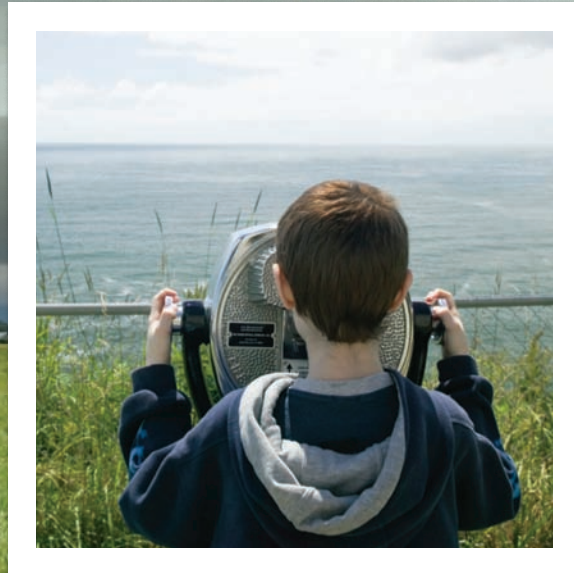


Bancorp. of Southern Indiana
2010 Annual Report



PLANNING *for* CLEARER SKIES *for* FUTURE GENERATIONS







Even when the outlook is cloudy...

JCB has shared in the successes and challenges of the communities we serve since 1900. Across that span of years, we've seen some difficult times come and go. And we understand that now is one of those times.

As a financial institution committed to its southern Indiana roots, we know our customers. We've empathized as many of our weekly visitors shared anxieties about job loss. We've seen families struggle to make mortgage payments as budgets tightened. And we've watched some of our neighbors defer adding to their savings balances due to budget constraints and surviving in a "just get by" mode.

Jo Ann Kasprzycki, manager and 19-year employee of JCB, provided a sounding board to many of these Hoosiers in 2010.

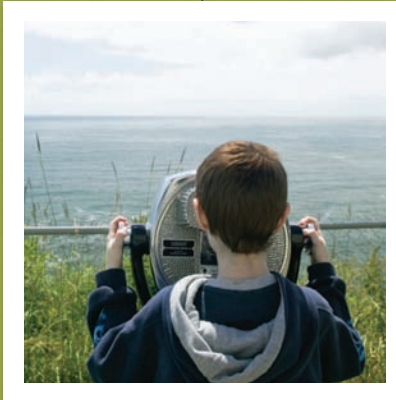
"They all want to know when it's going to get better," Kasprzycki explained. "The government says the cost of living is down, but that's not what we've observed. Still, we try to remind our customers that it's cyclical, and the economy will come around again."

Many of Kasprzycki's customers have adjusted their lifestyles to adapt to the changes in the economy – selling big kid "toys," like boats, campers and motorcycles, eliminating non-essentials from the family budget, trimming donations and even cutting back on food expenses.

The recent recession has been challenging for JCB, too – our organization felt the effects of the economy more in 2010 than we did in 2009. Despite this, JCB has fared better than most of our industry peers – from small, community banks like ours, to large, regional conglomerates. Again this year, our strong foundation and long standing conservative business model allowed JCB to maneuver through the recession. And perhaps most importantly, as a result of JCB's capital strength, we continued to loan money to qualified businesses and individuals to help them and thereby help our local economy.

We'll guide you toward a brighter future.

The good news is things are getting better for our industry and the markets we serve. In the year ahead, JCB will continue to weather the economic challenges by making good decisions on behalf of our stockholders mainly by how we take care of our customers. It's important for banks and consumers alike to adopt this philosophy of responsibility. If we all learn from past experiences, these trying economic times could result in a positive change of attitude that will last a lifetime.



But as with any journey, this new economy requires planning and forward thinking to help customers reach their goals.

Susan Haskett, senior vice president of consumer/retail services and 21-year veteran of JCB, feels that the best advice is to be proactive, not reactive.

"When we talk about planning, JCB's mission is to 'fulfill customer dreams and goals.' I see a big tie-in between that age-old mission and our efforts to help people get back to financial security," Haskett shared.

Getting back on the path to fiscal recovery may seem daunting, but creating a plan is the first and most critical step.

"Things just don't happen by accident. A plan is critical – and having the discipline to stick to the plan is even more important,"

Haskett said. "It's been widely reported that feelings of entitlement led people to borrow to get things they may not have really needed. For example, instead of saving for retirement, they might have gone on lavish vacations. In short, although some people have suffered a major event like job loss that led to desperate financial conditions, many others may have become victims of their failure to be engaged in their own personal financial success."

For commercial customers, planning was not a problem in 2010 – confidence was. John Fox, senior vice president of commercial services with 14 years at JCB and 36 years in the lending business, noticed more potential business borrowers proceeding with caution last year – or not at all.

"People want to see if this improvement in the economy is a short-term blip – most aren't going to invest large sums of money in a new venture until the economy has decisively turned," Fox said.

But despite commercial client hesitancy, JCB has been throughout this period, actively looking for qualified commercial borrowers.

"Contrary to what you may read in the national press, it's not that banks aren't out there actively seeking loans – there are a lot of folks who have capital and a project sitting on the sidelines. The demand by quality borrowers is simply down. But by and large, many community banks like us are still seeking good, qualified borrowers," Fox shared.

It's true that the months and years ahead still hold challenges for our industry and our customers alike. But JCB is confident that we have a plan in place to guide us all out of the clouds and into the brighter skies ahead. Our experienced commercial and retail teams stand ready to provide support – with lending solutions to qualified current and new customers; with investment advice and products customized to individual needs. Let us help you achieve your brighter future.



FINANCIALS

- 3 Message to Shareholders
- 4 Consolidated Financial Highlights
- 5 Five Year Summary
- 6 Consolidated Financial Statements
- 10 Notes to Consolidated Financial Statements
- 31 Report to Independent Auditors
- 31 Banking Locations
- 32 Officers
- 33 Board of Directors

The Annual Meeting of Bancorp. of Southern Indiana shareholders will be held on Monday, April 18, 2011, at 5:00 p.m. in the E.P. Elsner, Jr. Conference and Training Center, located at the bank's main office complex at 125 South Chestnut Street, Seymour, Indiana.

MESSAGE *to* SHAREHOLDERS

The cover of this year's Annual Report to stockholders speaks metaphorically and pictorially to the passing of the storm of the Great Recession of 2008 and 2009, but the residual clouds are still visible and in the process of breaking up. A young boy views the horizon with hope, a plan and anticipation of a brighter future.

Bancorp. of Southern Indiana and JCB are a reflection of its customers, both big and small, business and individual. While the Great Recession has been technically over now for a number of months, the residual effects of it linger in a number of ways. We believe BSI is weathering the storm quite well and we understand why. It is due to our solid foundation and experience, principled approach to doing business, having a well thought out plan with measured conservatism in how we lend to our customers, and a determination to stay within our capabilities. We are not apologetic for these tried and true values and give credit to them for successfully maneuvering us through these times.

I encourage you to invest a few minutes to read the feature article at the front of this report. It conveys the thoughts of some of our key bank officers, their care, concern and empathy for what individuals we work with each and every day have been experiencing. They also shed light on what it may take to assure that brighter future for which the young boy on the cover so desperately longs. We have the people with the talent within our organization and the tools to help customers effectively plan in an effort to achieve a better future for themselves, their families and their businesses. Your company has been here for 110 years doing just that and it is our intent to be here for a long time to come.

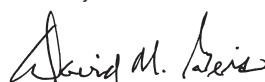
While 2010 was not a year in which we set any records of earnings performance, we managed to modestly exceed 2009's level of net income. The Board of Directors and bank leadership considers this an achievement in comparison to many of our peers, both larger and smaller. BSI's 2010 consolidated net earnings amounted to \$2,425,000 or \$5.02 per share. This compares with 2009's consolidated net earnings of \$2,379,000 or \$4.84 per share. Return on stockholders equity was 6.63% and 6.68% for 2010 and 2009, respectively. To place this

performance into context, during 2010 the average return on equity of all Indiana commercial banks was 5.45%. BSI's return on average assets for 2010 was 0.64% compared to 0.60% for 2009. With BSI's level of earnings performance and strong capital position we were able to maintain the annual dividend to our stockholders at \$1.55 per share. BSI's book value per share increased 4.4% to \$76.47 at year end 2010 from \$73.24 per share year end 2009. The most recent stock redemption price approved by the board of directors is \$62.00 per share. I invite you to peruse the comparative measures of BSI's consolidated financial performance on pages 4 through 30.

As I have emphasized with stockholders during these past two years, JCB's capital is strong and liquidity more than ample to meet prospective growth and funding needs respectively. Capital ratios have even improved due to retention of earnings as well as a planned contraction of the balance sheet, as this was not an environment that was conducive to growing the bank. In fact, net interest income slightly improved over the prior year despite average assets contracting \$15.6 million during the course of 2010. In summary, JCB's Tier One Capital to Average Assets ratio was 10.3% at year end 2010 compared with 9.4% at year end 2009. This also compares favorably to the regulatory "Well-Capitalized" ratio requirement of 5.0%.

As your board of directors and senior leadership look to 2011 and beyond, we are like the young boy on the Annual Report cover who sees a brighter future once the lingering clouds of the recent recession clear away. We see the horizon full of opportunity for our customers and stockholders, knowing we have a solid foundation, a strategic direction and the resources of a dedicated team of employees to serve our customers in an *Extraordinary* way. Thank you for your support and confidence.

Sincerely,



David M. Geis, President

CONSOLIDATED FINANCIAL HIGHLIGHTS

(Dollar amounts in thousands except per share data)

	2010	2009	Percentage Change
Operating Results:			
Net interest income	\$ 12,325	\$ 12,252	0.60%
Noninterest income	4,863	5,177	-6.07%
Noninterest expense	12,083	13,399	-9.82%
Net income	2,425	2,379	1.93%
Cash dividends paid	746	760	-1.84%
Return on average equity	6.63%	6.68%	-0.75%
Return on average assets	0.64%	0.60%	6.67%
Per Share Data:			
Net income	\$ 5.02	\$ 4.84	3.72%
Dividends	1.55	1.55	—
Book value	76.47	73.24	4.41%
Number of average shares outstanding	482,795	491,704	-1.81%
Number of shares outstanding	477,856	488,340	-2.15%
Number of stockholders	414	408	1.47%
Year-End Totals:			
Assets	\$ 372,395	\$ 400,242	-6.96%
Deposits	288,858	319,796	-9.67%
Loans held-for-sale	3,225	—	—
Loans, net	276,095	288,163	-4.19%
Stockholders' equity	36,544	35,767	2.17%
Averages:			
Assets	\$ 380,722	\$ 396,330	-3.94%
Deposits	298,105	306,629	-2.78%
Loans held-for-sale	1,498	2,539	-41.00%
Loans, net	276,947	293,873	-5.76%
Stockholders' equity	36,570	35,611	2.69%

FIVE YEAR SUMMARY

(Dollar amounts in thousands except per share data)

	2010	2009	2008	2007	2006
Assets:					
Cash and cash equivalents	\$ 16,013	\$ 20,108	\$ 27,192	\$ 16,037	\$ 20,937
Investments	50,656	68,825	56,294	42,181	46,634
Loans held-for-sale	3,225	0	2,118	1,094	956
Loans, net	276,095	288,163	301,525	277,097	287,217
Bank premises and equipment, net	4,993	5,140	5,277	5,413	5,671
Other assets	21,413	18,006	12,916	9,567	4,479
Total assets	\$ 372,395	\$ 400,242	\$ 405,322	\$ 351,389	\$ 365,894
Liabilities:					
Noninterest-bearing deposits	\$ 54,749	\$ 51,973	\$ 40,069	\$ 42,876	\$ 45,649
Interest-bearing deposits	234,109	267,823	262,106	232,126	256,015
Total deposits	288,858	319,796	302,175	275,002	301,664
Short-term borrowings	13,397	4,797	14,134	3,244	6,880
Long-term debt	27,385	35,175	48,686	35,304	21,200
Other liabilities	6,211	4,707	5,318	3,949	3,570
Total liabilities	335,851	364,475	370,313	317,499	333,314
Stockholders' equity	36,544	35,767	35,009	33,890	32,580
Total liabilities and stockholders' equity	\$ 372,395	\$ 400,242	\$ 405,322	\$ 351,389	\$ 365,894
Summary of Operations:					
Interest income	\$ 17,589	\$ 19,376	\$ 21,495	\$ 22,600	\$ 20,769
Interest expense	5,264	7,124	8,369	10,514	9,059
Net interest income	12,325	12,252	13,126	12,086	11,710
Provision for loans losses	2,250	1,350	900	600	255
Net interest income after provision for loan losses	10,075	10,902	12,226	11,486	11,455
Noninterest income	4,863	5,177	3,700	3,938	3,342
Noninterest expense	12,083	13,399	11,916	11,239	10,837
Income before income taxes	2,855	2,680	4,010	4,185	3,960
Provision for income taxes	430	301	892	979	1,030
Net income	\$ 2,425	\$ 2,379	\$ 3,118	\$ 3,206	\$ 2,930
Earnings per share	\$ 5.02	\$ 4.84	\$ 6.20	\$ 6.25	\$ 5.58
Cash dividends per share	\$ 1.55	\$ 1.55	\$ 2.10	\$ 2.05	\$ 1.90
Average shares outstanding	482,795	491,704	503,047	513,086	524,881

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

December 31, 2010 and 2009

(Dollar amounts in thousands except per share data)

	2010	2009
Assets		
Cash and due from financial institutions	\$ 5,786	\$ 14,545
Fed funds sold and other interest bearing deposits	10,227	5,563
Cash and cash equivalents	16,013	20,108
Trading securities	717	574
Securities available-for-sale	47,649	65,812
Federal Home Loan Bank stock, at cost	2,290	2,439
Loans held-for-sale	3,225	—
Loans, net of allowance of \$4,144 and \$3,050	276,095	288,163
Premises and equipment, net	4,993	5,140
Company owned life insurance	7,825	7,547
Other real estate, net	5,468	3,217
Prepaid FDIC Insurance	1,281	1,741
Accrued interest receivable and other assets	6,839	5,501
	\$ 372,395	\$ 400,242
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing deposits	\$ 54,749	\$ 51,973
Interest-bearing deposits	234,109	267,823
Total deposits	288,858	319,796
Short-term borrowings	13,397	4,797
Federal Home Loan Bank advances	27,385	35,175
Accrued interest payable and other liabilities	6,211	4,707
Total liabilities	335,851	364,475
Stockholders' equity		
Preferred stock, no par value, 200,000 shares authorized, none issued	—	—
Common stock, no par value, \$.50 stated value, 680,000 shares authorized, 2010 – 477,856 issued and outstanding; 2009 – 488,340 issued and outstanding	239	244
Additional paid-in capital	3,092	3,160
Retained earnings	33,657	32,586
Accumulated other comprehensive income/(loss)	(444)	(223)
Total stockholders' equity	36,544	35,767
	\$ 372,395	\$ 400,242

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME

December 31, 2010 and 2009

(Dollar amounts in thousands except per share data)

	2010	2009
Interest and dividend income		
Loans, including fees	\$ 16,045	\$ 17,567
Securities		
Taxable	579	719
Non-taxable	954	1,081
Federal funds sold and other	11	9
	17,589	19,376
Interest expense		
Deposits	3,892	5,327
Short-term borrowings	69	62
Federal Home Loan Bank advances	1,303	1,735
	5,264	7,124
Net interest income	12,325	12,252
Provision for loan losses	2,250	1,350
Net interest income after provision for loan losses	10,075	10,902
Other income		
Fiduciary income	723	709
Service charges	1,652	1,489
Earnings on company owned life insurance	278	285
Loan servicing income, net	48	(46)
Net gain on sale of securities	309	—
Mortgage banking income	815	1,292
Other	1,038	1,448
	4,863	5,177
Other expenses		
Salaries and employee benefits	5,682	6,391
Occupancy and equipment	1,304	1,411
Data processing	671	655
FDIC insurance assessment	497	690
Other	3,929	4,252
	12,083	13,399
Income before income taxes	2,855	2,680
Provision for income taxes	430	301
Net income	\$ 2,425	\$ 2,379
Earnings per share	\$ 5.02	\$ 4.84
Average shares outstanding	482,795	491,704

See accompanying notes.

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years ended December 31, 2010 and 2009

(Dollar amounts in thousands except per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
Balance at January 1, 2009	\$ 248	\$ 3,212	\$ 31,489	\$ 60	\$ 35,009
Comprehensive income:					
Net income			2,379		2,379
Change in unrealized gain (loss) on securities available-for-sale, net				(286)	(286)
Change in unrealized gain (loss) on retirement plans, net (Note 9)				3	3
Total comprehensive income					2,096
Stock redemption (8,111 shares)	(4)	(52)	(522)		(578)
Cash dividends (\$1.55 per share)			(760)		(760)
Balance at December 31, 2009	\$ 244	\$ 3,160	\$ 32,586	\$ (223)	\$ 35,767
Comprehensive income:					
Net income			2,425		2,425
Change in unrealized gain (loss) on securities available-for-sale, net				(99)	(99)
Change in unrealized gain (loss) on retirement plans, net (Note 9)				(122)	(122)
Total comprehensive income					2,204
Stock redemption (10,484 shares)	(5)	(68)	(608)		(681)
Cash dividends (\$1.55 per share)			(746)		(746)
Balance at December 31, 2010	\$ 239	\$ 3,092	\$ 33,657	\$ (444)	\$ 36,544

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2010 and 2009

(Dollar amounts in thousands)

	2010	2009
Cash flows from operating activities		
Net income	\$ 2,425	\$ 2,379
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	564	554
Net amortization of securities	76	147
Servicing rights amortization	316	427
Provision for loan losses	2,250	1,350
Net change in trading securities	(143)	(242)
Net realized gain on sales of securities	(309)	—
Gain on loans sold	(451)	(616)
Loans originated for resale	(39,187)	(71,086)
Proceeds from sale of loans	36,413	73,820
Loss on sale and writedowns of foreclosed property	294	26
Gain on sale of equipment	—	(9)
Earnings on company owned life insurance	(278)	(285)
Net change in:		
Accrued interest receivable and other assets	(1,367)	(2,177)
Accrued interest payable and other liabilities	1,504	(611)
Net cash from operating activities	2,107	3,677
Cash flows from investing activities		
Securities available-for-sale:		
Purchases	(37,662)	(50,345)
Proceeds from sales	10,140	—
Proceeds from calls, maturities, and payments	45,755	37,440
Loans made to customers, net of repayment	5,930	8,306
Purchases of premises and equipment	(341)	(332)
Proceeds from sale of equipment	—	11
Proceeds from Federal Home Loan Bank stock repurchase	149	—
Proceeds from company owned life insurance	—	163
Proceeds from sale of foreclosed property	1,382	561
Net cash from investing activities	25,353	(4,196)
Cash flows from financing activities		
Net change in deposit accounts	\$ (30,938)	17,621
Net change in short-term borrowings	8,600	(9,337)
Proceeds from Federal Home Loan Bank advances	12,000	—
Repayment of Federal Home Loan Bank advances	(19,790)	(13,511)
Dividends paid	(746)	(760)
Stock redemption	(681)	(578)
Net cash from financing activities	(31,555)	(6,565)
Net change in cash and cash equivalents	(4,095)	(7,084)
Beginning cash and cash equivalents	20,108	27,192
Ending cash and cash equivalents	\$ 16,013	\$ 20,108
Supplemental disclosures of cash flow information		
Interest paid	\$ 5,569	\$ 7,666
Income taxes paid	520	630
Supplemental non-cash disclosures		
Loans transferred to other real estate	\$ 3,888	\$ 3,706

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 1 - Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation:

The consolidated financial statements include the accounts of Bancorp. of Southern Indiana ("Company") and its wholly owned subsidiary, Jackson County Bank ("the Bank"), and the Bank's wholly owned subsidiaries, JCB Holdings, Inc. ("Holdings") and JCB Properties Management, Inc. ("Properties"). All significant intercompany transactions and balances have been eliminated in consolidation. The Bank is a full-service commercial bank operating primarily in Jackson County and five adjacent counties located in South Central Indiana. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through February 10, 2011, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management must make estimates and assumptions based on available information. These estimates and assumptions affect amounts reported in the financial statements and the disclosure provided, and actual results could differ. The allowance for loan losses, loan servicing rights and fair values of financial instruments are particularly subject to change.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, federal funds purchased and repurchase agreements.

Trading Securities: Trading securities are related to deferred compensation plans and are carried at fair value with changes in fair value included in other income. Interest and dividends are included in securities interest income. Quoted market prices are used to determine the fair value of trading securities.

Securities: Securities are classified as available-for-sale when they might be sold before maturity. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Gains and losses on sales are determined using the amortized cost of the security sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In estimating other than temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and whether the Company intends to sell or more likely than not will be required to sell the security prior to any anticipated recovery in fair value. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB of Indianapolis. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held-For-Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held-for-sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the cost allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the principal balance outstanding, net of an allowance for loan losses and deferred loan fees and costs. Interest income on loans is accrued over the term of the loans based on the principal outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments. Interest income is discontinued when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days. Loans are placed on nonaccrual or charged-off at an earlier date if collection of principal and interest is considered doubtful.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required based on past loan loss experience, nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors. Allocations of the allowance may be made for specific loans but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Premises and equipment are depreciated primarily on the straight-line method over the estimated useful lives of the assets. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

Servicing Assets: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income

statement effect recorded in mortgage banking income. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on an independent valuation. The independent valuations incorporate assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, ancillary income, prepayment speeds and default rates and losses. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as Loan servicing income, net, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled \$364 and \$381 for the years ended December 31, 2010 and 2009. Late fees and ancillary fees related to loan servicing are not material.

Other Real Estate: Assets acquired through or instead of loan foreclosure are recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Company Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Prepaid FDIC Insurance: On September 29, 2009 the Federal Deposit Insurance Corporation ("FDIC") adopted an Amended Restoration Plan to allow the Deposit Insurance Fund to return to a reserve ratio of 1.15% within eight years, as mandated by statute. As part of the Amended Restoration Plan, the FDIC amended its assessment

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 1 - Summary of Significant Accounting Policies (continued)

regulations to require all institutions to prepay on December 30, 2009 their estimated risk-based insurance assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. At that same time, institutions were also required to pay their regular quarterly assessments for the third quarter of 2009. An institution's quarterly risk-based deposit insurance assessments thereafter would be paid from the amount the institution prepaid until that amount was exhausted or until December 31, 2014, when any amount remaining would be returned to the institution. However, if the FDIC determined the insurance prepayment would adversely affect an institution's safety and soundness, the FDIC could exercise its supervisory discretion to exempt an institution from the prepayment requirement. Further, an institution could apply to the FDIC for an exemption from the prepayment requirement if the institution could demonstrate that the prepayment would significantly impair the institution's liquidity, or otherwise create a significant hardship.

Short-term Borrowings: Short-term borrowings include repurchase agreement liabilities representing amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Retirement Plans: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company did not have any amounts accrued for interest and penalties at December 31, 2010 and 2009.

Earnings Per Share: Earnings per share is based on net income divided by the weighted-average number of common shares outstanding during the year. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale and changes in the funded status of the pension plan, which are also recognized as a separate component of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are now such matters that will have a material effect on the financial statements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to stockholders.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Adoption of New Accounting Standards:

In June 2009, the FASB issued guidance on accounting for transfers of financial assets. This guidance amends previous guidance relating to the transfers of financial assets and eliminates the concept of a qualifying special purpose entity. This guidance must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. Additionally, the disclosure provisions of this guidance were also amended and apply to transfers that occurred both before and after the effective date of this Statement. This new guidance did not have an impact on the Company's financial statements.

NOTE 2 - Securities

The fair value of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				
Federal agencies	\$ 17,693	\$ 54	\$ (101)	\$ 17,646
Residential mortgage-backed	3,275	45	(11)	3,309
State and municipal	26,149	678	(133)	26,694
	<u>\$ 47,117</u>	<u>\$ 777</u>	<u>\$ (245)</u>	<u>\$ 47,649</u>
2009				
Federal agencies	\$ 35,106	\$ 100	\$ (111)	\$ 35,095
Residential mortgage-backed	435	24	—	459
State and municipal	29,577	708	(27)	30,258
	<u>\$ 65,118</u>	<u>\$ 832</u>	<u>\$ (138)</u>	<u>\$ 65,812</u>

Trading securities consist of investments in mutual funds and are related to deferred compensation plans. Income recognized on trading securities totaled \$110 and \$147 for 2010 and 2009.

Securities with a carrying value of \$16,018 and \$6,084 were pledged to secure repurchase agreements and other borrowings at year-end 2010 and 2009.

During 2010, proceeds from the sales of securities available-for-sale totaled \$10,140, with gross gains of \$309 and gross losses of \$0. During 2009, there were no sales of securities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 2 - Securities (continued)

The fair value of debt securities at year-end 2010, by contractual maturity, is shown below. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

	December 31, 2010	
	Amortized Cost	Fair Value
Due in one year or less	\$ 4,221	\$ 4,243
Due after one year through five years	26,830	27,202
Due after five years through 10 years	11,707	11,846
Due after 10 years	1,084	1,049
Residential mortgage-backed	3,275	3,309
	<u>\$ 47,117</u>	<u>\$ 47,649</u>

Below is a summary of securities with unrealized losses as of year-end 2010 and 2009, presented by investment category and length of time the securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2010						
Federal agency	\$ 8,842	\$ (101)	\$ —	\$ —	\$ 8,842	\$ (101)
Residential mortgage-backed	969	(11)	—	—	969	(11)
State and municipal	2,981	(133)	—	—	2,981	(133)
Total temporarily impaired	<u>\$ 12,792</u>	<u>\$ (245)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,792</u>	<u>\$ (245)</u>
2009						
Federal agency	\$ 17,639	\$ (111)	\$ —	\$ —	\$ 17,639	\$ (111)
State and municipal	2,462	(27)	—	—	2,462	(27)
Total temporarily impaired	<u>\$ 20,101</u>	<u>\$ (138)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 20,101</u>	<u>\$ (138)</u>

Unrealized losses have not been recognized into income because the bonds are U.S. government agency issues or of high credit quality (rated AA or higher), the unrealized losses have been predominately of short duration due to changes in interest rates, and management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery. The fair value is expected to recover as the bonds approach their maturity dates or market rates change.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 3 - Loans

Loans are comprised of the following:

	2010	2009
Real estate:		
Residential	\$ 82,741	\$ 91,419
Commercial	78,640	87,072
Construction	18,840	13,796
Secondary liens	8,349	10,229
Equity lines of credit	15,978	15,351
Subtotal	204,548	217,867
Commercial loans	67,603	59,834
Consumer loans	8,088	13,512
	280,239	291,213
Less: Allowance for loan losses	(4,144)	(3,050)
Loans, net	\$ 276,095	\$ 288,163

Certain directors, executive officers and principal stockholders of the Company, including their immediate families and companies in which they are principal owners, were loan customers of the Bank. At December 31, 2010 and 2009, loans to these individuals totaled approximately \$187 and \$397.

Activity in the allowance for loan losses was as follows:

	2010	2009
Beginning balance	\$ 3,050	\$ 2,584
Provision for loan losses	2,250	1,350
Loan losses charged-off	(1,219)	(990)
Recoveries	63	106
Ending balance	\$ 4,144	\$ 3,050

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 3 - Loans (continued)

Impaired loans were as follows:

	2010	2009
Year-end impaired loans with no allowance for loan losses allocated	\$ 6,283	\$ 7,049
Year-end impaired loans with allowance for loan losses allocated	14,990	12,487
Total	\$ 21,273	\$ 19,536
Amount of the allowance allocated	\$ 2,478	\$ 917
Average of impaired loans during the year	21,577	14,890
Interest income recognized during impairment	959	825
Cash-basis interest income recognized	1,042	808

Nonperforming loans were as follows:

	2010	2009
Loans past due over 90 days still on accrual	\$ 159	\$ 449
Nonaccrual loans	8,231	3,831
Troubled debt restructurings	5,519	11,569

Nonperforming loans and impaired loans are defined differently. Some loans may be included in both categories, whereas other loans may only be included in one category. The Company has allocated \$594 and \$555 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2010 and 2009, respectively. The Company has not committed to lend any additional amounts to customers whose outstanding loans are classified as troubled debt restructurings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 4 - Secondary Mortgage Market Activities

Activity for capitalized mortgage servicing rights, which are included in other assets on the balance sheet, was as follows:

	2010	2009
Servicing rights:		
Beginning of year	\$ 907	\$ 658
Additions	367	676
Amortized to expense	(316)	(427)
End of year	\$ 958	\$ 907

There was no valuation allowance activity for 2010 or 2009. At year-end 2010 and 2009, the fair value of mortgage servicing rights was \$1,377 and \$1,246. Significant assumptions used to estimate fair value included immediate and long-term weighted average prepayment speed of approximately 16.8% (immediate) and 12.9% (long-term) for 2010 and 18.1% (immediate) and 13.4% (long-term) for 2009, and a weighted average discount rate of 7.75% and 8.25% for 2010 and 2009.

Mortgage loans serviced for others are not reported as assets. The principal balances of these loans at year-end 2010 and 2009 were approximately \$172,617 and \$170,126.

NOTE 5 - Premises and Equipment

Year-end premises and equipment were as follows:

	2010	2009
Land and improvements	\$ 1,770	\$ 1,770
Buildings and improvements	5,430	5,442
Furniture, fixtures, equipment and vehicles	3,599	3,827
Total cost	10,799	11,039
Accumulated depreciation	(5,806)	(5,899)
	\$ 4,993	\$ 5,140

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 6 - Deposits

Interest-bearing deposits consisted of the following at year-end:

	2010	2009
Interest-bearing demand deposits and savings	\$ 116,596	\$ 116,588
Time deposits over \$100,000	41,053	62,853
Other time deposits	76,460	88,382
	\$ 234,109	\$ 267,823

Scheduled maturities of time deposits for the next five years were as follows:

2011	\$ 58,405
2012	26,535
2013	22,272
2014	3,167
2015	7,127
Thereafter	7
	\$ 117,513

Time deposits originated from outside the geographic area, generally through brokers, totaled \$8,464 and \$8,491 at December 31, 2010 and 2009, respectively.

The Bank had deposits from related parties at year-end 2010 and 2009 of \$4,663 and \$5,109.

NOTE 7 - Short-term Borrowings

Year-end short-term borrowings were comprised of the following:

	2010	2009
Repurchase agreements	\$ 12,347	\$ 3,872
Line of credit	1,050	925
	\$ 13,397	\$ 4,797

Securities sold under agreements to repurchase (repurchase agreements) are financing arrangements that generally mature within 30 days from the transaction date. The weighted average interest rate on these borrowings was 0.47% and 0.63% at December 31, 2010 and 2009.

The Company has a \$5,000 line of credit from a financial institution that expires August 14, 2012. Interest is variable and accrues at the national prime interest rate, which resulted in a rate of 3.25% at December 31, 2010 and 2009, respectively. This line of credit is secured by 19,515 shares of Bank common stock. The balance on this line of credit was \$1,050 and \$925 at December 31, 2010 and 2009, respectively.

The Company had a \$1,000 line of credit from a different financial institution that expired February 28, 2010. There was no outstanding balance on this line of credit at any time during 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 8 - Federal Home Loan Bank Advances

At year-end, advances from the Federal Home Loan Bank were as follows:

	2010	2009
Maturities from 2011 through 2015, primarily fixed rates from 1.93% to 5.76%, with a weighted average rate of 3.28% at year-end 2010.	\$ 27,385	
Maturities from 2010 through 2014, primarily fixed rates from 3.13% to 5.76%, with a weighted average rate of 4.19% at year-end 2009.		\$ 35,175
	\$ 27,385	\$ 35,175

Maturities and scheduled principal reductions over the next five years are as follows:

2011	\$ 3,544
2012	555
2013	11,286
2014	3,000
2015	9,000
	\$ 27,385

Prepayments are subject to penalty except for those payments made on various contractual prepayment dates. The advances are secured by first residential mortgage loans totaling \$59,653 and \$65,753 at year-end 2010 and 2009.

NOTE 9 - Pension Plan and Other Postretirement Benefits

Pension Plan: The Bank has a funded noncontributory defined benefit pension plan that was frozen on April 15, 2007. Plan benefits are based primarily on years of service and employees' compensation. The Bank uses a December 31 measurement date for its plan.

Information about the pension plan was as follows:

	2010	2009
Projected benefit obligation	\$ 3,149	\$ 2,859
Fair value of plan assets	2,647	2,528
Funded status (plan assets less benefit obligation)	\$ (502)	\$ (331)
Accumulated benefit obligation	\$ 3,149	\$ 2,859
Net pension expense (benefit)	\$ 26	\$ 38
Employer contributions	—	100
Benefits paid	163	181

Because the plan has been frozen, the projected benefit obligation and accumulated benefit obligation are the same for 2010 and 2009.

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2010	2009
Net gain (loss)	\$ (1,180)	\$ (1,035)

The estimated net loss for the pension plan that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit costs during the year ending December 31, 2011 is \$79.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 9 - Pension Plan and Other Postretirement Benefits (continued)

Estimated Future Payments: The following benefit payments, which reflect expected future service, are expected:

	Pension Benefits
2011	\$ 109
2012	111
2013	109
2014	127
2015	145
2016-2020	1,095

Contributions: The Company expects to contribute \$0 to its pension plan in 2011.

Actuarial Assumptions: Weighted average assumptions used to determine net periodic pension cost and pension benefit obligations at year-end:

	2010	2009
Discount rate on benefit obligation	5.30%	5.91%
Rate of compensation increase	N/A	N/A
Long-term expected rate of return on assets	8.00%	8.00%

Management closely monitors the Plan's return results to ensure long-term performance measures are satisfactory. Management estimated the rate of return on plan assets based on the 10-year average historical return for the Plan.

Plan Assets: The Company's pension plan asset allocation at year-end 2010 and 2009 and target allocation for 2010 are as follows:

Asset Category	Target Allocation	Percentage of Plan Assets at Year-end	
	2011	2010	2009
Equity securities	50 - 70%	64.6%	58.5%
Debt securities	30 - 50	11.4	18.5
Other	0 - 10	24.0	23.0
Total		100.0%	100.0%

The investment objective for the Company's pension plan is to maximize total return without exposure to undue risk. Asset allocation favors equities, with a target allocation range of 50 to 70 percent. Other investment target allocations include a range of 30 to 50 percent in fixed debt securities and 0 to 10 percent in other plan assets.

Equity securities include Company common stock in the amounts of \$38 (1% of total plan assets) and \$56 (2% of total plan assets) at year-end 2010 and 2009, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Fair Value of Plan Assets: Fair value is the exchange price that would be received for an asset in the principal or most advantageous market for the asset in an orderly transaction between market participants on the measurement date. The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Equity Securities and Mutual Funds: The fair values for equity securities and mutual funds are determined by obtaining quoted market prices on nationally recognized securities exchanges, if available (Level 1). For securities where quoted prices are not available, such as the Company's stock, fair values are calculated based on recent Company stock transactions that have occurred between shareholders (Level 2).

Fixed Income Securities: Fair values reflect the closing price reported in the active market in which the securities are traded (Level 1).

Other Securities: These securities represent balances held in money market and certificate of deposit accounts and the fair values are estimated to approximate deposit account balances, payable on demand, as no discounts for credit quality or liquidity were determined to be applicable (Level 2).

The fair value of the plan assets at December 31, 2010, by asset category, is as follows:

Fair Value Measurements at December 31, 2010 Using:

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Plan Assets				
Equity securities				
U.S. large cap	\$ 476	\$ 476	\$ —	\$ —
Company common stock	38	—	38	
Mutual funds (a)	1,298	1,298	—	—
Fixed income securities				
Municipal bonds	100	100	—	—
Other	735	216	519	—
Total Plan Assets	\$ 2,647	\$ 2,090	\$ 557	\$ 0

(a) 68% of the plan's mutual fund investments are in small and mid-cap funds which invest in U.S. companies. 24% of the plan's mutual fund investments are in international funds. 8% of the plan's mutual fund investments are in bond funds that hold primarily short-term U.S. Treasury and government agency securities.

Deferred Savings Plan: The deferred savings plan allows Company matching up to a maximum of 4% of the employee's compensation. The matching component is based on years of service to the Bank and ranges from 25% to 100% of the first 4% of the compensation contributed. Expense for 2010 and 2009 was \$108 and \$115. The plan also provides for additional discretionary employer contributions for Pension Plan participants affected by the freezing of the Pension Plan. A pension replacement contribution provides for an annual discretionary contribution to achieve combined pension and deferred savings plan benefits equal to 90% of the benefits that would have been earned under the pension plan prior to freezing the plan. Affected participants must work at least 1,000 hours and be employed by the Bank as of December 31 in order for this contribution to be made on their behalf. Expense for 2010 and 2009 was \$0 and \$145.

Other Postretirement Benefits: The Bank has another postretirement plan which covers directors. The plan provides for continuation of directors' fees to former directors or their spouses upon retirement or death and upon fulfillment of certain service requirements. The Bank accrues the estimated cost of retiree benefit payments during the years the director provides services. The Bank is recognizing the initial postretirement benefit obligation of \$253 over a period of 20 years beginning January 1, 1995. The postretirement benefit plan is unfunded. The Bank has elected to amortize unrecognized net gain or loss from experience that differs from that assumed over the average remaining service period of active plan participants. For active participants, monthly benefits are projected to increase nominally every two years. Monthly benefits for retirees are frozen at the time of retirement. The Bank uses a December 31 measurement date for the plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 9 - Pension Plan and Other Postretirement Benefits (continued)

	2010	2009
Benefit obligation	\$ 1,237	\$ 1,075
Accrued benefit cost	1,237	1,075
Discount rate on benefit obligation	5.25%	5.75%
Benefits expense	\$ 136	\$ 115
Benefits paid	31	44

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2010	2009
Net gain (loss)	\$ (88)	\$ (18)
Transition obligation	(51)	(63)
	<u>\$ (139)</u>	<u>\$ (81)</u>

The estimated net loss and transition costs for the postretirement plan that will be amortized from accumulated other comprehensive income into net periodic benefit costs during the year ending December 31, 2011 is \$9 and \$13.

Estimated Future Payments: The following benefit payments, which reflect expected future service, are expected:

	Other Benefits
2011	\$ 31
2012	31
2013	47
2014	67
2015	79
2016-2019	416

NOTE 10 - Incentive Compensation Plan

The Bank has an incentive compensation plan and a related deferred compensation plan for certain executives and officers. The amount of the compensation awarded under the plan is contingent upon the achievement of pre-established performance criteria. Compensation expense charged to operations under the incentive plan in 2010 and 2009 was \$0 and \$182. Beginning in 2006, amounts deferred under the deferred compensation plan are invested at the participants' discretion and amounts payable under the plan are based on the fair value of the investments (carried as trading securities). The change in the fair value of the investments is recognized as income or loss on trading securities, and an offsetting expense or benefit is recognized as part of employee benefits expense. At December 31, 2010 and 2009, the liability under the deferred compensation plan was \$717 and \$574.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 11 - Income Taxes

Income taxes consist of the following components:

	2010	2009
Current income tax expense (benefit)	\$ 857	\$ 312
Deferred income tax expense (benefit)	(549)	(319)
Change in valuation allowance	122	308
	<u>\$ 430</u>	<u>\$ 301</u>
	2010	2009
Statutory rate applied to income before income taxes	\$ 971	\$ 911
Add (deduct) tax effect of:		
Tax exempt interest income	(448)	(446)
Cash surrender value of life insurance	(95)	(97)
Other, net	2	(67)
	<u>\$ 430</u>	<u>\$ 301</u>
	2010	2009
Deferred tax assets:		
Net unrealized loss on postretirement benefits	\$ 523	\$ 442
Allowance for loan losses	1,363	1,011
Pension and other postretirement benefits	449	341
Nonaccrual loan interest	42	7
Accrued expenses	10	130
Other real estate writedowns	85	9
Net operating loss and credit carryforward	730	645
Other	39	27
	<u>\$ 3,241</u>	<u>\$ 2,612</u>
Deferred tax liabilities:		
Net unrealized appreciation on securities available-for-sale	\$ (179)	\$ (243)
Mortgage servicing rights	(377)	(358)
Depreciation and amortization	(101)	(144)
Deferred loan costs	(82)	(39)
Other	(90)	(110)
	<u>(829)</u>	<u>(894)</u>
Valuation allowance	(843)	(721)
Net deferred tax asset (liability)	<u>\$ 1,569</u>	<u>\$ 997</u>

The Company has state tax net operating loss carryforwards of \$11,900, which expire beginning in 2025, and state tax credit carryforwards of \$95, which expire beginning in 2015. The Company maintains a valuation allowance to reduce these carryforward items and other state deferred tax assets to the amount expected to be realized.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of Indiana. The Company is no longer subject to examination by taxing authorities for years before 2007. The Company does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 12 - Loan Commitments and Other Related Activities

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

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

	2010	2009
Commitments to make loans	\$ 52,100	\$ 43,211
Letters of credit	3,451	335

At December 31, 2010 and 2009, the Bank was required to have \$121 and \$75 on deposit with the Federal Reserve or as cash on hand.

NOTE 13 - Operating Leases

The Company leases certain branch properties and equipment under operating leases. Rent expense was \$134 and \$226 in 2010 and 2009, and is included in occupancy expenses.

Rent commitments under noncancelable operating leases were as follows, before considering renewal options that are generally present:

2011	\$ 121
2012	102
2013	34
2014	—
2015	—
Thereafter	—
Total	\$ 257

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 14 - Regulatory Matters

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of December 31, 2010, the Bank met all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well-capitalized; adequately capitalized; undercapitalized; significantly undercapitalized; and critically undercapitalized; although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required. As of year-end 2010 and 2009, the most recent regulatory notifications categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts and ratios for the Bank are presented below at year-end.

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2010						
Total capital to risk-weighted assets	\$ 41,508	15.0%	\$ 22,187	8.0%	\$ 27,734	10.0%
Tier 1 capital to risk-weighted assets	\$ 38,033	13.7%	\$ 11,094	4.0%	\$ 16,640	6.0%
Tier 1 capital to average assets	\$ 38,033	10.3%	\$ 14,736	4.0%	\$ 18,420	5.0%
2009						
Total capital to risk-weighted assets	\$ 39,955	13.8%	\$ 23,167	8.0%	\$ 28,959	10.0%
Tier 1 capital to risk-weighted assets	\$ 36,906	12.7%	\$ 11,584	4.0%	\$ 17,375	6.0%
Tier 1 capital to average assets	\$ 36,906	9.4%	\$ 15,781	4.0%	\$ 19,726	5.0%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 15 - Disclosure About Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

The fair values of trading and available-for-sale securities are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at December 31, 2010 Using

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investment securities available-for-sale:				
Federal agencies	\$ 17,646	\$ —	\$ 17,646	\$ —
Residential mortgage-backed	3,309	—	3,309	—
State and municipal	26,694	—	26,694	—
Trading securities — mutual funds	717	717	—	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Fair Value Measurements at December 31, 2009 Using

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investment securities available-for-sale:				
Federal agencies	\$ 35,095	\$ —	\$ 35,095	\$ —
Residential mortgage-backed	459	—	459	—
State and municipal	30,258	—	30,258	—
Trading securities — mutual funds	574	574	—	—

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

Fair Value Measurements at December 31, 2010 Using

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans				
Residential real estate	\$ 2,158	\$ —	\$ —	\$ 2,158
Commercial real estate	7,847	—	—	7,847
Commercial	2,507	—	—	2,507
Other real estate owned, net				
Residential	\$ 575	—	—	\$ 575
Commercial	158	—	—	158
Construction	1,171	—	—	1,171

Fair Value Measurements at December 31, 2009 Using

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans	\$ 11,570	\$ —	\$ —	\$ 11,570

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$14,990, with a valuation allowance of \$2,478 at December 31, 2010, resulting in an additional provision for loan losses of \$1,847 for the year ending December 31, 2010. At December 31, 2009, impaired loans had a carrying amount \$12,487, with a valuation allowance of \$917, resulting in an additional provision for loan losses of \$706 for the year ending December 31, 2009.

Other real estate owned which is measured at fair value less costs to sell, had a net carrying amount of \$1,904, which is made up of the outstanding balance of \$2,102, net of a valuation allowance of \$198 at December 31, 2010, resulting in a write-down of \$198 for the year ending December 31, 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 15 - Disclosure About Fair Value of Financial Instruments (continued)

The carrying amount and estimated fair values of financial instruments, not previously presented, were as follows at year-end:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 16,013	\$ 16,013	\$ 20,108	\$ 20,108
FHLB stock	2,290	N/A	2,439	N/A
Loans held-for-sale	3,225	3,267	—	—
Loans, net (including impaired loans)	276,095	279,334	288,163	292,182
Accrued interest receivable	1,283	1,283	1,607	1,607
Financial liabilities				
Deposits	\$ (288,858)	\$ (291,784)	\$ (319,796)	\$ (321,859)
Short-term borrowings	(13,397)	(13,397)	(4,797)	(4,797)
FHLB advances	(27,385)	(28,326)	(35,175)	(36,994)
Accrued interest payable	(388)	(388)	(693)	(693)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, demand deposits, short-term borrowings and variable rate loans or deposits that reprice frequently and fully. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. Fair value of loans held-for-sale is based on market quotes. Fair value of FHLB advances is based on current rates for similar financing. Loan commitments and letters of credit are short-term or variable rate with minor amounts of fees charged, and, accordingly, the fair value is not significant.

NOTE 16 - Other Comprehensive Income (Loss)

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

	2010	2009
Unrealized holding gains (losses) on available-for-sale securities	\$ 147	\$ (469)
Reclassification adjustment for losses (gains) realized in income	(309)	—
Net unrealized gains (losses)	(162)	(469)
Tax effect	63	183
Net-of-tax amount	(99)	(286)
Net loss and prior service cost arising during the year on pension and other postretirement benefits	(202)	5
Tax effect	80	(2)
Net-of-tax amount	(122)	3
	\$ (221)	\$ (283)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

The following is a summary of the accumulated other comprehensive income (loss) balances, net of tax:

	Balance at 2009	Current Period Change	Balance at 2010
Unrealized gains on securities available-for-sale	\$ 452	\$ (99)	\$ 353
Unrealized loss on pension and other postretirement benefits	(675)	(122)	(797)
Total	\$ (223)	\$ (221)	\$ (444)

NOTE 17 - Parent Company Only Condensed Financial Statements

CONDENSED BALANCE SHEETS

December 31, 2010 and 2009

	2010	2009
Assets		
Cash	\$ 11	\$ 7
Investment in subsidiary	37,588	36,683
Other assets	—	2
	\$ 37,599	\$ 36,692
Liabilities		
Short-term borrowings	\$ 1,050	\$ 925
Other liabilities	5	—
Shareholders' equity	36,544	35,767
	\$ 37,599	\$ 36,692

CONDENSED STATEMENTS OF INCOME

Years ended December 31, 2010 and 2009

	2010	2009
Dividends from subsidiary	\$ 1,350	\$ 800
Interest expense	37	17
Other operating expenses	41	41
Income tax expense (benefit)	(26)	(20)
Equity in subsidiary undistributed income	1,127	1,617
Net income	\$ 2,425	\$ 2,379

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

NOTE 17 - Parent Company Only Condensed Financial Statements (continued)

CONDENSED STATEMENTS OF CASH FLOWS

Years ended December 31, 2010 and 2009

	2010	2009
Cash flows from operating activities		
Net income	\$ 2,425	\$ 2,379
Adjustments to reconcile net income to net cash from operating activities		
Equity in subsidiary undistributed income	(1,127)	(1,617)
Net change in other assets and liabilities	8	(4)
Net cash from operating activities	1,306	758
Cash flows from financing activities		
Dividends paid	(746)	(760)
Change in short-term borrowings	125	575
Stock redemption	(681)	(578)
Net cash from financing activities	(1,302)	(763)
Net change in cash	4	(5)
Beginning cash	7	12
Ending cash	\$ 11	\$ 7

Board of Directors Bancorp. of Southern Indiana Seymour, Indiana

We have audited the accompanying consolidated balance sheets of Bancorp. of Southern Indiana as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bancorp. of Southern Indiana as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Louisville, Kentucky

February 10, 2011

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