
Additional paid-in capital	22,651,222	22,651,222
Retained earnings	92,087,734	85,564,078
	12,465,296	9,492,753

Accumulated other comprehensive income-net unrealized gain on securities available-for-sale		
Treasury stock, at cost; 122,002 shares at September 30, 2012 and December 31, 2011, respectively	(2,016,498)	(2,016,498)
Total stockholders' equity	144,053,584	134,557,385
Total liabilities and stockholders' equity	$1,167,878,338	$1,035,563,833

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest income:				
Loans, including fees	$6,413,866	$5,905,777	$18,470,183	$17,646,097
Securities:				
Taxable	1,441,987	1,906,708	4,660,121	5,365,245
Tax-exempt	1,697,690	1,624,310	5,046,835	4,892,269
Interest bearing deposits and federal funds sold	113,149	112,929	371,328	337,622
Total interest income	9,666,692	9,549,724	28,548,467	28,241,233
Interest expense:				
Deposits	1,097,372	1,323,083	3,419,854	4,076,697
Other borrowed funds	322,887	353,739	972,023	1,086,646
Total interest expense	1,420,259	1,676,822	4,391,877	5,163,343
Net interest income	8,246,433	7,872,902	24,156,590	23,077,890
Provision for loan losses	35,664	4,904	151,369	409,692
Net interest income after provision for loan losses	8,210,769	7,867,998	24,005,221	22,668,198
Noninterest income:				
Trust services income	491,943	547,917	1,527,657	1,619,617
Service fees	429,958	401,055	1,161,170	1,095,273
Securities gains, net	220,230	361,444	538,298	947,570
Gain on sale of loans held for sale	440,232	252,163	1,082,126	680,551
Merchant and ATM fees	273,514	183,987	809,764	555,481
Other noninterest income	202,627	152,115	571,009	459,011
Total noninterest income	2,058,504	1,898,681	5,690,024	5,357,503
Noninterest expense:				
Salaries and employee benefits	3,112,396	2,945,361	9,293,203	8,667,217
Data processing	558,314	524,602	1,632,518	1,451,420
Occupancy expenses	362,217	349,918	1,069,972	1,066,383
FDIC insurance assessments	158,745	129,289	477,961	607,785
Other real estate owned, net	31,330	252,039	472,123	418,175
Core deposit intangible amortization	73,776	-	122,960	-
Other operating expenses, net	745,781	670,714	2,307,533	2,002,262
Total noninterest expense	5,042,559	4,871,923	15,376,270	14,213,242
Income before income taxes	5,226,714	4,894,756	14,318,975	13,812,459

Provision for income taxes	1,365,719	1,304,882	3,605,406	3,506,692
Net income	$3,860,995	$3,589,874	$10,713,569	$10,305,767
Basic and diluted earnings per share	$0.41	$0.38	$1.15	$1.09
Dividends declared per share	$0.15	$0.13	$0.45	$0.39

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$3,860,995	$3,589,874	$10,713,569	$10,305,767
Other comprehensive income, before tax:				
Unrealized gains on securities without other than temporary impairment before tax:				
Unrealized holding gains arising during the period	2,643,541	2,867,399	5,212,820	11,430,616
Less: reclassification adjustment for gains realized in net income	220,230	361,444	538,298	947,570
Other comprehensive income before tax	2,423,311	2,505,955	4,674,522	10,483,046
Tax expense related to other comprehensive income	(869,031)	(927,203)	(1,701,979)	(3,878,728)
Other comprehensive income, net of tax	1,554,280	1,578,752	2,972,543	6,604,318
Comprehensive income	$5,415,275	$5,168,626	$13,686,112	$16,910,085

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)
Nine Months Ended September 30, 2012 and 2011

	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2010	$18,865,830	$ 22,651,222	$76,519,493	$ 3,326,479	$ -	$121,363,024
Net income	-	-	10,305,767	-	-	10,305,767
Other comprehensive income	-	-	-	6,604,318	-	6,604,318
Cash dividends declared, $0.39 per share	-	-	(3,667,363)	-	-	(3,667,363)
Purchase of 66,231 shares of treasury stock	-	-	-	-	(1,089,975)	(1,089,975)
Balance, September 30, 2011	$18,865,830	$ 22,651,222	$83,157,897	$ 9,930,797	$ (1,089,975)	$133,515,771
Balance, December 31, 2011	$18,865,830	$ 22,651,222	$85,564,078	$ 9,492,753	$ (2,016,498)	$134,557,385
Net income	-	-	10,713,569	-	-	10,713,569
Other comprehensive income	-	-	-	2,972,543	-	2,972,543
Cash dividends declared, $0.45 per share	-	-	(4,189,913)	-	-	(4,189,913)
Balance, September 30, 2012	$18,865,830	$ 22,651,222	$92,087,734	$ 12,465,296	$ (2,016,498)	$144,053,584

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
Nine Months Ended September 30, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$10,713,569	$10,305,767
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	151,369	409,692
Provision for off-balance sheet commitments	19,000	5,000
Amortization, net of securities available for sale	4,649,555	3,639,781
Amortization of core deposit intangible asset	122,960	-
Depreciation	568,080	557,477
Provision (credit) for deferred income taxes	(189,224)	586,954
Securities gains, net	(538,298)	(947,570)
Impairment of other real estate owned	303,588	335,048
Loss (gain) on sale of other real estate owned, net	46,867	(76,178)
Change in assets and liabilities:		
Decrease (increase) in loans held for sale	(358,001)	689,283
Increase in accrued income receivable	(1,058,920)	(1,222,157)
Increase in other assets	(4,897,038)	(444,821)
Increase in accrued expenses and other liabilities	693,448	747,713
Net cash provided by operating activities	10,226,955	14,585,989
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(175,323,766)	(156,980,283)
Proceeds from sale of securities available-for-sale	19,612,753	23,684,117
Proceeds from maturities and calls of securities available-for-sale	91,016,839	110,908,297
Net increase in interest bearing deposits in financial institutions	(2,018,139)	(15,349,664)
Net decrease in federal funds sold	-	3,000,000
Net increase in loans	(5,205,943)	(10,894,139)
Net proceeds from the sale of other real estate owned	840,725	657,766
Purchase of bank premises and equipment, net	(370,766)	(437,973)
Other changes in other real estate owned	-	(49,785)
Cash aquired, net of cash paid, for aquired bank offices	44,303,137	-
Net cash used in investing activities	(27,145,160)	(45,461,664)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in deposits	24,908,092	56,374,821
Decrease in federal funds purchased and securities sold under agreements to repurchase	(2,721,894)	(14,770,679)
Payments from other short-term borrowings, net	-	(1,046,161)
Proceeds from FHLB borrowings	-	4,000,000
Payments on FHLB borrowings	(551,021)	(1,550,021)
Purchase of treasury stock	-	(1,089,975)
Dividends paid	(4,003,695)	(3,487,315)

Net cash provided by financing activities	17,631,482	38,430,670
Net increase in cash and due from banks	713,277	7,554,995
CASH AND DUE FROM BANKS		
Beginning	22,829,291	15,478,133
Ending	$23,542,568	$23,033,128

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(unaudited)
Nine Months Ended September 30, 2012 and 2011

	2012	2011
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	$4,606,845	$5,189,947
Income taxes	3,599,844	3,204,391
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Transfer of loans to other real estate owned	$1,592,446	$213,586
Business Combination:		
Fair value of loans receivable acquired	$46,103,022	$-
Fair value of bank premises and equipment acquired	864,500	-
Fair value of other tangible assets acquired	514,760	-
Goodwill	5,600,749	-
Core deposit intangible asset	1,500,000	-
Deposits assumed	98,766,558	-
Other liabilities assumed	119,610	-

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

1. Significant Accounting Policies

The consolidated financial statements for the three and nine month periods ended September 30, 2012 and 2011 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the “Annual Report”). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the “Banks”). All significant intercompany balances and transactions have been eliminated in consolidation.

Goodwill and core deposit intangible asset: Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually or whenever events change and circumstances indicate that it is more likely than not that an impairment loss has occurred. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The second step, if necessary, measures the amount of impairment, if any.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. At September 30, 2012, the Company believes there is not any potential impairment due to the proximity of the acquisition to September 30, 2012.

The only other significant intangible asset is a core deposit intangible. The core deposit intangible asset is determined to have a definite life and is amortized over the estimated useful life. The core deposit intangible asset is a customer based relationship valuation attributed to the expectation of a lower net cost of these deposits versus alternative sources of funds. The core deposit intangible asset is reviewed for impairment whenever events occur or circumstances indicate that the carrying amount may not be recoverable.

Fair value of financial instruments: The following methods and assumptions were used by the Company in estimating fair value disclosures:

Cash and due from banks and interest bearing deposits in financial institutions: The recorded amount of these assets approximates fair value.

Securities available-for-sale: Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the securities credit rating, prepayment assumptions and other factors such as credit loss assumptions.

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Loans receivable: The fair value of loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates, which reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the historical experience, with repayments for each loan classification modified, as required, by an estimate of the effect of current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate.

Loans held for sale: The fair value of loans held for sale is based on prevailing market prices.

Deposit liabilities: Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW and money market accounts, are equal to the amount payable on demand as of the respective balance sheet date. Fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Federal funds purchased and securities sold under agreements to repurchase: The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximate fair value because of the generally short-term nature of the instruments.

FHLB advances and other long-term borrowings: Fair values of FHLB advances and other long-term borrowings are estimated using discounted cash flow analysis based on interest rates currently being offered with similar terms.

Accrued income receivable and accrued interest payable: The carrying amounts of accrued income receivable and interest payable approximate fair value.

New and Pending Accounting Pronouncements:

In June, 2011, the FASB issued guidance on comprehensive income to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, the guidance requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The guidance is effective for annual periods beginning after December 15, 2011, and did not have a significant impact on the Company's financial statements.

In April, 2011, the FASB issued guidance which modifies certain aspects contained in the Receivables topic of FASB ASC 310. The standard clarifies the guidance on evaluating whether a receivable term modification constitutes a troubled debt restructuring (TDR). The amendments in this guidance was effective for the first interim or annual period beginning on or after June 15, 2011, and was applied retrospectively to the beginning of the annual period of adoption. The adoption did not have a material impact on the Company's consolidated financial statements.

In May, 2011, the FASB issued amended guidance which eliminates terminology difference between U.S. generally accepted accounting principles ("GAAP") and International Financial Reporting Standards ("IFRS") on the measurement of fair value and the related fair value disclosures. While largely consistent with existing fair value measurement principles and disclosures, the changes were made as part of the continuing efforts to converge GAAP and IFRS. The adoption of this guidance was effective for annual periods beginning after December 15, 2011, and did not have a significant impact on the Company's financial statements.

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In July, 2012, the FASB amended guidance on the impairment testing for indefinite-lived intangible assets contained in subtopic 350-30, the Intangibles-Goodwill and Other-General Intangibles Other than Goodwill. The objectives of the amendments in this ASU are to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by providing the entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived asset is impaired to determine whether the entity should perform a qualitative impairment test. The amendments in this guidance will be effective for annual periods beginning after September 15, 2012, and is not expected to have a material effect on the Company's financial statements.

2. Branch Acquisition

On April 27, 2012, Reliance State Bank (RSB) completed the purchase of two bank offices of Liberty Bank, F.S.B. located in Garner and Klemme, Iowa. This acquisition was consistent with the Bank's strategy to strengthen and expand its Iowa market share. The acquired assets and liabilities were recorded at fair value at the date of acquisition. These branches were purchased for cash consideration of $5.4 million. As a result of the acquisition, the Company recorded a core deposit intangible asset of $1,500,000 and goodwill of $5,601,000. The results of operations for this acquisition have been included since the transaction date of April 27, 2012. Non-routine expenses associated with this transaction were approximately $232,000 for the nine months ended September 30, 2012.

The following table summarizes the fair value of the total consideration transferred as a part of the acquisition as well as the fair value of identifiable assets acquired and liabilities assumed as of the effective date of the transaction.

	April 27, 2012
Cash consideration transferred	$5,400,000
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash	$49,703,137
Loans receivable	46,103,022
Accrued interest receivable	514,760
Bank premises and equipment	864,500
Core deposit intangible asset	1,500,000
Deposits	(98,766,558)
Accrued interest payable and other liabilities	(119,610)
Total identifiable net liabilities	$(200,749)
Goodwill	$5,600,749

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On April 27, 2012, the contractual balance of loans receivable acquired was $46,972,000 and the contractual balance of the deposits assumed was $98,109,000. Loans receivable acquired include agricultural real estate, commercial real estate, 1-4 family real estate, commercial operating, agricultural operating and consumer loans determined to be pass rated.

The core deposit intangible asset is amortized to expense on a declining basis over a period of seven years. The loan market valuation is accreted to income on a declining basis over a nine year period. The time deposits market valuation is amortized to expense on a declining basis over a three year period.

Cash obtained as a part of this transaction has been invested in securities available-for-sale.

3. Dividends

On August 8, 2012, the Company declared a cash dividend on its common stock, payable on November 15, 2012 to stockholders of record as of November 1, 2012, equal to $0.15 per share.

4.Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended September 30, 2012 and 2011 were 9,310,913 and 9,399,336, respectively. The weighted average outstanding shares for the nine months ended September 30, 2012 and 2011 were 9,310,913 and 9,419,731, respectively. The Company had no potentially dilutive securities outstanding during the periods presented.

5. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company’s off-balance sheet arrangements have occurred since December 31, 2011.

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6.Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments as described in Note 1 were as follows:

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	$23,542,568	$23,543,000	$22,829,291	$22,829,000
Interest bearing deposits	35,759,545	35,760,000	33,741,406	33,741,000
Securities available-for-sale	573,557,196	573,557,000	508,624,622	508,625,000
Loans receivable, net	488,426,392	494,916,000	438,650,837	445,240,000
Loans held for sale	1,570,621	1,571,000	1,212,620	1,213,000
Accrued income receivable	8,041,189	8,041,000	6,467,509	6,468,000
Financial liabilities:				
Deposits	$942,221,781	$944,920,000	$818,705,391	$821,979,000
Federal funds purchased and securities sold under agreements to repurchase	38,974,691	38,975,000	41,696,585	41,697,000
FHLB and other long-term borrowings	34,628,314	38,513,000	35,179,335	38,705,000
Accrued interest payable	746,139	746,000	802,847	803,000

The methodology used to determine fair value as of September 30, 2012 did not change from the methodology used in the December 31, 2011 Annual Report.

7. Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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The following table presents the balances of assets measured at fair value on a recurring basis by level as of September 30, 2012 and December 31, 2011:

Description	Total	Level 1	Level 2	Level 3
2012				
U.S. government agencies	$49,630,000	$-	$49,630,000	$-
U.S. government mortgage-backed securities	201,645,000	-	201,645,000	-
State and political subdivisions	295,641,000	-	295,641,000	-
Corporate bonds	23,140,000	-	23,140,000	-
Equity securities, financial industry common stock	682,000	682,000	-	-
Equity securities, other	2,819,000	-	2,819,000	-
	$573,557,000	$682,000	$572,875,000	$-
2011				
U.S. government agencies	$63,200,000	$-	$63,200,000	$-
U.S. government mortgage-backed securities	159,855,000	-	159,855,000	-
State and political subdivisions	259,393,000	-	259,393,000	-
Corporate bonds	20,387,000	-	20,387,000	-
Equity securities, financial industry common stock	2,810,000	2,810,000	-	-
Equity securities, other	2,980,000	-	2,980,000	-
	$508,625,000	$2,810,000	$505,815,000	$-

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Other securities available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security’s terms and conditions, among other things.

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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level with the valuation hierarchy as of September 30, 2012 and December 31, 2011:

Description	Total	Level 1	Level 2	Level 3
2012				
Loans receivable	$2,788,000	$-	$-	$2,788,000
Other real estate owned	9,940,000	-	-	9,940,000
Total	$12,728,000	$-	$-	$12,728,000
2011				
Loans receivable	$2,453,000	$-	$-	$2,453,000
Other real estate owned	9,538,000	-	-	9,538,000
Total	$11,991,000	$-	$-	$11,991,000

Loans: Loans in the tables above consist of impaired credits held for investment. In accordance with the loan impairment guidance, impairment was measured based on the fair value of collateral less estimated selling costs for collateral dependent loans. Fair value for impaired loans is based upon appraised values of collateral adjusted for trends observed in the market. A valuation allowance was recorded for the excess of the loan's recorded investment over the amounts determined by the collateral value method. This valuation is a component of the allowance for loan losses. The Company considers these fair values Level 3.

Other Real Estate Owned: Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The Company considers these fair values Level 3.

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8.Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values are summarized below:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2012:				
U.S. government agencies	$47,049,556	$2,581,111	$(480)	$49,630,187
U.S. government mortgage-backed securities	196,042,477	5,710,653	(107,839)	201,645,291
State and political subdivisions	285,007,382	10,824,325	(190,487)	295,641,220
Corporate bonds	21,963,047	1,180,421	(3,271)	23,140,197
Equity securities, financial industry common stock	889,552	-	(208,251)	681,301
Equity securities, other	2,819,000	-	-	2,819,000
	$553,771,014	$20,296,510	$(510,328)	$573,557,196

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2011:				
U.S. government agencies	$60,868,023	$2,341,093	$(8,720)	$63,200,396
U.S. government mortgage-backed securities	156,310,052	3,643,552	(99,143)	159,854,461
State and political subdivisions	249,707,887	9,788,715	(103,279)	259,393,323
Corporate bonds	20,288,210	465,331	(366,798)	20,386,743
Equity securities, financial industry common stock	3,402,389	-	(592,889)	2,809,500
Equity securities, other	2,980,199	-	-	2,980,199
	$493,556,760	$16,238,691	$(1,170,829)	$508,624,622

The proceeds, gains and losses from securities available-for-sale for the three and nine months ended September 30, 2012 and 2011 are summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Proceeds from sales of securities available-for-sale	$9,580,189	$2,757,199	$19,612,753	$23,684,117
Gross realized gains on securities available-for-sale	222,096	361,452	540,394	952,386
Gross realized losses on securities available-for-sale	1,866	8	2,096	4,816
Tax provision applicable to net realized gains on securities available-for-sale	82,000	134,000	201,000	353,000

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Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2012 and December 31, 2011, are summarized as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2012:						
Securities available-for-sale:						
U.S. government agencies	$719,159	$(480)	$-	$-	$719,159	$(480)
U.S. government mortgage-backed securities	$20,482,575	$(105,694)	$447,619	$(2,145)	$20,930,194	$(107,839)
State and political subdivisions	21,147,812	(189,210)	210,466	(1,277)	21,358,278	(190,487)
Corporate bonds	276,840	(3,271)	-	-	276,840	(3,271)
Equity securities, financial industry common stock	-	-	889,552	(208,251)	889,552	(208,251)
	$42,626,386	$(298,655)	$1,547,637	$(211,673)	$44,174,023	$(510,328)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2011:						
Securities available-for-sale:						
U.S. government agencies	$4,256,053	$(8,720)	$-	$-	$4,256,053	$(8,720)
U.S. government mortgage-backed securities	20,579,759	(99,143)	-	-	20,579,759	(99,143)
State and political subdivisions	6,838,342	(102,718)	454,850	(561)	7,293,192	(103,279)
Corporate bonds	6,571,481	(366,798)	-	-	6,571,481	(366,798)
Equity securities, financial industry common stock	-	-	2,809,500	(592,889)	2,809,500	(592,889)
	$38,245,635	$(577,379)	$3,264,350	$(593,450)	$41,509,985	$(1,170,829)

Gross unrealized losses on debt securities totaled $302,077 as of September 30, 2012. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. Management concluded that the gross unrealized losses on debt securities were temporary. Gross unrealized losses on equity securities totaled $208,251 as of September 30, 2012. Management analyzed the financial condition of the equity issuers and considered the general market conditions and other factors in concluding that the gross unrealized losses on equity securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

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9. Loan Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three and nine months ended September 30, 2012 and 2011 is as follows:

Three Months Ended September 30 2012

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, June 30, 2012	$739,000	$1,473,000	$2,912,000	$466,000	$1,406,000	$820,000	$205,000	$8,021,000
Provision (credit) for loan losses	(48,000)	49,000	48,000	10,000	(10,000)	(8,000)	(6,000)	35,000
Recoveries of loans charged-off	-	2,000	-	-	1,000	-	8,000	11,000
Loans charged-off	-	(39,000)	-	-	-	-	(19,000)	(58,000)
Balance, September 30, 2012	$691,000	$1,485,000	$2,960,000	$476,000	$1,397,000	$812,000	$188,000	$8,009,000

Nine Months Ended September 30 2012

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2011	$793,000	$1,402,000	$2,859,000	$501,000	$1,352,000	$764,000	$234,000	$7,905,000
Provision (credit) for loan losses	(102,000)	127,000	101,000	(25,000)	51,000	48,000	(49,000)	151,000
Recoveries of loans charged-off	-	5,000	-	-	6,000	-	41,000	52,000
Loans charged-off	-	(49,000)	-	-	(12,000)	-	(38,000)	(99,000)
Balance, September 30, 2012	$691,000	$1,485,000	$2,960,000	$476,000	$1,397,000	$812,000	$188,000	$8,009,000

Three Months Ended September 30 2011

	Construction	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural	Commercial	Agricultural	Consumer and Other	Total

	Real Estate			Real Estate				
Balance, June 30, 2011	$747,000	$1,437,000	$2,788,000	$525,000	$1,433,000	$703,000	$243,000	$7,876,000
Provision (credit) for loan losses	25,000	(17,000)	4,000	(18,000)	(35,000)	27,000	19,000	5,000
Recoveries of loans charged-off	-	-	-	-	5,000	4,000	5,000	14,000
Loans charged-off	-	-	-	-	(2,000)	(7,000)	(21,000)	(30,000)
Balance, September 30, 2011	$772,000	$1,420,000	$2,792,000	$507,000	$1,401,000	$727,000	$246,000	$7,865,000

	Nine Months Ended September 30, 2011							
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2010	$731,000	$1,404,000	$2,720,000	$486,000	$1,152,000	$735,000	$293,000	$7,521,000
Provision (credit) for loan losses	41,000	22,000	123,000	21,000	231,000	(2,000)	(26,000)	410,000
Recoveries of loans charged-off	-	-	-	-	20,000	11,000	12,000	43,000
Loans charged-off	-	(6,000)	(51,000)	-	(2,000)	(17,000)	(33,000)	(109,000)
Balance, September 30, 2011	$772,000	$1,420,000	$2,792,000	$507,000	$1,401,000	$727,000	$246,000	$7,865,000

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Allowance for loan losses disaggregated on the basis of impairment analysis method as of September 30, 2012 and December 31, 2011 is as follows:

2012

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$100,000	$195,000	$113,000	$ -	$400,000	$ 6,000	$ -	$814,000
Collectively evaluated for impairment	591,000	1,290,000	2,847,000	476,000	997,000	806,000	188,000	7,195,000
Balance September 30 2012	$691,000	$1,485,000	$2,960,000	$ 476,000	$1,397,000	$ 812,000	$188,000	$8,009,000

2011

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$165,000	$111,000	$199,000	$ -	$400,000	$ -	$1,000	$876,000
Collectively evaluated for impairment	628,000	1,291,000	2,660,000	501,000	952,000	764,000	233,000	7,029,000
Balance December 31, 2011	$793,000	$1,402,000	$2,859,000	$ 501,000	$1,352,000	$ 764,000	$234,000	$7,905,000

Loans receivable disaggregated on the basis of impairment analysis method as of September 30, 2012 and December 31, 2011 is as follows:

2012

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	T
Individually evaluated for impairment	$1,732,000	$871,000	$2,485,000	$-	$633,000	$6,000	$5,000	$5,73
Collectively evaluated for impairment	23,615,000	98,080,000	165,611,000	38,187,000	81,534,000	66,287,000	17,452,000	490,
Balance September' 30, 2012	$25,347,000	$98,951,000	$168,096,000	$38,187,000	$82,167,000	$66,293,000	$17,457,000	$496,

2011

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$2,163,000	$2,346,000	$2,703,000	$-	$590,000	$-	$1,000	$7,803,00
Collectively evaluated for impairment	21,468,000	91,916,000	144,797,000	32,503,000	75,368,000	52,179,000	20,753,000	438,984,
Balance December 31, 2011	$23,631,000	$94,262,000	$147,500,000	$32,503,000	$75,958,000	$52,179,000	$20,754,000	$446,787,

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A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment. The following is a recap of impaired loans, on a disaggregated basis, at September 30, 2012 and December 31, 2011:

2012

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:			
Real estate - construction	$ 1,260,000	$ 1,260,000	$ -
Real estate - 1 to 4 family residential	201,000	201,000	-
Real estate - commercial	558,000	558,000	-
Real estate - agricultural	-	-	-
Commercial	78,000	78,000	-
Agricultural	-	-	-
Consumer and other	-	-	-
Total loans with no specific reserve:	2,097,000	2,097,000	-
With an allowance recorded:			
Real estate - construction	472,000	472,000	100,000
Real estate - 1 to 4 family residential	670,000	670,000	195,000
Real estate - commercial	1,927,000	1,927,000	113,000
Real estate - agricultural	-	-	-
Commercial	555,000	555,000	400,000
Agricultural	6,000	6,000	6,000
Consumer and other	5,000	5,000	-
Total loans with specific reserve:	3,635,000	3,635,000	814,000
Total			
Real estate - construction	1,732,000	1,732,000	100,000
Real estate - 1 to 4 family residential	871,000	871,000	195,000
Real estate - commercial	2,485,000	2,485,000	113,000
Real estate - agricultural	-	-	-
Commercial	633,000	633,000	400,000
Agricultural	6,000	6,000	6,000
Consumer and other	5,000	5,000	-
	$ 5,732,000	$ 5,732,000	$ 814,000

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2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:			
Real estate - construction	$ 1,493,000	$ 1,493,000	$ -
Real estate - 1 to 4 family residential	2,030,000	2,030,000	-
Real estate - commercial	951,000	951,000	-
Real estate - agricultural	-	-	-
Commercial	-	-	-
Agricultural	-	-	-
Consumer and other	-	-	-
Total loans with no specific reserve:	4,474,000	4,474,000	-
With an allowance recorded:			
Real estate - construction	670,000	670,000	165,000
Real estate - 1 to 4 family residential	316,000	316,000	111,000
Real estate - commercial	1,752,000	1,752,000	199,000
Real estate - agricultural	-	-	-
Commercial	590,000	590,000	400,000
Agricultural	-	-	-
Consumer and other	1,000	1,000	1,000
Total loans with specific reserve:	3,329,000	3,329,000	876,000
Total			
Real estate - construction	2,163,000	2,163,000	165,000
Real estate - 1 to 4 family residential	2,346,000	2,346,000	111,000
Real estate - commercial	2,703,000	2,703,000	199,000
Real estate - agricultural	-	-	-
Commercial	590,000	590,000	400,000
Agricultural	-	-	-
Consumer and other	1,000	1,000	1,000
	$ 7,803,000	$ 7,803,000	$ 876,000

There are no significant differences between nonaccrual and impaired loan balances at September 30, 2012 and December 31, 2011.

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The following is a recap of the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2012 and 2011:

	Three Months ended September 30,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded:				
Real estate - construction	$ 1,424,000	$ 2,000	$ 239,000	$ -
Real estate - 1 to 4 family residential	820,000	-	1,940,000	1,000
Real estate - commercial	599,000	-	558,000	-
Real estate - agricultural	-	-	-	-
Commercial	39,000	-	-	-
Agricultural	-	-	-	-
Consumer and other	-	-	-	-
Total loans with no specific reserve:	2,882,000	2,000	2,737,000	1,000
With an allowance recorded:				
Real estate - construction	530,000	-	2,218,000	6,000
Real estate - 1 to 4 family residential	659,000	-	437,000	3,000
Real estate - commercial	1,947,000	-	318,000	-
Real estate - agricultural	-	-	-	-
Commercial	634,000	-	624,000	-
Agricultural	3,000	-	-	-
Consumer and other	6,000	-	8,000	-
Total loans with specific reserve:	3,779,000	-	3,605,000	9,000
Total				
Real estate - construction	1,954,000	2,000	2,457,000	6,000
Real estate - 1 to 4 family residential	1,479,000	-	2,377,000	4,000
Real estate - commercial	2,546,000	-	876,000	-
Real estate - agricultural	-	-	-	-
Commercial	673,000	-	624,000	-
Agricultural	3,000	-	-	-
Consumer and other	6,000	-	8,000	-
	$ 6,661,000	$ 2,000	$ 6,342,000	$ 10,000

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	Nine Months ended September 30,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded:				
Real estate - construction	$ 1,542,000	$ 4,000	$ 729,000	$ 182,000
Real estate - 1 to 4 family residential	1,393,000	14,000	1,307,000	1,000
Real estate - commercial	770,000	5,000	393,000	-
Real estate - agricultural	-	-	-	-
Commercial	20,000	-	23,000	-
Agricultural	-	-	-	-
Consumer and other	-	-	3,000	-
Total loans with no specific reserve:	3,725,000	23,000	2,455,000	183,000
With an allowance recorded:				
Real estate - construction	581,000	-	2,519,000	6,000
Real estate - 1 to 4 family residential	487,000	-	491,000	3,000
Real estate - commercial	1,843,000	-	488,000	-
Real estate - agricultural	-	-	-	-
Commercial	611,000	-	312,000	-
Agricultural	2,000	-	-	-
Consumer and other	3,000	-	14,000	-
Total loans with specific reserve:	3,527,000	-	3,824,000	9,000
Total				
Real estate - construction	2,123,000	4,000	3,248,000	188,000
Real estate - 1 to 4 family residential	1,880,000	14,000	1,798,000	4,000
Real estate - commercial	2,613,000	5,000	881,000	-
Real estate - agricultural	-	-	-	-
Commercial	631,000	-	335,000	-
Agricultural	2,000	-	-	-
Consumer and other	3,000	-	17,000	-
	$ 7,252,000	$ 23,000	$ 6,279,000	$ 192,000

The interest foregone on nonaccrual loans for the three months ended September 30, 2012 and 2011 was approximately $89,000 and $93,000, respectively. The interest foregone on nonaccrual loans for the nine months ended September 30, 2012 and 2011 was approximately $322,000 and $265,000, respectively.

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of $6,076,000 as of September 30, 2012, of which $4,537,000 was included in impaired loans and $1,538,000 was on accrual status. The Company had TDR of $3,602,000 as of December 31, 2011, of which $2,545,000 was included in impaired loans and $1,057,000 was on accrual status.

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The following table sets forth information on the Company's TDR, on a disaggregated basis, occuring in the three and nine months ended September 30:

	Three Months Ended September 30, 2012					
	2012			2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate - construction	2	$ 195,000	$ 195,000	-	$ -	$ -
Real estate - 1 to 4 family residential	-	-	-	-	-	-
Real estate - commercial	-	-	-	-	-	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	1	28,000	28,000	-	-	-
Agricultural	1	6,000	6,000	-	-	-
Consumer and other	-	-	-	-	-	-
	4	$ 229,000	$ 229,000	-	$ -	$ -

	Nine Months Ended September 30, 2012					
	2012			2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate - construction	2	$ 195,000	$ 195,000	-	$ -	$ -
Real estate - 1 to 4 family residential	2	391,000	401,000	3	544,000	553,000
Real estate - commercial	2	2,697,000	2,697,000	-	-	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	2	132,000	132,000	1	630,000	630,000
Agricultural	1	6,000	6,000	-	-	-
Consumer and other	-	-	-	-	-	-
	9	$ 3,421,000	$ 3,431,000	4	$ 1,174,000	$ 1,183,000

During the three and nine months ended September 30, 2012, the Company granted concessions to borrowers experiencing financial difficulties, for four and nine loans respectively. The two construction real estate loans were restructured by not requiring curtailments. The two commercial loans were restructured by reducing periodic payments and extending amortization. One one-to-four family real estate loan was restructured at a below market interest rate. One one-to-four family real estate loan was restructured to include previously unpaid interest in the new loan balance. One commercial real estate and the agricultural loans were restructured to extend the amortization of the loan beyond normal terms. One commercial real estate loan was restructured as an interest only loan for a period of time.

There was no new TDR activity in the three months ended September 30, 2011. However, during the nine months ended September 30, 2011, the company restructured four loans by granting concessions to borrowers experiencing financial difficulties. The commercial loan was restructured with a below market interest rate. Two of the one-to-four family real estate loans were restructured to include previously unpaid interest in the new loan balance. The other one-to-four family loan was restructured to extend the amortization of the loan beyond normal terms.

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There was no financial impact for specific reserves or from charge-offs for the TDR loans included in the previous table.

An aging analysis of the recorded investments in loans, on a disaggregated basis, as of September 30, 2012 and December 31, 2011, is as follows:

2012

	30-89 Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total	90 Days or Greater Accruing
Real estate - construction	$ -	$ -	$ -	$ 25,347,000	$ 25,347,000	$ -
Real estate - 1 to 4 family residential	1,026,000	839,000	1,865,000	97,086,000	98,951,000	228,000
Real estate - commercial	9,375,000	129,000	9,504,000	158,592,000	168,096,000	81,000
Real estate - agricultural	-	-	-	38,187,000	38,187,000	-
Commercial	567,000	4,000	571,000	81,596,000	82,167,000	4,000
Agricultural	-	-	-	66,293,000	66,293,000	-
Consumer and other	109,000	6,000	115,000	17,342,000	17,457,000	-
	$ 11,077,000	$ 978,000	$ 12,055,000	$ 484,443,000	$ 496,498,000	$ 313,000

2011

	30-89 Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total	90 Days or Greater Accruing
Real estate - construction	$34,000	$-	$34,000	$23,597,000	$23,631,000	$-
Real estate - 1 to 4 family residential	273,000	2,275,000	2,548,000	91,714,000	94,262,000	112,000
Real estate - commercial	105,000	113,000	218,000	147,282,000	147,500,000	-
Real estate - agricultural	-	-	-	32,503,000	32,503,000	-
Commercial	1,342,000	23,000	1,365,000	74,593,000	75,958,000	-
Agricultural	-	-	-	52,179,000	52,179,000	-
Consumer and other	98,000	17,000	115,000	20,639,000	20,754,000	40,000
	$1,852,000	$2,428,000	$4,280,000	$442,507,000	$446,787,000	$152,000

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The credit risk profile by internally assigned grade, on a disaggregated basis, at September 30, 2012 and December 31, 2011 is as follows:

2012

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	$15,655,000	$125,911,000	$34,927,000	$68,056,000	$64,985,000	$309,534,000
Watch	2,222,000	21,921,000	2,522,000	11,345,000	837,000	38,847,000
Special Mention	741,000	10,250,000	-	34,000	-	11,025,000
Substandard	4,997,000	7,529,000	738,000	2,099,000	465,000	15,828,000
Substandard-Impaired	1,732,000	2,485,000	-	633,000	6,000	4,856,000
	$25,347,000	$168,096,000	$38,187,000	$82,167,000	$66,293,000	$380,090,000

2011

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	$9,942,000	$94,820,000	$29,534,000	$65,502,000	$49,489,000	$249,287,000
Watch	3,258,000	37,005,000	2,441,000	7,622,000	2,190,000	52,516,000
Special Mention	829,000	6,196,000	-	45,000	-	7,070,000
Substandard	7,439,000	6,776,000	528,000	2,199,000	500,000	17,442,000
Substandard-Impaired	2,163,000	2,703,000	-	590,000	-	5,456,000
	$23,631,000	$147,500,000	$32,503,000	$75,958,000	$52,179,000	$331,771,000

The credit risk profile based on payment activity, on a disaggregated basis, at September 30, 2012 and December 31, 2011 is as follows:

2012

	1-4 Family Residential Real Estate	Consumer and Other	Total
Performing	$ 97,852,000	$ 17,452,000	$ 115,304,000
Non-performing	1,099,000	5,000	1,104,000
	$ 98,951,000	$ 17,457,000	$ 116,408,000

2011

	1-4 Family Residential Real Estate	Consumer and Other	Total
Performing	$ 91,804,000	$ 20,713,000	$ 112,517,000
Non-performing	2,458,000	41,000	2,499,000
	$ 94,262,000	$ 20,754,000	$ 115,016,000

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10.Other Real Estate Owned

The following table provides the composition of other real estate owned as of September 30, 2012 and December 31, 2011:

	2012	2011
Construction and land development	$ 7,697,828	$ 8,455,697
1 to 4 family residential real estate	1,427,500	154,699
Commercial real estate	814,378	928,044
	$ 9,939,706	$ 9,538,440

The Company is actively marketing the assets referred in the table above. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. The assets above are primarily located in the metropolitan Des Moines, Iowa and Ames, Iowa areas.

11.Goodwill

As of April 27, 2012, RSB acquired two bank branches located in Garner and Klemme, Iowa, which resulted in the recognition of $5.6 million of goodwill. Goodwill recognized in the acquisition was primarily attributable to an expanded market share and economies of scale expected from combining the operations of the Garner and Klemme branches with RSB. The goodwill recorded in conjunction with the acquisition is evaluated for impairment at least annually and is deductible for tax purposes over fifteen years.

12.Core deposit intangible asset

In conjunction with the acquisition of the two bank branches in 2012, the Corporation recorded $1.5 million in core deposit intangible assets. The following sets forth the carrying amounts and accumulated amortization of core deposit intangible assets:

	2012	
	Gross Amount	Accumulated Amortization
Core deposit intangible asset	$ 1,500,000	$ 122,960

There were no additions of other significant acquired intangible assets during 2012.

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Amortization expense on core deposit intangible assets totaled $122,960 for the nine months ended September 30, 2012. Estimated remaining amortization expense on core deposit intangible for the years ending is as follows:

2012	$73,776
2013	273,700
2014	244,000
2015	217,500
2016	193,864
2017 and thereafter	374,200

13. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. There were no significant events or transactions occurring after September 30, 2012, but prior to November 9, 2012, that provided additional evidence about conditions that existed at September 30, 2012. There were no significant events or transactions that provided evidence about conditions that did not exist at September 30, 2012.

Item 2.Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Ames National Corporation (the "Company") is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa (the "Banks"). The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Reliance State Bank (RSB), and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and trust services. The Banks also offer investment services through a third-party broker-dealer. The Company employs eleven individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 194 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

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The principal sources of Company revenues and cash flow are: (i) interest and fees earned on loans made by the Company and Banks; (ii) interest on fixed income investments held by the Company and Banks; (iii) fees on trust services provided by those Banks exercising trust powers; (iv) service charges on deposit accounts maintained at the Banks and (v) gain on sale of loans held for sale. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) provision for loan losses; (iii) salaries and employee benefits; (iv) data processing costs associated with maintaining the Banks' loan and deposit functions; (v) occupancy expenses for maintaining the Banks' facilities; (vi) other real estate owned costs and (vii) Federal Deposit Insurance Corporation ("FDIC") insurance assessments. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company had net income of $3,861,000, or $0.41 per share, for the three months ended September 30, 2012, compared to net income of $3,590,000, or $0.38 per share, for the three months ended September 30, 2011. Total equity capital as of September 30, 2012 totaled $144.1 million or 12.3% of total assets. Total tangible equity capital as of September 30, 2012 totaled $137.1 million or 11.8% of total tangible assets.

The improvement in quarterly earnings can be primarily attributed to the net income attributable to the acquisition of the Garner and Klemme, Iowa offices by RSB, lower interest expense on deposits and a higher gain on loans held for sale sold on the secondary market.

Net loan charge-offs totaled $47,000 and $16,000 for the three months ended September 30, 2012 and 2011, respectively. The provision for loan losses totaled $36,000 and $5,000 for the three months ended September 30, 2012 and 2011, respectively.

The Company had net income of $10,714,000, or $1.15 per share, for the nine months ended September 30, 2012, compared to net income of $10,306,000, or $1.09 per share, for the nine months ended September 30, 2011.

The change in nine months earnings can be primarily attributed to the net income attributable to the RSB acquisition, lower interest expense on deposits and a higher gain on loans held for sale sold on the secondary market.

Net loan charge-offs totaled $47,000 and $66,000 for the nine months ended September 30, 2012 and 2011, respectively. The provision for loan losses totaled $151,000 and $410,000 for the nine months ended September 30, 2012 and 2011, respectively.

The following management discussion and analysis will provide a review of important items relating to:

- Challenges
- Key Performance Indicators and Industry Results
- Critical Accounting Policies
- Income Statement Review
- Balance Sheet Review
- Asset Quality and Credit Risk Management
- Liquidity and Capital Resources
- Forward-Looking Statements and Business Risks

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Challenges

Management has identified certain events or circumstances that may negatively impact the Company's financial condition and results of operations in the future and is attempting to position the Company to best respond to those challenges.

- Interest rates are likely to increase as the economy continues its gradual recovery and the increasing interest rate environment may present a challenge to the Company. Increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense may increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Banks' earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

- The Company's market in central Iowa has numerous banks, credit unions, and investment and insurance companies competing for similar business opportunities. This competitive environment will continue to compress the Banks' net interest margins and, thus, affect profitability. Strategic planning efforts at the Company and Banks continue to focus on capitalizing on the Banks' strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.

- Other real estate owned amounted to $9.9 million and $9.5 million as of September 30, 2012 and December 31, 2011, respectively. Other real estate owned costs, net amounted to $472,000 and $418,000 for the nine months ended September 30, 2012 and 2011, respectively. Management obtains independent appraisals or performs evaluations to determine that these properties are carried at the lower of the new cost basis or fair value less cost to sell. It is at least reasonably possible that change in fair values will occur in the near term and that such changes could have a negative impact on the Company's earnings.

- The Company operates in a highly regulated environment and is subject to extensive regulation, supervision and examination. The compliance burden and impact on the Company's operations and profitability is significant. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States and, among many other things, establishes the new federal Consumer Finance Protection Bureau ("CFPB"). The CFPB and other federal agencies are continuing to implement many new and significant rules and regulations. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will impact the Company's and the Banks' business. Compliance with the new law and regulations are likely to result in additional costs, which could be significant, and could adversely impact the Company's results of operations, financial condition or liquidity. The Company cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any changes may have on future business and earnings prospects.

Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the FDIC and are derived from 7,246 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

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Selected Indicators for the Company and the Industry

	September 30, 2012		June 30, 2012		Year Ended December 31,			
	3 Months Ended	9 Months Ended	6 Months Ended		2011		2010	
	Company	Company	Company	Industry*	Company	Industry	Company	Industry
Return on assets	1.32 %	1.27 %	1.24 %	0.99 %	1.38 %	0.88 %	1.40 %	0.66 %
Return on equity	10.86 %	10.26 %	9.94 %	8.84 %	10.82 %	7.86 %	10.91 %	5.99 %
Net interest margin	3.34 %	3.37 %	3.39 %	3.49 %	3.60 %	3.60 %	3.74 %	3.76 %
Efficiency ratio	48.93 %	51.52 %	52.88 %	61.60 %	49.80 %	61.37 %	50.12 %	57.22 %
Capital ratio	12.18 %	12.34 %	12.43 %	9.25 %	12.75 %	9.09 %	12.80 %	8.90 %

*Latest available data

Key performances indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.32% and 1.43%, respectively, for the three months ended September 30, 2012 and 2011. The decrease in this ratio in 2012 from the previous period is primarily the result of an increase in average assets, offset in part by an increase in net income.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was 10.86% and 10.91%, respectively for the three months ended September 30, 2012 and 2011. The decrease in this ratio in 2012 from the previous period is primarily the result of higher average equity, offset in part by an increase in net income.

- Net Interest Margin

The net interest margin for the three months ended September 30, 2012 and 2011 was 3.34% and 3.67%, respectively. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings. The decrease in this ratio in 2012 is primarily the result of lower market yields on interest earning assets, offset in part by lower market cost of funds on interest bearing liabilities.

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- Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 48.93% and 50.61% for the three months ended September 30, 2012 and 2011, respectively. The change in the efficiency ratio in 2012 from the previous period is primarily the result of increased net interest income.

- Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio is significantly higher than the industry average.

Industry Results

The FDIC Quarterly Banking Profile reported the following results for the second quarter of 2012:

Earnings Improvement Trend Reaches Three-Year Mark

The benefits of reduced expenses for loan losses outweighed the drag from declining net interest margins, as insured institutions posted a 12th consecutive year-over-year increase in quarterly net income. Banks earned $34.5 billion in the quarter, a $5.9 billion (20.7%) increase compared with second quarter 2011. Almost two out of every three banks (62.7%) reported higher earnings than a year ago. Only 10.9% were unprofitable, down from 15.7% in second quarter 2011. The average return on assets (ROA) rose to 0.99% from 0.85% a year earlier. This is the third-highest quarterly ROA for the industry since second quarter 2007.

Banks Reduce Loan-Loss Provisions to Five-Year Low

Banks set aside $14.2 billion in provisions for loan losses in the second quarter. This amount represents a $5 billion (26.2%) decline from second quarter 2011, and is the smallest quarterly total in five years. The reduction in provision expenses helped offset a $287 million (0.3%) decline in net interest income, as the industry's average net interest margin fell to a three-year low. The average net interest margin was 3.46%, compared with 3.61% a year earlier, because average asset yields declined faster than average funding costs. Noninterest income made a positive contribution to the increase in earnings, rising by $1.6 billion (2.8%) from second quarter 2011. Gains on loan sales and on fair values of financial instruments contributed to the rise in noninterest income, while a $4.7 billion decline in trading income limited the year-over-year improvement. Net operating revenue (the sum of net interest income and total noninterest income) was only $1.3 billion (0.8%) higher than in second quarter 2011. Realized gains on securities and other assets were $1.7 billion (208.2%) higher than a year ago. A few large banks accounted for most of the dollar amounts of the decline in trading results, increased gains on loan sales and higher realized gains on securities.

Net Charge-Offs Decline Across All Loan Categories

Net charge-offs totaled $20.5 billion in the second quarter, an $8.4 billion (29.1%) reduction from second quarter 2011. This is the eighth consecutive quarter that charge-offs have declined from year-earlier levels and represents the lowest quarterly charge-off total since first quarter 2008. The year-over-year improvement was led by a $2.2 billion (24.6%) decline in credit card charge-offs, a $1.5 billion (25.2%) decline in charge-offs of residential mortgage loans, and a $1.2 billion (51.5%) drop in real estate construction loan charge-offs. All major loan categories posted lower charge-offs compared with a year ago. Half of all insured institutions (50.6%) reported year-over-year declines in charge-offs.

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Noncurrent Loan Balances Continue to Fall

Noncurrent loan balances (loans 90 days or more past due or in nonaccrual status) declined for a ninth consecutive quarter, falling by $12.9 billion (4.2%). Noncurrent levels fell in all major loan categories. The largest declines occurred in real estate construction and development loans, where noncurrent balances fell by $5.1 billion (17.8%), and in real estate loans secured by nonfarm nonresidential properties, where noncurrents declined by $3.6 billion (9.2%). Well over half of all institutions (58%) reported reductions in noncurrent balances during the quarter.

Reserve Drawdowns at Large Banks Surpass Reserve Buildups at Smaller Institutions

Reserves for loan losses fell by $6.7 billion (3.6%) during the quarter, as the $14.2 billion in loss provisions that banks added to reserves were less than the $20.5 billion in net charge-offs that were taken out. More banks (54.4%) reported reserve increases than reported reductions (38.2%), but the reductions were concentrated among larger institutions, and added up to more than the additions. Eight of the 10 largest banks (and 34 of the 50 largest) reduced their reserves in the second quarter. Reserve balances have fallen for nine consecutive quarters, and are $86.7 billion (32.9%) below the peak level reached at the end of first quarter 2010. Even with the reduction in reserves, the larger drop in noncurrent loan balances during the quarter meant that the industry's "coverage ratio" of reserves to noncurrent loans inched up from 60% to 60.4% between March 31 and June 30.

Retained Earnings Provide a Boost to Capital

Insured institutions continued to build their capital in the second quarter. Total equity capital increased by $20.3 billion (1.3%), with retained earnings contributing $14.9 billion to capital growth. This is the second-highest quarterly total for retained earnings since third quarter 2006. Dividends were $763 million (3.8%) lower than in second quarter 2011. Tier 1 regulatory capital rose by $14 billion (1.1%), but total risk-based capital was basically unchanged (up $524 million, or 0.04%), due to the decline in reserves, declines in deferred tax assets, and declines in intangible assets. At midyear, almost 97% of all insured institutions, representing more than 99% of insured institution assets, met or exceeded the requirements for "well-capitalized" institutions as defined for Prompt Corrective Action purposes.

Loans Increase for Fourth Time in Last Five Quarters

Total assets increased by $105.3 billion (0.8%), as loan balances rose for the fourth time in the last five quarters. Total loans and leases grew by $102 billion (1.4%), with loans to commercial and industrial (C&I) borrowers increasing by $48.9 billion (3.6%), residential mortgage loans rising by $16.6 billion (0.9%), and credit card balances growing by $14.7 billion (2.3%). Balances of real estate construction and development loans fell for a 17th consecutive quarter, declining by $10.9 billion (4.8%), while home equity lines of credit declined for the 13th quarter in a row, falling by $10.2 billion (1.7%). Loans to small businesses and farms posted a $1.5 billion (0.2%) increase, driven primarily by seasonal demand for agricultural credit. More than 60% of institutions reported growth in total loan balances during the quarter. Banks reduced their mortgage-backed securities holdings by $33.1 billion (1.9%), and increased their holdings of U.S. Treasury securities by $20.1 billion (12%).

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Nondeposit Liabilities Increase

Deposits increased by $61.6 billion (0.6%) during the quarter. Deposits in domestic offices rose by $88.1 billion (1.0%), while foreign office deposits fell by $26.5 billion (1.8%). Much of the growth in domestic deposits ($71.7 billion) consisted of noninterest-bearing transaction accounts with balances greater than $250,000 that are temporarily fully covered by the FDIC. The portion of these deposits that is above the $250,000 basic coverage limit increased by $65.7 billion (5.0%). In addition to the increase in large-denomination domestic deposits, insured institutions increased their nondeposit liabilities for the first time in seven quarters. Securities sold under repurchase agreements increased by $28 billion (6.7%), and Federal Home Loan Bank advances rose by $19.8 billion (6.5%).

More Than a Year Since Last New Charter

During the second quarter, the number of insured institutions reporting financial results declined from 7,308 to 7,246. Forty-five institutions were merged into other institutions, and 15 institutions failed. No new charters were added during the quarter. This is the fourth quarter in a row in which no new charters have been added. It has been more than six quarters since the last time a new charter was created other than to absorb a failing bank. The number of full-time equivalent employees at FDIC-insured institutions increased from 2,102,280 to 2,108,200. The number of institutions on the FDIC's "Problem List" fell for a fifth consecutive quarter, from 772 to 732. Total assets of "problem" institutions declined from $291 billion to $282 billion.

Critical Accounting Policies

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company's audited consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" contained in the Company's Annual Report. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified its most critical accounting policies to be those related to the allowance for loan losses, valuation of other real estate owned, the assessment of other-than-temporary impairment of certain securities available-for-sale and the valuation of goodwill and other intangible assets.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs. Due to potential changes in conditions, it is at least reasonably possible that change in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

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Other Real Estate Owned

Real estate properties acquired through or in lieu of foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Impairment losses are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. The portion of interest costs relating to development of real estate is capitalized. Independent appraisals or evaluations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost basis or fair value less cost to sell. These appraisals or evaluations are inherently subjective and require estimates that are susceptible to significant revisions as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

Other-Than-Temporary Impairment of Available-for-Sale Securities

Declines in the fair value of securities available-for-sale below their cost that are deemed to be other-than-temporary are generally reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers: (1) the intent to sell the investment securities and the more likely than not requirement that the Company will be required to sell the investment securities prior to recovery; (2) the length of time and the extent to which the fair value has been less than cost; and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that change in management's assessment of other-than-temporary impairment will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

Goodwill and Intangible Assets

Goodwill and the core deposit intangible asset arose in connection with the acquisition of the Garner and Klemme, Iowa offices by RSB on April 27, 2012. These assets are tested annually for impairment or more often if conditions indicate a possible impairment. For the purposes of goodwill impairment testing, determination of the fair value of a reporting unit involves the use of significant estimates and assumptions.   Through September 30, 2012, no conditions indicated impairment has incurred. The first annual test will be performed in the fourth quarter of 2012. Actual future test results may differ from the present evaluation of impairment due to changes in the conditions used in the current evaluation.

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Income Statement Review for the Three Months ended September 30, 2012

The following highlights a comparative discussion of the major components of net income and their impact for the three months ended September 30, 2012 and 2011:

AVERAGE BALANCES AND INTEREST RATES

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Three Months ended September 30,					
	2012			2011		
ASSETS (dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-earning assets						
Loans 1						
Commercial	$82,408	$1,018	4.94 %	$72,278	$954	5.28 %
Agricultural	66,203	939	5.67 %	46,226	644	5.58 %
Real estate	329,331	4,216	5.12 %	293,691	4,035	5.50 %
Consumer and other	18,001	241	5.35 %	20,136	273	5.41 %
Total loans (including fees)	495,943	6,414	5.17 %	432,331	5,906	5.46 %
Investment securities						
Taxable	292,557	1,442	1.97 %	267,249	1,907	2.85 %
Tax-exempt 2	261,927	2,611	3.99 %	220,820	2,497	4.52 %
Total investment securities	554,484	4,053	2.92 %	488,069	4,404	3.61 %
Interest bearing deposits with banks and federal funds sold	46,109	113	0.98 %	31,871	112	1.41 %
Total interest-earning assets	1,096,536	$10,580	3.86 %	952,271	$10,422	4.38 %
Noninterest-earning assets	70,467			54,946		
TOTAL ASSETS	$1,167,003			$1,007,217		

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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AVERAGE BALANCE SHEETS AND INTEREST RATES

	Three Months ended September 30,					
	2012			2011		
LIABILITIES AND STOCKHOLDERS' EQUITY (dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	$531,091	$289	0.22 %	$428,462	$309	0.29 %
Time deposits > $100,000	97,578	305	1.25 %	104,733	410	1.57 %
Time deposits < $100,000	160,291	503	1.26 %	141,657	604	1.70 %
Total deposits	788,960	1,097	0.56 %	674,852	1,323	0.78 %
Other borrowed funds	74,688	323	1.73 %	80,702	354	1.75 %
Total Interest-bearing liabilities	863,648	1,420	0.66 %	755,554	1,677	0.89 %
Noninterest-bearing liabilities						
Demand deposits	153,267			114,302		
Other liabilities	7,927			5,749		
Stockholders' equity	142,161			131,612		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,167,003			$1,007,217		
Net interest income		$9,160	3.34 %		$8,745	3.67 %
Spread Analysis						
Interest income/average assets	$10,580	3.63 %		$10,422	4.14 %	
Interest expense/average assets	$1,420	0.49 %		$1,677	0.67 %	
Net interest income/average assets	$9,160	3.14 %		$8,745	3.47 %	

Net Interest Income

For the three months ended September 30, 2012 and 2011, the Company's net interest margin adjusted for tax exempt income was 3.34% and 3.67%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the three months ended September 30, 2012 totaled $8,246,000 compared to $7,873,000 for the three months ended September 30, 2011.

For the three months ended September 30, 2012, interest income increased $117,000, or 1.2%, when compared to the same period in 2011. The increase from 2011 was primarily attributable to higher average balance of investment securities and loans, offset in part by lower average yields on loans and investment securities. The higher average balances were due primarily to the acquisition of the Garner and Klemme, Iowa offices by RSB.

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Interest expense decreased $257,000, or 15.3%, for the three months ended September 30, 2012 when compared to the same period in 2011. The lower interest expense for the period is primarily attributable to lower average rates paid on deposits, offset in part by a higher average balance on deposits. The higher average balances were due primarily to the acquisition of the Garner and Klemme, Iowa offices by RSB.

Provision for Loan Losses

The Company's provision for loan losses was $36,000 and $5,000 for the three months ended September 30, 2012 and 2011, respectively. Net loan charge-offs were $47,000 and $16,000 for the three months ended September 30, 2012 and 2011, respectively.

Non-interest Income and Expense

Non-interest income increased $160,000 or 8.4% for the three months ended September 30, 2012 compared to the same period in 2011. The increase in non-interest income is primarily due to the gain on the sale of loans and merchant and ATM fees, offset in part by a decrease in security gains. The increase in the gain on the sale of loans was due primarily to increased volume as a result of lower interest rates. Excluding net security gains, which were lower by $141,000 than the same quarter of 2011, for the three months ending September 30, 2012 and 2011, non-interest income increased $301,000, or 19.6%.

Non-interest expense increased $171,000 or 3.5% for the three months ended September 30, 2012 compared to the same period in 2011 primarily as a result of higher costs of salaries and employee benefits, core deposit intangibles amortization, offset in part by a decrease in other real estate owned costs. The higher salaries and employee benefit costs are primarily due to additional payroll costs as a result of the branch acquisition and normal salary increases. The lower other real estate costs are mainly due to higher impairment write downs in 2011 as compared to 2012.

Income Taxes

The provision for income taxes expense for the three months ended September 30, 2012 and 2011 was $1,366,000 and $1,305,000, representing an effective tax rate of 26% and 27%, respectively. The increase in income tax expense was due primarily to higher pretax earnings in 2012.

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Income Statement Review for the Nine Months ended September 30, 2012

The following highlights a comparative discussion of the major components of net income and their impact for the nine months ended September 30, 2012 and 2011:

AVERAGE BALANCES AND INTEREST RATES

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Nine Months ended September 30,					
	2012			2011		
ASSETS (dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-earning assets						
Loans 1						
Commercial	$81,743	$3,027	4.94 %	$76,216	$2,965	5.19 %
Agricultural	58,839	2,443	5.54 %	44,327	1,844	5.55 %
Real estate	317,924	12,250	5.14 %	286,609	12,011	5.59 %
Consumer and other	18,931	751	5.29 %	21,118	826	5.21 %
Total loans (including fees)	477,437	18,471	5.16 %	428,270	17,646	5.49 %
Investment securities						
Taxable	282,649	4,660	2.20 %	264,812	5,365	2.70 %
Tax-exempt 2	248,177	7,762	4.17 %	219,471	7,519	4.57 %
Total investment securities	530,826	12,422	3.12 %	484,283	12,884	3.55 %
Interest bearing deposits with banks and federal funds sold	53,581	371	0.92 %	36,591	338	1.23 %
Total interest-earning assets	1,061,844	$31,264	3.93 %	949,144	$30,868	4.34 %
Noninterest-earning assets	66,666			53,514		
TOTAL ASSETS	$1,128,510			$1,002,658		

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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AVERAGE BALANCE SHEETS AND INTEREST RATES

	Nine Months ended September 30,							
	2012				2011			
	Average balance	Revenue/ expense	Yield/ rate		Average balance	Revenue/ expense	Yield/ rate	
LIABILITIES AND STOCKHOLDERS' EQUITY (dollars in thousands)								
Interest-bearing liabilities								
Deposits								
NOW, savings accounts and money markets	$509,511	$858	0.22	%	$434,622	$1,003	0.31	%
Time deposits > $100,000	102,984	1,004	1.30	%	101,035	1,226	1.62	%
Time deposits < $100,000	151,189	1,558	1.37	%	141,602	1,848	1.74	%
Total deposits	763,684	3,420	0.60	%	677,259	4,077	0.80	%
Other borrowed funds	73,767	972	1.76	%	84,895	1,087	1.71	%
Total Interest-bearing liabilities	837,451	4,392	0.70	%	762,154	5,164	0.90	%
Noninterest-bearing liabilities								
Demand deposits	143,837							