MBT FINANCIAL CORP
Form 10-Q
August 14, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended June 30, 2012

Or

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 000-30973

MBT FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Michigan	38-3516922
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

102 E. Front Street

Monroe, Michigan 48161

(Address of principal executive offices)

(Zip Code)

(734) 241-3431

(Registrant’s telephone number, including area code)

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 þ No ¨

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 (§ 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 þ No ¨

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

Large accelerated filer ¨	Accelerated Filer ¨
Non-accelerated filer ¨	Smaller reporting company þ

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

As of August 14, 2012, there were 17,321,592 shares of the Company’s Common Stock outstanding.

Part I Financial Information

Item 1. Financial Statements

MBT FINANCIAL CORP.

CONSOLIDATED BALANCE SHEETS

Dollars in thousands	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and Cash Equivalents		
Cash and due from banks		
Non-interest bearing	$ 18,705	$ 18,201
Interest bearing	67,088	57,794
Total cash and cash equivalents	85,793	75,995
Securities - Held to Maturity	30,577	35,364
Securities - Available for Sale	361,317	354,899
Federal Home Loan Bank stock - at cost	10,605	10,605
Loans held for sale	1,376	1,035
Loans	667,228	679,475
Allowance for Loan Losses	(19,486)	(20,865)
Loans - Net	647,742	658,610
Accrued interest receivable and other assets	7,938	7,700
Other Real Estate Owned	12,756	16,650
Bank Owned Life Insurance	48,356	47,653
Premises and Equipment - Net	28,811	29,516
Total assets	$ 1,235,271	$ 1,238,027
LIABILITIES		
Deposits:		
Non-interest bearing	$ 168,419	$ 164,852
Interest-bearing	849,083	857,458
Total deposits	1,017,502	1,022,310
Federal Home Loan Bank advances	107,000	107,000
Repurchase agreements	20,000	20,000
Interest payable and other liabilities	13,985	13,006

Total liabilities	1,158,487	1,162,316
STOCKHOLDERS' EQUITY		
Common stock (no par value; 50,000,000 shares authorized, 17,318,153 and 17,291,729 shares issued and outstanding)	2,156	2,099
Retained earnings	74,205	72,735
Unearned compensation	(47)	(87)
Accumulated other comprehensive income	470	964
Total stockholders' equity	76,784	75,711
Total liabilities and stockholders' equity	$ 1,235,271	$ 1,238,027

The accompanying notes to consolidated financial statements are an integral part of these statements.

MBT FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

Dollars in thousands, except per share data	Three Months Ended June 30, 2012	2011	Six Months Ended June 30, 2012	2011
Interest Income				
Interest and fees on loans	$ 8,938	$ 9,992	$ 18,077	$ 20,344
Interest on investment securities-				
Tax-exempt	355	351	735	723
Taxable	1,995	2,121	4,129	4,161
Interest on balances due from banks	46	30	89	68
Total interest income	11,334	12,494	23,030	25,296
Interest Expense				
Interest on deposits	1,637	2,960	3,476	5,975
Interest on borrowed funds	913	956	1,842	1,974
Total interest expense	2,550	3,916	5,318	7,949
Net Interest Income	8,784	8,578	17,712	17,347
Provision For Loan Losses	1,050	2,850	3,300	8,600
Net Interest Income After Provision For Loan Losses	7,734	5,728	14,412	8,747
Other Income				
Income from wealth management services	828	996	1,796	1,983
Service charges and other fees	1,125	1,179	2,215	2,296
Net gain on sales of securities available for sale	40	29	1,140	96
Origination fees on mortgage loans sold	204	86	326	169
Bank owned life insurance income	333	390	703	802
Other	1,034	1,178	2,061	2,175
Total other income	3,564	3,858	8,241	7,521
Other Expenses				
Salaries and employee benefits	4,953	4,884	10,059	9,733
Occupancy expense	626	688	1,351	1,465
Equipment expense	746	748	1,549	1,442
Marketing expense	175	235	373	481
Professional fees	524	594	1,112	1,293
Collection expenses	98	57	160	134
Net loss on other real estate owned	230	884	499	2,125

Other real estate owned expenses	439	564	908	872
FDIC Deposit Insurance Assessment	694	790	1,373	1,636
Other	1,137	925	2,250	1,912
Total other expenses	9,622	10,369	19,634	21,093
Income (Loss) Before Income Taxes	1,676	(783)	3,019	(4,825)
Income Tax Expense	1,423	-	1,549	-
Net Income (Loss)	$ 253	$ (783)	$ 1,470	$ (4,825)
Other Comprehensive Income (Net of Tax)				
Unrealized gains on securities	559	3,259	154	3,801
Reclassification adjustment for gains included in net income	(26)	(19)	(752)	(63)
Postretirement benefit liability	52	51	104	103
Total Other Comprehensive Income (Net of Tax)	585	3,291	(494)	3,841
Comprehensive Income (Loss)	$ 838	$ 2,508	$ 976	$ (984)
Basic Earnings (Loss) Per Common Share	$ 0.01	$ (0.05)	$ 0.08	$ (0.28)
Diluted Earnings (Loss) Per Common Share	$ 0.01	$ (0.05)	$ 0.08	$ (0.28)
Common Stock Dividends Declared Per Share	$ -	$ -	$ -	$ -

The accompanying notes to consolidated financial statements are an integral part of these statements.

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MBT FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY - UNAUDITED

Dollars in thousands	Common Stock	Retained Earnings	Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Total
Balance - January 1, 2012	$ 2,099	$ 72,735	$ (87)	$ 964	$ 75,711
Issuance of Common Stock (26,424 shares)	39	-	-	-	‘ 39
Equity Compensation	18	-	40	-	58
Comprehensive income:					
Net income	-	1,470	-	-	1,470
Change in net unrealized gain (loss) on securities available for sale - Net of tax effect of $(80)	-	-	-	154	154
Reclassification adjustment for gains included in net income - Net of tax effect of $388	-	-	-	(752)	(752)
Change in postretirement benefit obligation Net of tax effect of $(53)	-	-	-	104	104
Total Comprehensive Income					976
Balance - June 30, 2012	$ 2,156	$ 74,205	$ (47)	$ 470	$ 76,784

The accompanying notes to consolidated financial statements are an integral part of these statements.

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MBT FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	Six Months Ended June 30,	
Dollars in thousands	2012	2011
Cash Flows from Operating Activities		
Net Income (Loss)	$1,470	$(4,825)
Adjustments to reconcile net loss to net cash from operating activities		
Provision for loan losses	3,300	8,600
Depreciation	990	1,040
Net amortization of investment premium and discount	967	525
Writedowns of Other Real Estate Owned	861	1,951
Net increase in interest payable and other liabilities	1,359	1,329
Net decrease in interest receivable and other assets	(632)	(5,660)
Equity based compensation expense	90	85
Net gain on sale/settlement of securities	(1,140)	(96)
Increase in cash surrender value of life insurance	(703)	(802)
Net cash provided by operating activities	$6,562	$2,147
Cash Flows from Investing Activities		
Proceeds from maturities and redemptions of investment securities held to maturity	$8,656	$3,805
Proceeds from maturities and redemptions of investment securities available for sale	145,582	54,366
Proceeds from sales of investment securities available for sale	15,184	5,068
Net decrease in loans	3,139	29,178
Proceeds from sales of other real estate owned	7,418	3,096
Proceeds from sales of other assets	99	229
Purchase of investment securities held to maturity	(3,860)	(13,000)
Proceeds from surrender of Bank Owned Life Insurance	-	3,654
Purchase of investment securities available for sale	(167,926)	(91,720)
Purchase of bank premises and equipment	(287)	(202)
Net cash provided by (used for) investing activities	$8,005	$(5,526)
Cash Flows from Financing Activities		
Net increase in deposits	$(4,808)	$(13,589)
Repayment of Federal Home Loan Bank borrowings	-	(3,500)
Repayment of repurchase agreements	-	(10,000)
Proceeds from issuance of common stock	39	27
Net cash provided by financing activities	$(4,769)	$(27,062)
Net Increase (Decrease) In Cash and Cash Equivalents	$9,798	$(30,441)
Cash and Cash Equivalents at Beginning Of Period	75,995	86,300

Cash And Cash Equivalents At End Of Period	$85,793	$55,859
Supplemental Cash Flow Information		
Cash paid for interest	$5,378	$8,010
Cash paid for federal income taxes	$-	$-
Supplemental Schedule of Non Cash Investing Activities		
Transfer of loans to other real estate owned	$4,031	$6,929
Transfer of loans to other assets	$57	$53

The accompanying notes to consolidated financial statements are an integral part of these statements.

MBT FINANCIAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

The unaudited consolidated financial statements include the accounts of MBT Financial Corp. (the “Company”) and its subsidiary, Monroe Bank & Trust (the “Bank”). The Bank includes the accounts of its wholly owned subsidiary, MB&T Financial Services, Inc. The Bank operates seventeen branches in Monroe County, Michigan, seven branches in Wayne County, Michigan, and a mortgage loan office in Monroe County. The Bank’s primary source of revenue is from providing loans to customers, who are predominantly small and middle-market businesses and middle-income individuals. The Company’s sole business segment is community banking.

The accounting and reporting policies of the Bank conform to practice within the banking industry and are in accordance with accounting principles generally accepted in the United States. Preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term are the determination of the allowance for loan losses, the valuation of other real estate owned, the deferred tax asset valuation allowance, and the fair value of investment securities.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of Management, necessary for fair statement of results for the interim periods.

The significant accounting policies are as follows:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiary. All material intercompany transactions and balances have been eliminated.

COMPREHENSIVE INCOME

Accounting principles generally require that revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, however, such as unrealized gains and losses on securities available for sale and amounts recognized related to postretirement benefit plans (gains and losses, prior service costs, and transition assets or obligations), are reported as a direct adjustment to the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

BUSINESS SEGMENTS

While the Company's chief decision makers monitor the revenue streams of various products and services, operations are managed and financial performance is evaluated on a company wide basis. Accordingly, all of the Company’s operations are considered by management to be aggregated in one reportable segment.

FAIR VALUE

The Corporation measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for assets and liabilities that are elected to be accounted for under The Fair Value Option as well as for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Corporation uses various valuation techniques and assumptions when estimating fair value.

The Corporation applied the following fair value hierarchy:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. The Corporation’s mutual fund investments where quoted prices are available in an active market generally are classified within Level 1 of the fair value hierarchy.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. The Corporation’s borrowed funds and investments in U.S. government agency securities, government sponsored mortgage backed securities, and obligations of states and political subdivisions are generally classified in Level 2 of the fair value hierarchy. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Private equity investments and trust preferred collateralized debt obligations are classified within Level 3 of the fair value hierarchy. Fair values are initially valued based on transaction price and are adjusted to reflect exit values.

When determining the fair value measurements for assets and liabilities required or permitted to be recorded at and/or marked to fair value, the Corporation considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Corporation looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Corporation looks to market observable data for similar assets or liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets and the Corporation must use alternative valuation techniques to derive a fair value measurement.

ACCOUNTING PRONOUNCEMENTS

No recent accounting pronouncements are expected to have a significant impact on the Corporation's financial statements.

In May 2011, the FASB issued Accounting Standards Update 2011-04, Fair Value Measurement (ASU 2011-04). ASU 2011-04 is the result of the work of the FASB and the IASB to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRSs. Disclosure of the fair value levels of our financial assets and financial liabilities was added to Note 7 upon adoption of this ASU in the first quarter of 2012.

In June 2011, the FASB issued Accounting Standards Update 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 provides entities with the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income, along with a total for other comprehensive income, and a total amount for comprehensive income. Regardless of whether an entity chooses to present comprehensive income in a single continuous statement or in two separate but consecutive statements, the entity is required 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(s) where the components of net income and the components of other comprehensive income are presented. This update applies retrospectively effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We adopted this statement in the first quarter of 2012, electing to present each component of other comprehensive income in a single continuous statement.

2. EARNINGS PER SHARE

The calculations of earnings (loss) per common share are as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2012	2011	2012	2011
Basic				
Net profit (loss)	$ 253,000	$ (783,000)	$ 1,470,000	$ (4,825,000)
Net profit (loss) applicable to common stock	$ 253,000	$ (783,000)	$ 1,470,000	$ (4,825,000)
Average common shares outstanding	17,315,696	17,265,075	17,310,239	17,260,797
Earnings (Loss) per common share - basic	$ 0.01	$ (0.05)	$ 0.08	$ (0.28)

	2012	2011	2012	2011
Diluted				
Net profit (loss)	$253,000	$(783,000)	$1,470,000	$(4,825,000)
Net profit (loss) applicable to common stock	$253,000	$(783,000)	$1,470,000	$(4,825,000)
Average common shares outstanding	17,315,696	17,265,075	17,310,239	17,260,797
Stock option adjustment	66,723	-	30,052	-
Average common shares outstanding - diluted	17,382,419	17,265,075	17,340,291	17,260,797
Earnings (Loss) per common share - diluted	$0.01	$(0.05)	$0.08	$(0.28)

3. STOCK BASED COMPENSATION

Stock Options - The following table summarizes the options that had been granted to certain key executives in accordance with the Long-Term Incentive Compensation Plan that was approved by shareholders at the Annual Meeting of Shareholders on April 6, 2000.

	Shares	Weighted Average Exercise Price
Options Outstanding, January 1, 2012	436,503	$ 17.34
Granted	-	-
Exercised	-	-
Forfeited	22,168	13.85
Options Outstanding, June 30, 2012	414,335	$ 17.53
Options Exercisable, June 30, 2012	414,335	$ 17.53

Stock Only Stock Appreciation Rights (SOSARs) - On February 23, 2012, Stock Only Stock Appreciation Rights (SOSARs) were awarded to certain executives in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008. The SOSARs have a term of ten years and vest in three equal annual installments beginning on December 31, 2012. SOSARs granted under the plan are structured as fixed grants with the exercise price equal to the market value of the underlying stock on the date of the grant.

The fair value of $1.11 for the SOSARs was estimated at the date of the grant, using the Black-Scholes option pricing model, with the following assumptions: expected option lives of 7 years, expected volatility of 60.7%, a risk free interest rate of 1.40% and dividend yield of 0.00%. The following table summarizes the SOSARs that have been granted:

	Shares	Weighted Average Exercise Price
SOSARs Outstanding, January 1, 2012	320,000	$ 4.08
Granted	104,000	1.85
Exercised	-	-
Forfeited	6,000	5.13
SOSARs Outstanding, June 30, 2012	418,000	$ 3.51
SOSARs Exercisable, June 30, 2012	247,321	$ 4.65

Restricted Stock Unit Awards – On February 23, 2012, performance restricted stock units were awarded to certain key executive officers in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008. Each Restricted Stock Unit (RSU) is equivalent to one share of MBT Financial Corp. common stock. Stock will be issued to the participants following a two year performance period that ends on December 31, 2013. Up to 50% of the aggregate RSUs granted may be earned in each year of the performance period subject to satisfying weighted performance thresholds. Earned RSUs vest on December 31, 2014.

The total expense for equity based compensation was $50,000 in the second quarter of 2012 and $40,000 in the second quarter of 2011. The total expense for equity based compensation was $90,000 in the first six months of 2012 and $85,000 in the first six months of 2011.

4. LOANS

The Bank makes commercial, consumer, and mortgage loans primarily to customers in Monroe County, Michigan, southern and western Wayne County, Michigan, and surrounding areas. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the automotive, manufacturing, and real estate development economic sectors.

Loans consist of the following (000s omitted):

	June 30, 2012	December 31, 2011
Residential real estate loans	$254,416	$ 255,555
Commercial and Construction real estate loans	319,014	330,498
Agriculture and agricultural real estate loans	16,170	15,931
Commercial and industrial loans	64,971	63,762
Loans to individuals for household, family, and other personal expenditures	12,657	13,729
Total loans, gross	667,228	679,475

Less: Allowance for loan losses	19,486	20,865
	647,742	658,610

Loans are placed in a nonaccrual status when, in the opinion of Management, the collection of additional interest is doubtful. All loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are reviewed for impairment each quarter. Allowances for loans determined to be impaired are included in the allowance for loan losses. All cash received on nonaccrual loans is applied to the principal balance. Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due, restructured loans, nonaccrual investment securities, and other real estate owned. Other real estate owned includes real estate that has been acquired in full or partial satisfaction of loan obligations or upon foreclosure and real estate that the bank has purchased but no longer intends to use for bank premises.

The following table summarizes nonperforming assets (000's omitted):

	June 30, 2012	December 31, 2011
Nonaccrual loans	$40,139	$ 50,717
Loans 90 days past due and accruing	2	20
Restructured loans	26,134	24,774
Total nonperforming loans	$66,275	$ 75,511
Other real estate owned	12,756	16,650
Other assets	21	61
Nonperforming investment securities	2,829	2,984
Total nonperforming assets	$81,881	$ 95,206
Nonperforming assets to total assets	6.63 %	7.69 %
Allowance for loan losses to nonperforming loans	29.40 %	27.63 %

5. ALLOWANCE FOR LOAN LOSSES

The Company separates its loan portfolio into segments to perform the calculation and analysis of the allowance for loan losses. The six segments analyzed are Agriculture and Agricultural Real Estate, Commercial, Commercial Real Estate, Construction Real Estate, Residential Real Estate, and Consumer and Other. The Agriculture and Agricultural Real Estate segment includes all loans to finance agricultural production and all loans secured by agricultural real estate. This segment does not include loans to finance agriculture that are secured by residential real estate, which are included in the Residential Real Estate segment. The Commercial segment includes loans to finance commercial and industrial businesses that are not secured by real estate. The Commercial Real Estate segment includes loans secured by non-farm, non-residential real estate. The Construction Real Estate segment includes loans to finance construction and land development. This includes residential and commercial construction and land development. The Residential Real Estate segment includes all loans, other than construction loans, that are secured by single family and multi family residential real estate properties. The Consumer and Other segment includes all loans not included in any other segment. These are primarily loans to consumers for household, family, and other personal expenditures, such as autos, boats, and recreational vehicles.

Activity in the allowance for loan losses during the three and six months ended June 30, 2012 was as follows (000's omitted):

	Agriculture and Agricultural Real Estate	Commercial	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Consumer and Other	Total
Allowance for loan losses: For the three months ended June 30, 2011							
Beginning Balance	$ 69	$ 2,740	$ 9,306	$ 2,320	$ 5,630	$ 416	$20,481
Charge-offs	-	(166)	(1,490)	(140)	(540)	(34)	(2,370)
Recoveries	-	104	12	105	53	51	325
Provision	(69)	103	909	(274)	500	(119)	1,050
Ending balance	$ -	$ 2,781	$ 8,737	$ 2,011	$ 5,643	$ 314	$19,486
Allowance for loan losses: For the six months ended June 30, 2012							
Beginning Balance	$ 64	$ 2,184	$ 9,351	$ 2,632	$ 6,227	$ 407	$20,865
Charge-offs	-	(262)	(3,063)	(602)	(1,194)	(81)	(5,202)
Recoveries	-	170	21	142	103	87	523
Provision	(64)	689	2,428	(161)	507	(99)	3,300
Ending balance	$ -	$ 2,781	$ 8,737	$ 2,011	$ 5,643	$ 314	$19,486
Allowance for loan losses as of June 30, 2012							
Ending balance individually evaluated for impairment	$ -	$ 1,614	$ 2,476	$ 1,264	$ 2,478	$ 71	$7,903
Ending balance collectively evaluated for impairment	-	1,167	6,261	747	3,165	243	11,583
Ending balance	$ -	$ 2,781	$ 8,737	$ 2,011	$ 5,643	$ 314	$19,486

Activity in the allowance for loan losses during the three and six months ended June 30, 2011 was as follows (000's omitted):

	Agriculture and Agricultural Real Estate	Commercial	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Consumer and Other	Total
Allowance for loan losses: For the three months ended June 30, 2011							
Beginning Balance	$ 93	$ 2,879	$ 11,230	$ 3,588	$ 5,398	$ 239	$23,427
Charge-offs	-	(596)	(1,380)	(645)	(1,234)	(115)	(3,970)

Recoveries	-	81	113	11	60	57	322
Provision	89	(570)	935	390	1,709	297	2,850
Ending balance	$ 182	$ 1,794	$ 10,898	$ 3,344	$ 5,933	$ 478	$ 22,629
Allowance for loan losses: For the six months ended June 30, 2011							
Beginning Balance	$ 77	$ 3,875	$ 9,040	$ 3,285	$ 4,596	$ 350	$ 21,223
Charge-offs	-	(1,424)	(3,678)	(847)	(1,939)	(146)	(8,034)
Recoveries	-	174	120	21	362	163	840
Provision	105	(831)	5,416	885	2,914	111	8,600
Ending balance	$ 182	$ 1,794	$ 10,898	$ 3,344	$ 5,933	$ 478	$ 22,629
Allowance for loan losses as of June 30, 2011							
Ending balance individually evaluated for impairment	$ 89	$ 427	$ 4,933	$ 854	$ 1,056	$ 71	$ 7,430
Ending balance collectively evaluated for impairment	93	1,367	5,965	2,490	4,877	407	15,199
Ending balance	$ 182	$ 1,794	$ 10,898	$ 3,344	$ 5,933	$ 478	$ 22,629
Loans as of June 30, 2011							
Ending balance individually evaluated for impairment	$ 1,168	$ 3,032	$ 41,029	$ 7,860	$ 18,056	$ 166	$ 71,311
Ending balance collectively evaluated for impairment	18,586	66,412	272,209	23,073	250,057	15,491	645,828
Ending balance	$ 19,754	$ 69,444	$ 313,238	$ 30,933	$ 268,113	$ 15,657	$ 717,139

Each period the provision for loan losses in the income statement results from the combination of an estimate by Management of loan losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods.

The provision for loan losses increases the allowance for loan losses, a valuation account which appears on the consolidated balance sheets. As the specific customer and amount of a loan loss is confirmed by gathering additional information, taking collateral in full or partial settlement of the loan, bankruptcy of the borrower, etc., the loan is charged off, reducing the allowance for loan losses. If, subsequent to a charge off, the Bank is able to collect additional amounts from the customer or sell collateral worth more than earlier estimated, a recovery is recorded.

To serve as a basis for making this provision, the Bank maintains an extensive credit risk monitoring process that considers several factors including: current economic conditions affecting the Bank’s customers, the payment performance of individual loans and pools of homogeneous loans, portfolio seasoning, changes in collateral values, and detailed reviews of specific loan relationships.

The Company utilizes an internal loan grading system to assign a risk grade to all commercial loans, all renegotiated loans, and each commercial credit relationship. Grades 1 through 4 are considered “pass” credits and grades 5 through 9 are considered “watch” credits and are subject to greater scrutiny. Loans with grades 6 and higher are considered substandard and most are evaluated for impairment. A description of the general characteristics of each grade is as follows:

- Grade 1 – Excellent – Loans secured by marketable collateral, with adequate margin, or supported by strong financial statements. Probability of serious financial deterioration is unlikely. Possess a sound repayment source and a secondary source. This classification will also include all loans secured by certificates of deposit or cash equivalents.
- Grade 2 – Satisfactory – Loans that have less than average risk and clearly demonstrate adequate debt service coverage. These loans may have some vulnerability, but are sufficiently strong to have minimal deterioration if adverse factors are encountered, and are expected to be fully collectable.
- Grade 3 – Average – Loans that have a reasonable amount of risk and may exhibit vulnerability to deterioration if adverse factors are encountered. These loans should demonstrate adequate debt service coverage but warrant a higher level of monitoring to ensure that weaknesses do not advance.
- Grade 4 – Pass/Watch – Loans that are considered “pass credits” yet appear on the “watch list”. Credit deficiency or potential weakness may include a lack of current or complete financial information. The level of risk is considered acceptable so long as the loan is given additional management supervision.
- Grade 5 – Watch – Loans that possess some credit deficiency or potential weakness that if not corrected, could increase risk in the future. The source of loan repayment is sufficient but may be considered inadequate by the Bank’s standards.
- Grade 6 – Substandard – Loans that exhibit one or more of the following characteristics: (1) uncertainty of repayment from primary source and financial deterioration currently underway; (2) inadequate current net worth and paying capacity of the obligor; (3) reliance on secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility the Bank will sustain loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain probability of repayment; (6) insufficient cash flow to repay principal but continuing to pay interest; (7) the Bank is subordinated or unsecured due to flaws in documentation; (8) loans are restructured or are on nonaccrual status due to concessions to the borrower when compared to normal terms; (9) the Bank is contemplating foreclosure or legal action due to deterioration in the loan; or (10) there is deterioration in conditions and the borrower is highly vulnerable to these conditions.
- Grade 7 – Doubtful – Loans that exhibit one or more of the following characteristics: (1) loans with the weaknesses of Substandard loans and collection or liquidation is not probable to result in payment in full; (2) the primary source of

repayment is gone and the quality of the secondary source is doubtful; or (3) the possibility of loss is high, but important pending factors may strengthen the loan.

- Grades 8 & 9 - Loss – Loans are considered uncollectible and of such little value that carrying them on the Bank's financial statements is not feasible.

The assessment of compensating factors may result in a rating plus or minus one grade from those listed above. These factors include, but are not limited to collateral, guarantors, environmental conditions, history, plan/projection reasonableness, quality of information, and payment delinquency.

The portfolio segments in each credit risk grade as of June 30, 2012 are as follows (000s omitted):

	Agriculture and Agricultural Real Estate	Commercial	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Consumer and Other	Total
Not Rated	$ 157	$ 2,590	$ -	$ 3,035	$ 173,596	$ 12,389	$ 191,767
1	3	2,532	-	-	-	-	2,535
2	210	277	2,813	89	750	-	4,139
3	1,808	5,855	11,591	219	2,066	12	21,551
4	12,527	34,126	160,303	2,981	40,876	23	250,836
5	301	11,734	66,405	5,496	9,049	-	92,985
6	1,164	7,857	58,149	7,933	28,079	233	103,415
7	-	-	-	-	-	-	-
8	-	-	-	-	-	-	-
9	-	-	-	-	-	-	-
Total	$ 16,170	$ 64,971	$ 299,261	$ 19,753	$ 254,416	$ 12,657	$ 667,228
Performing	$ 15,338	$ 61,193	$ 266,425	$ 11,372	$ 234,331	$ 12,294	$ 600,953
Nonperforming	832	3,778	32,836	8,381	20,085	363	66,275
Total	$ 16,170	$ 64,971	$ 299,261	$ 19,753	$ 254,416	$ 12,657	$ 667,228

The portfolio segments in each credit risk grade as of December 31, 2011 are as follows (000s omitted):

	Agriculture and Agricultural Real Estate	Commercial	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Consumer and Other	Total
Not Rated	$ 158	$ 823	$ 139	$ 3,021	$ 181,853	$ 13,454	$ 199,448
1	-	1,188	-	-	-	-	1,188
2	145	341	3,735	95	770	-	5,086
3	3,547	7,049	14,331	322	1,853	26	27,128
4	10,337	32,726	163,586	3,261	29,984	31	239,925
5	274	14,556	65,611	6,124	10,969	-	97,534

6	1,470	7,079	59,673	10,600	30,126	218	109,166
7	-	-	-	-	-	-	-
8	-	-	-	-	-	-	-
9	-	-	-	-	-	-	-
Total	$ 15,931	$ 63,762	$ 307,075	$ 23,423	$ 255,555	$ 13,729	$ 679,475
Performing	$ 14,753	$ 61,054	$ 270,072	$ 13,657	$ 230,729	$ 13,350	$ 603,615
Nonperforming	1,178	2,708	37,003	9,766	24,826	379	75,860
Total	$ 15,931	$ 63,762	$ 307,075	$ 23,423	$ 255,555	$ 13,729	$ 679,475

Loans are considered past due when contractually required payment of interest or principal has not been received. The amount classified as past due is the entire principal balance outstanding of the loan, not just the amount of payments that are past due. The following is a summary of past due loans as of June 30, 2012 and December 31, 2011 (000s omitted):

June 30, 20112	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment >90 Days Past Due and Accruing
Agriculture and Agricultural Real Estate	$ 209	$ -	$ 382	$ 591	$ 15,579	$ 16,170	$ -
Commercial	1,179	272	424	1,875	63,096	64,971	2
Commercial Real Estate	5,996	2,418	8,945	17,359	281,902	299,261	-
Construction Real Estate	415	-	1,911	2,326	17,427	19,753	-
Residential Real Estate	6,121	1,522	3,712	11,355	243,061	254,416	-
Consumer and Other	158	23	48	229	12,428	12,657	-
Total	$ 14,078	$ 4,235	$ 15,422	$ 33,735	$ 633,493	$ 667,228	$ 2

December 31, 2011	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment >90 Days Past Due and Accruing
Agriculture and Agricultural Real Estate	$ 614	$ -	$ 364	$ 978	$ 14,953	$ 15,931	$ -
Commercial	1,530	50	1,240	2,820	60,942	63,762	11
Commercial Real Estate	3,340	286	11,988	15,614	291,461	307,075	-
Construction Real Estate	460	2,093	2,134	4,687	18,736	23,423	-
Residential Real Estate	5,604	1,337	5,344	12,285	243,270	255,555	-
Consumer and Other	188	58	130	376	13,353	13,729	9
Total	$ 11,736	$ 3,824	$ 21,200	$ 36,760	$ 642,715	$ 679,475	$ 20

Loans are placed on non-accrual status when, in the opinion of Management, the collection of additional interest is doubtful. Loans are automatically placed on non-accrual status upon becoming ninety days past due, however, loans may be placed on non-accrual status regardless of whether or not they are past due. All cash received on non-accrual loans is applied to the principal balance. Loans are considered for return to accrual status on an individual basis when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following is a summary of non-accrual loans as of June 30, 2012 and December 31, 2011 (000s omitted):

	6/30/2012	12/31/2011
Agriculture and Agricultural Real Estate	$ 391	$ 867
Commercial	2,370	2,309
Commercial Real Estate	18,482	23,557
Construction Real Estate	5,178	6,653
Residential Real Estate	13,521	17,484
Consumer and Other	197	196
Total	$ 40,139	$ 51,066

For loans deemed to be impaired due to an expectation that all contractual payments will probably not be received, impairment is measured by comparing the Bank's recorded investment in the loan to the present value of expected cash flows discounted at the loan's effective interest rate, the fair value of the collateral, or the loan's observable market price.

The following is a summary of impaired loans as of June 30, 2012 and 2011 (000s omitted):

June 30, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment for the Three Months Ended	Interest Income Recognized in the Three Months Ended	Average Recorded Investment for the Six Months Ended	Interest Income Recognized in the Six Months Ended
With no related allowance recorded:							
Agriculture and Agricultural Real Estate	$ 801	$ 1,337	$ -	$ 832	$ 12	$ 835	$ 29
Commercial	126	309	-	222	4	222	11
Commercial Real Estate	14,098	18,895	-	16,951	240	16,278	333
Construction Real Estate	881	1,334	-	1,124	20	1,106	26
Residential Real Estate	7,006	10,971	-	8,846	116	8,595	252
Consumer and Other	-	-	-	-	-	-	-
.With an allowance recorded:							
Agriculture and Agricultural Real Estate	-	-	-	-		-	-
Commercial	3,707	3,946	1,614	3,953	53	3,942	109
Commercial Real Estate	18,398	24,112	2,476	18,910	186	18,989	370
Construction Real Estate	7,055	9,462	1,264	7,533	45	7,509	125
Residential Real Estate	11,426	11,952	2,478	11,767	126	11,699	271
Consumer and Other	223	223	71	227	4	225	7
Total:							
Agriculture and Agricultural Real Estate	$ 801	$ 1,337	$ -	$ 832	$ 12	$ 835	$ 29
Commercial	3,833	4,255	1,614	4,175	57	4,164	120
Commercial Real Estate	32,496	43,007	2,476	35,861	426	35,267	703
Construction Real Estate	7,936	10,796	1,264	8,657	65	8,615	151
Residential Real Estate	18,432	22,923	2,478	20,613	242	20,294	523
Consumer and Other	223	223	71	227	4	225	7

June 30, 2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment for the Three Months Ended	Interest Income Recognized in the Three Months Ended	Average Recorded Investment for the Six Months Ended	Interest Income Recognized in the Six Months Ended

With no related allowance recorded:							
Agriculture and Agricultural Real Estate	$ 555	$ 1,078	$ -	$ 581	$ 19	$ 533	$ 19
Commercial	688	1,142	-	790	-	758	9
Commercial Real Estate	6,546	9,049	-	6,812	78	6,820	128
Construction Real Estate	587	788	-	614	5	611	15
Residential Real Estate	8,711	11,454	-	9,514	142	9,407	370
Consumer and Other	3	3	-	3	-	3	-
With an allowance recorded:							
Agriculture and Agricultural Real Estate	613	612	89	612	-	612	2
Commercial	2,344	2,714	427	2,420	4	2,405	53
Commercial Real Estate	34,483	42,703	4,933	35,200	314	35,205	652
Construction Real Estate	7,273	12,920	854	7,799	26	7,779	38
Residential Real Estate	9,345	11,334	1,056	10,319	187	9,976	264
Consumer and Other	163	162	71	165	3	164	5
Total:							
Agriculture and Agricultural Real Estate	$ 1,168	$ 1,690	$ 89	$ 1,193	$ 19	$ 1,145	$ 21
Commercial	3,032	3,856	427	3,210	4	3,163	62
Commercial Real Estate	41,029	51,752	4,933	42,012	392	42,025	780
Construction Real Estate	7,860	13,708	854	8,413	31	8,390	53
Residential Real Estate	18,056	22,788	1,056	19,833	329	19,383	634
Consumer and Other	166	165	71	168	3	167	5

The Bank may agree to modify the terms of a loan in order to improve the Bank’s ability to collect amounts due. These modifications may include reduction of the interest rate, extension of the loan term, or in some cases, reduction of the principal balance. Modifications that are performed due to the debtor’s financial difficulties are considered Troubled Debt Restructurings (“TDRs”).

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Loans that have been classified as TDRs during the three and six month periods ended June 30, 2012 are as follows (000s omitted from dollar amounts):

	Three months ended June 30, 2012			Six months ended June 30, 2012		
	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance	Number of Contracts	Pre-Modification Recorded Principal Balance	Post-Modification Recorded Principal Balance
Agriculture and Agricultural Real Estate	-	$ -	$ -	-	$ -	$ -
Commercial	-	-	-	6	782	412
Commercial Real Estate	2	264	264	9	2,403	2,091
Construction Real Estate	-	-	-	5	2,686	2,631
Residential Real Estate	11	1,964	1,964	14	2,479	1,678
Consumer and Other	-	-	-	2	27	26
Total	13	$ 2,228	$ 2,228	36	$ 8,377	$ 6,838

The Bank considers TDRs that become 90 days or more past due under the modified terms as defaulted. There were no loans that became TDRs during the six months ended June 30, 2012 that subsequently defaulted during the six months ended June 30, 2012.

6. INVESTMENT SECURITIES

The following is a summary of the Bank's investment securities portfolio as of June 30, 2012 and December 31, 2011 (000's omitted):

	Held to Maturity June 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of States and Political Subdivisions	$30,577	$ 842	$ (215)	$31,204
	$30,577	$ 842	$ (215)	$31,204

Available for Sale
June 30, 2012

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of U.S. Government Agencies	$147,960	$ 3,171	$ (49)	$151,082
Mortgage Backed Securities issued by U.S. Government Agencies	173,488	3,652	(101)	177,039
Obligations of States and Political Subdivisions	14,982	631	(3)	15,610
Trust Preferred CDO Securities	9,534	-	(4,453)	5,081
Corporate Debt Securities	9,954	43	(96)	9,901
Other Securities	2,567	185	(148)	2,604
	$358,485	$ 7,682	$ (4,850)	$361,317

	Held to Maturity December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of States and Political Subdivisions	$35,364	$ 688	$ (240)	$ 35,812
	$35,364	$ 688	$ (240)	$ 35,812

	Available for Sale December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of U.S. Government Agencies	$161,483	$ 4,071	$ (22)	$165,532
Mortgage Backed Securities issued by U.S. Government Agencies	156,883	3,320	(35)	160,168
Obligations of States and Political Subdivisions	14,616	567	(5)	15,178
Trust Preferred CDO Securities	9,542	-	(4,075)	5,467
Corporate Debt Securities	6,070	-	(91)	5,979
Other Securities	2,567	156	(148)	2,575
	$351,161	$ 8,114	$ (4,376)	$354,899

The investment securities portfolio is evaluated for impairment throughout the year. Impairment is recorded against individual securities, unless the decrease in fair value is attributable to interest rates or the lack of an active market, and Management determines that the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before a recovery of their amortized costs bases, which may be maturity. The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2012 and December 31, 2011.

June 30, 2012

	Less than 12 months		12 months or longer		Total	
	Aggregate Fair Value	Gross Unrealized Losses	Aggregate Fair Value	Gross Unrealized Losses	Aggregate Fair Value	Gross Unrealized Losses
Obligations of United States Government Agencies	$ 20,626	$ 49	$ -	$ -	$20,626	$ 49
Mortgage Backed Securities issued by U.S. Government Agencies	25,471	101	-	-	25,471	101
Obligations of States and Political Subdivisions	11,069	213	1,161	5	12,230	218
Trust Preferred CDO Securities	-	-	5,081	4,453	5,081	4,453
Corporate Debt Securities	5,904	96	-	-	5,904	96
Equity Securities	-	-	392	148	392	148

$ 63,070	$ 459	$ 6,634	$ 4,606	$69,704	$ 5,065

December 31, 2011

	Less than 12 months		12 months or longer		Total	
	Aggregate Fair Value	Gross Unrealized Losses	Aggregate Fair Value	Gross Unrealized Losses	Aggregate Fair Value	Gross Unrealized Losses
Obligations of United States Government Agencies	$14,729	$ 22	$-	$ -	$14,729	$ 22
Mortgage Backed Securities issued by U.S. Government Agencies	26,453	35	-	-	26,453	35
Obligations of States and Political Subdivisions	12,766	239	1,261	6	14,027	245
Trust Preferred CDO Securities	-	-	5,467	4,075	5,467	4,075
Corporate Debt Securities	5,979	91	-	-	5,979	91
Equity Securities	-	-	392	148	392	148
	$59,927	$ 387	$7,120	$ 4,229	$67,047	$ 4,616

The amount of investment securities issued by government agencies, states, and political subdivisions with unrealized losses and the amount of unrealized losses on those investment securities are primarily the result of market interest rates and not the result of the credit quality of the issuers of the securities. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at June 30, 2012.

The Trust Preferred CDO Securities are issued by companies in the financial services industry, including banks, thrifts, and insurance companies. Each of the three securities owned by the Company is in an unrealized loss position. The main reasons for the impairment are the overall decline in market values for financial industry securities and the lack of an active market for these types of securities in particular. In determining whether the impairment is not other-than-temporary, the Company analyzed each security’s expected cash flows. The assumptions used in the cash flow analysis were developed following a review of historical losses and prepayment activity and the financial condition of the individual obligors in the pools. Key assumptions utilized in the cash flow projections include prepayment speeds, obligor deferral and default rates, and loss severity rates on obligor defaults. The analysis concluded that disruption of our cash flows due to defaults by issuers is currently expected to occur in one of the three securities owned. A disruption of cash flows has been expected for this security since 2009. The impairment calculated by the analysis was determined to be other than temporary in 2009, and at that time the credit related portion of the impairment was charged to earnings. As a result of uncertainties in the market place affecting companies in the financial services industry, it is at least reasonably possible that a change in the estimates will occur in the near term. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, the Company does not consider this investment to have additional other than temporary impairment in the quarter ended June 30, 2012.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value, as defined in ASC Topic 820, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for market activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is used on a recurring basis for Available for Sale Securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Depending on the nature of the asset or liability, the Corporation uses various valuation techniques and assumptions when estimating fair value.

The Corporation applied the following fair value hierarchy:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. The Corporation’s mutual fund investments where quoted prices are available in an active market generally are classified within Level 1 of the fair value hierarchy.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. The Corporation’s borrowed funds and investments in U.S. government agency securities, government sponsored mortgage backed securities, and obligations of states and political subdivisions are generally classified in Level 2 of the fair value hierarchy. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Private equity investments and trust preferred collateralized debt obligations are classified within Level 3 of the fair value hierarchy. Fair values are initially valued based on transaction price and are adjusted to reflect exit values.

The following tables present information about the Company’s financial assets and liabilities measured at fair value on a recurring basis at June 30, 2012 and December 31, 2011, and the valuation techniques used by the Company to determine those fair values.

June 30, 2012	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Financial Assets:					
Cash and due from banks	$85,793	$85,793	$-	$-	$ 85,793
Securities - Held to Maturity					
Obligations of States and Political Subdivisions	30,577	-	31,204		31,204
Securities - Available for Sale					
Obligations of U.S. Government Agencies	151,082	-	151,082	-	151,082
MBS issued by U.S. Government Agencies	177,039	-	177,039	-	177,039
Obligations of States and Political Subdivisions	15,610	-	15,610	-	15,610
Trust Preferred CDO Securities	5,081	-	-	5,081	5,081
Corporate Debt Securities	9,901	-	9,901	-	9,901
Other Securities	2,604	2,212	392	-	2,604
Federal Home Loan Bank Stock	10,605	-	10,605	-	10,605
Loans Held for Sale	1,376	-	-	1,376	1,376
Loans, net	647,742	-	-	667,897	667,897
Accrued Interest Receivable	3,658	-	3,658	-	3,658
Financial Liabilities:					
Demand, NOW, savings and money market savings deposits	710,657	710,657	-	-	710,657
Other Time Deposits	306,845	-	313,763	-	313,763
Borrowed funds					
FHLB Advances	107,000	-	108,954	-	108,954
Repurchase Agreements	20,000	-	22,352	-	22,352
Accrued Interest Payable	417	-	417	-	417

December 31, 2011	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Financial Assets:					
Cash and due from banks	$75,995	$75,995			$ 75,995
Securities - Held to Maturity					
Obligations of States and Political Subdivisions	35,364	-	35,812		35,812
Securities - Available for Sale					
Obligations of U.S. Government Agencies	165,532	-	165,532	-	165,532
MBS issued by U.S. Government Agencies	160,168	-	160,168	-	160,168
Obligations of States and Political Subdivisions	15,178	-	15,178	-	15,178
Trust Preferred CDO Securities	5,467	-	-	5,467	5,467
Corporate Debt Securities	5,979	-	5,979	-	5,979
Other Securities	2,575	2,183	392	-	2,575

Federal Home Loan Bank Stock	10,605	-	10,605	-	10,605
Loans Held for Sale	1,035	-	-	1,035	1,035
Loans, net	658,610	-	-	684,007	684,007
Accrued Interest Receivable	3,582	-	3,582	-	3,582
Financial Liabilities:					
Demand, NOW, savings and money market savings deposits	689,421	689,421	-	-	689,421
Other Time Deposits	332,889	-	339,927	-	339,927
Borrowed funds					
FHLB Advances	107,000	-	109,664	-	109,664
Repurchase Agreements	20,000	-	22,773	-	22,773
Accrued Interest Payable	477	-	477	-	477

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

The changes in Level 3 assets measured at fair value on a recurring basis were (000's omitted):

Investment Securities - Available for Sale	2012	2011
Balance at January 1	$5,467	$5,188
Total realized and unrealized gains (losses) included in income	(8)	(14)
Total unrealized gains (losses) included in other comprehensive income	(378)	384
Net purchases, sales, calls and maturities	-	-
Net transfers in/out of Level 3	-	-
Balance at June 30	$5,081	$5,558

Of the Level 3 assets that were held by the Company at June 30, 2012, the unrealized loss for the six months ended June 30, 2012 was $378,000, which is recognized in other comprehensive income in the consolidated statements of financial condition. The Company did not have any sales or purchases of Level 3 available for sale securities during the period.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets. As a result, the unrealized gains and losses for these assets presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

The Company owns pooled Trust Preferred Securities ("TRUPs") with a fair value of $5,081,000 as of June 30, 2012. Trading of these types of securities has increased recently but is primarily conducted on a distress sale or forced liquidation basis. As a result, the Company measures the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

The Company also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include loans and Other Real Estate Owned. The Company estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets measured at fair value on a nonrecurring basis are as follows (000's omitted):

	Balance at June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 63,721	$ -	$ -	$ 63,721
Other Real Estate Owned	$ 12,756	$ -	$ -	$ 12,756

	Balance at December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 70,803	$ -	$ -	$ 70,803
Other Real Estate Owned	$ 16,650	$ -	$ -	$ 16,650

Impaired loans categorized as Level 3 assets consist of non-homogenous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals). Other Real Estate Owned (OREO) consists of property received in full or partial satisfaction of a receivable. The Company utilizes independent appraisals to estimate the fair value of OREO properties.

9. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of condition.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for its other lending activities.

Financial instruments whose contractual amounts represent off-balance sheet credit risk were as follows (000s omitted):

	Contractual Amount	
	June 30, 2012	December 31, 2011
Commitments to extend credit:		
Unused portion of commercial lines of credit	$60,915	$ 65,460
Unused portion of credit card lines of credit	2,809	2,756
Unused portion of home equity lines of credit	15,968	15,026
Standby letters of credit and financial guarantees written	4,074	4,461
All other off-balance sheet commitments	-	-

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Most commercial lines of credit are secured by real estate mortgages or other collateral, and generally have fixed expiration dates or other termination clauses. Since the lines of credit may expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. Credit card lines of credit have various established expiration dates, but are fundable on demand. Home equity lines of credit are secured by real estate mortgages, a majority of which have ten year expiration dates, but are fundable on demand. The

Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on Management's credit evaluation of the counterparty.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and other business transactions.

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

Introduction

MBT Financial Corp. (the “Company) is a bank holding company with one subsidiary, Monroe Bank & Trust (“the Bank”). The Bank is a commercial bank with a wholly owned subsidiary, MB&T Financial Services. MB&T Financial Services is an insurance agency which sells insurance policies to the Bank. The Bank operates 17 branch offices in Monroe County, Michigan and 7 offices in Wayne County, Michigan. The Bank’s primary source of income is interest income on its loans and investments and its primary expense is interest expense on its deposits and borrowings. The discussion and analysis should be read in conjunction with the accompanying consolidated statements and footnotes.

Executive Overview

The Bank is operated as a community bank, primarily providing loan, deposit, and wealth management products and services to the people, businesses, and communities in its market area. In addition to our commitment to our mission of serving the needs of our local communities, we are focused on improving asset quality, profitability, and capital.

The national economic recovery is continuing slowly, and conditions in southeast Michigan are also slowly improving. Local unemployment rates improved significantly over the past year, and are now comparable to the state and national averages, but remain above the historical norms. Commercial and residential development property values continue to show some stability with some areas improving slightly. Our total problem assets, which include nonperforming loans, other real estate owned, non accrual investments, and performing loans that are internally classified as potential problems, decreased $2.4 million, or 1.8% during the second quarter of 2012, allowing us to decrease our Allowance for Loan and Lease Losses (ALLL) from $20.5 million to $19.5 million. The loan portfolio increased $1.3 million during the quarter, and the ALLL as a percent of loans decreased from 3.07% to 2.91%. Although local property values and the unemployment rate have stabilized over the past several quarters, we anticipate that the recovery in our local markets in 2012 will continue at a slower than normal pace. We will continue to focus our efforts on improving asset quality, maintaining liquidity, strengthening capital, and controlling expenses.

Net Interest Income increased $206,000 compared to the second quarter of 2011 even though the average earning assets decreased $5.0 million, or 0.4% as the net interest margin increased from 3.06% to 3.15%. The provision for loan losses decreased from $2.85 million in the second quarter of 2011 to $1.05 million in the second quarter of 2012. Improvement in the risk ratings of loans, a decrease in the historical loss rates, and a decrease in the amount of specific allocations during the quarter decreased the amount of ALLL required. As a result, we were able to record a provision that was smaller than the net charge offs for the quarter. Non interest income decreased $294,000 or 7.6%, primarily due to a refund of wealth management fees to a large employee benefit account and a decrease in rental income on Other Real Estate Owned (OREO). Non interest expenses decreased $747,000, or 7.2% due to lower losses on Other Real Estate Owned, and lower FDIC deposit insurance assessments. We continue to work to control costs, and we decreased several non interest expense categories. We expect credit related expenses to continue to improve, but still remain above normal levels, in the second half of 2012.

Critical Accounting Policies

The Company's Allowance for Loan Losses, Deferred Tax Asset Valuation Allowance, Fair Value of Investment Securities, and Other Real Estate Owned are "critical accounting estimates" because they are estimates that are based on assumptions that are highly uncertain, and if different assumptions were used or if any of the assumptions used were to change, there could be a material impact on the presentation of the Company's financial condition. These assumptions include, but are not limited to, collateral values, the effect of economic conditions on the financial condition of the borrowers, the Company, and the issuers of investment securities, market interest rates, and projected earnings for the Company.

To determine the Allowance for Loan Losses, the Company estimates losses on all loans that are not classified as non accrual or renegotiated by applying historical loss rates, adjusted for current conditions, to those loans. In addition, all non accrual loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are individually tested for impairment. Any amount of monetary impairment is included in the Allowance for Loan Losses.

Income tax accounting standards require companies to assess whether a valuation allowance should be established against deferred tax assets based on the consideration of all evidence using a “more likely than not” standard. We reviewed our deferred tax asset, considering both positive and negative evidence and analyzing changes in near term market conditions as well as other factors that may impact future operating results. Significant negative evidence is our net operating losses for the last three full years, combined with a difficult economic environment and a slow economic recovery projected for southeast Michigan. Positive evidence includes our history of strong earnings prior to 2008, our fourth consecutive quarterly profit in the second quarter of 2012, our strong capital position, our steady net interest margin, our improving asset quality, and our non interest expense control initiatives. Based on our analysis of the evidence, we believed that it was appropriate to maintain a valuation allowance of $25.2 million, which is equal to the full amount of the deferred tax asset as of June 30, 2012.

To determine the fair value of investment securities, the Company utilizes quoted prices in active markets for identical assets, quoted prices for similar assets in active markets, or discounted cash flow calculations for investments where there is little, if any, market activity for the asset.

To determine the fair value of Other Real Estate Owned, the Company utilizes independent appraisals to estimate the fair value of the property.

Financial Condition

National economic conditions began to recover in the second half of 2009, but regional conditions remained weak until 2010. Local unemployment and property values stabilized during 2011 and 2012 and the economic environment in southeast Michigan is continuing to slowly show improvement. Our nonperforming assets decreased 7.5% during the quarter, from $88.6 million to $81.9 million, and total problem assets decreased from $129.1 million to $126.8 million. Total loans increased for the quarter for the first time since the third quarter of 2007 as new loan demand exceeded payments received in the ordinary course of business, and charge offs of existing loans. We continued to manage toward a decreased use of high cost wholesale funding, which, coupled with a decrease in non accrual loans, has helped improve our net interest margin. As the local economy is slowly recovering, lending opportunities are beginning to increase. We expect the slow recovery to continue in our market area in 2012. The Company expects low deposit growth and a slight reduction in total assets in 2012, and intends to continue to focus efforts on improved credit quality, capital management, and enterprise risk mitigation.

Since December 31, 2011, total loans decreased $11.9 million (1.7%) because the loan demand did not result in enough new loan activity to offset write downs recorded and payments received. At the same time, deposits decreased $4.8 million, or 0.5% due to maturities of brokered certificates of deposit. The reductions in loans and deposits resulted in a decrease of $2.8 million (0.2%) in total assets since the end of 2011. Total capital increased $1,073,000 or 1.4%, as the year to date profit of $1.5 million was offset by the decrease of $494,000 in the accumulated other comprehensive income (AOCI) mainly due to a decrease in the value of our securities available for sale. The decrease in total assets and the increase in capital caused the capital to assets ratio to increase from 6.12% at December 31, 2011 to 6.22% at June 30, 2012.

The amount of nonperforming assets ("NPAs") decreased $13.3 million or 14.0% during the first two quarters of 2012. NPAs include non performing loans, which decreased 12.2% from $75.5 million to $66.3 million, and Other Real Estate Owned and Other Assets ("OREO"), which decreased 23.5% from $16.7 million to $12.8 million. Total problem assets, which includes all NPAs and performing loans that are internally classified as substandard, decreased $10.0 million, or 7.3%. The Company's Allowance for Loan and Lease Losses ("ALLL") decreased $1.4 million since December 31, 2011, due to a decrease in the size of the portfolio and an improvement in the quality of the assets in the loan portfolio. The ALLL is now 2.91% of loans, down from 3.07% at December 31, 2011 and 3.15% at June 30, 2011. The ALLL is 29.40% of nonperforming loans ("NPLs"), compared to 27.63% at year end and 28.91% at June 30, 2011. In light of current economic conditions, we believe that at this level the ALLL adequately estimates the potential losses in the loan portfolio.

Results of Operations – Second Quarter 2012 vs. Second Quarter 2011

Net Interest Income - A comparison of the income statements for the three months ended June 30, 2011 and 2012 shows an increase of $206,000, or 2.4%, in Net Interest Income. Interest income on loans decreased $1.1 million or 10.5% as the average loans outstanding decreased $54.5 million and the average yield on loans decreased from 5.54% to 5.38%. The interest income on investments, fed funds sold, and interest bearing balances due from banks decreased $106,000 as the average amount of investments, fed funds sold, and interest bearing balances due from banks increased $49.5 million but the yield decreased from 2.38% to 2.04%. The yield on investments decreased because the Company is maintaining its strong liquidity position by keeping its excess funds in low yielding short term investments and deposits in the Federal Reserve Bank. A continued low overall level of interest rates and the maturity of some high cost borrowings and brokered certificates of deposit allowed funding costs to decrease more than asset yields. The interest expense on deposits decreased $1,323,000 or 44.7% as the average deposits decreased $11.9 million and the average cost of deposits decreased from 1.15% to 0.65%. The cost of borrowed funds decreased $43,000 as the average amount of borrowed funds decreased $10.6 million but the average cost of the borrowings increased from 2.78% to 2.89%.

Provision for Loan Losses - The Provision for Loan Losses decreased from $2.85 million in the second quarter of 2011 to $1.05 million in the second quarter of 2012. Net charge offs were $2.0 million during the second quarter of 2012, compared to $3.6 million in the second quarter of 2011. Each quarter, the Company conducts a review and analysis of its ALLL to determine its adequacy. This analysis involves specific allocations for impaired credits and a general allocation for losses expected based on historical experience adjusted for current conditions. Due to a decrease in the size of the portfolio, a decrease in the historical loss percentages, and a decrease in the specific allocations, we were able to maintain an adequate ALLL in the second quarter of 2012 even though we recorded a provision that was less than our net charge offs. The ALLL is 2.91% of loans as of June 30, 2012, and, in light of current economic conditions, we believe that at this level the ALLL adequately estimates the potential losses in our loan portfolio.

Other Income – Non interest income decreased $294,000, or 7.6% compared to the second quarter of 2011. Wealth management income decreased $168,000 due to a fee refund on a large employee benefit account. Origination fees on mortgage loan sold increased $118,000, or 137.2% due to an increase in mortgage loan origination volume compared to 2011. Income on Bank Owned Life Insurance policies decreased $57,000, or 14.6% due to a decrease in the cash surrender value enhancement feature on some of the policies this year. Other non interest income decreased $144,000, or 12.2% due to decreases in rent income on Other Real Estate Owned (OREO) and lower commissions on brokerage services and check printing.

Other Expenses – Total non interest expenses decreased $747,000, or 7.2% compared to the second quarter of 2011. Salaries and Employee Benefits only increased $69,000, or 1.4%, as an increase in salaries was partially offset by a decrease in the retirement plan contribution. Occupancy expense decreased $62,000 due to lower depreciation and property tax expenses. Marketing expense decreased $60,000, or 25.5% due to the elimination of our debit card rewards program and a reduction in advertising activity due to the reduced need to attract deposits. Professional fees decreased $70,000, or 11.8% as the improvement in asset quality caused a reduction in collection related legal expenses. Losses on Other Real Estate Owned (OREO) properties decreased $654,000 compared to the second quarter of 2011 as the property values stabilized over the last three quarters, requiring fewer write downs of properties owned, and some of the OREO property sales that closed during the quarter produced gains. Other OREO expenses decreased $125,000 as the reduction in OREO properties owned resulted in a decrease in insurance, property tax, and maintenance costs. FDIC deposit insurance premium expense decreased $96,000, or 12.2%, due to a change in the assessment method in 2011. Other non interest expense increased $212,000, or 22.9% due to the accrual of $206,000 for the estimated interest on the Company’s proposed settlement of the federal income tax audit.

As a result of the above activity, the Profit Before Income Taxes in the second quarter of 2012 was $1,676,000, an improvement of $2.5 million compared to the loss of $783,000 in the second quarter of 2011. In the second quarter of 2012, we recorded a federal income tax expense of $1.4 million. The Company is currently being audited by the IRS, and the ultimate resolution of the exam is still uncertain. This accrual reflects the amount of a settlement offer that we made to the IRS in an attempt to resolve the audit. The issues being challenged mainly involve the timing of income recognition and would normally result in an increase in the deferred tax asset. However, the Company is maintaining a valuation allowance against 100% of its deferred tax asset, so the estimated tax adjustment must be expensed. No income tax benefit or expense was recorded in the second quarter of 2011 due to the net operating loss carry forwards and the uncertainty of our expected ability to utilize our existing deferred tax assets. The Net profit for the second quarter of 2012 was $253,000, compared to a net loss of $783,000 in the second quarter of 2011.

Results of Operations – Six months ended June 30, 2012 vs. Six months ended June 30, 2011

Net Interest Income - A comparison of the income statements for the six months ended June 30, 2011 and 2012 shows an increase of $365,000, or 2.1%, in Net Interest Income. Interest income on loans decreased $2.3 million or 11.1% as the average loans outstanding decreased $63.0 million and the average yield on loans decreased from 5.59% to 5.42%. The interest income on investments, fed funds sold, and interest bearing balances due from banks increased $1,000 as the average amount of investments, fed funds sold, and interest bearing balances due from banks increased $51.7 million but the yield decreased from 2.37% to 2.11%. The yield on investments decreased because the Company is maintaining its strong liquidity position by keeping its excess funds in low yielding short term investments and deposits in the Federal Reserve Bank. A continued low overall level of interest rates and the maturity of some high cost borrowings and brokered certificates of deposit allowed funding costs to decrease more than asset yields. The interest expense on deposits decreased $2,499,000 or 41.8% as the average deposits decreased $14.5 million and the average cost of deposits decreased from 1.16% to 0.68%. The cost of borrowed funds decreased $132,000 as the average amount of borrowed funds decreased $13.5 million but the average cost of the borrowings increased from 2.83% to 2.91%.

Provision for Loan Losses - The Provision for Loan Losses decreased from $8.6 million in the first six months of 2011 to $3.3 million in the first six months of 2012. Net charge offs were $4.7 million during the first six months of 2012, compared to $7.2 million in the first six months of 2011. Each quarter, the Company conducts a review and analysis of its ALLL to determine its adequacy. This analysis involves specific allocations for impaired credits and a general allocation for losses expected based on historical experience adjusted for current conditions. Due to a decrease in the size of the portfolio, a decrease in the historical loss percentages, and a decrease in the specific allocations, we were able to maintain an adequate ALLL in the first six months of 2012 even though we recorded a provision that was less than our net charge offs. The ALLL is 2.91% of loans as of June 30, 2012, and, in light of current economic conditions, we believe that at this level the ALLL adequately estimates the potential losses in our loan portfolio.

Other Income – Non interest income increased $720,000, or 9.6% compared to the first six months of 2011, primarily because gains on the sales of securities increased $1.0 million. The gain on securities transactions was the result of some sales of federal agency securities. Securities were sold to rebalance the Bank's interest rate risk. The sales had the additional benefit of producing the gain, which improved the bank's capital ratios. Wealth management fees decreased $187,000, or 9.4% due to a fee refund to a large employee benefit account. Service charges and other fees on deposit accounts decreased $81,000, or 3.5%, primarily due to a decrease in overdraft fees on checking accounts. Origination fees on mortgage loan sold increased $157,000, or 92.9% due to an increase in mortgage loan origination volume in 2012. Income on Bank Owned Life Insurance policies decreased $99,000, or 12.3% due to a decrease in the yields on the policies this year and a decrease in the cash surrender value enhancement feature on some of the policies this year. Other non interest income decreased $114,000, or 5.2% due to decreases in rental income on OREO properties and commission income on brokerage activity and check sales.

Other Expenses – Total non interest expenses decreased $1.5 million, or 6.9% compared to the first six months of 2011. Salaries and Employee Benefits increased $326,000, or 3.3%, as salaries increased $332,000. Benefits decreased slightly, as increases in life insurance and payroll tax expenses were offset by decreases in medical insurance and retirement contributions. Occupancy expense decreased $114,000 due to lower maintenance costs as a result of the mild winter weather in 2012 and lower property taxes due to a successful appeal of the assessment of one of our branches in 2012. Equipment expense increased $107,000 due to higher computer expenses. Marketing expense decreased $108,000, or 22.5% due to the elimination of our debit card rewards program and a reduction in our advertising activity. Professional fees decreased $181,000, or 14.0% due to a decrease in credit related legal fees. Losses on Other Real Estate Owned (OREO) properties decreased $1.6 million compared to the first six months of 2011 as the property values stabilized in the second half of 2011 and sales have been completed at prices close to the carrying values in 2012. FDIC deposit insurance premium expense decreased $263,000, or 16.1%, due to a change in the assessment method in 2011.

As a result of the above activity, the Profit Before Income Taxes in the first six months of 2012 was $3.0 million, an improvement of $7.8 million compared to the loss of $4.8 million in the first six months of 2011. In the first six months of 2012, we recorded a federal income tax expense of $1.5 million. The Company is currently being audited by the IRS, and the ultimate resolution of the exam is still uncertain. This accrual, along with the $500,000 accrued in the fourth quarter of 2011, reflects the amount of a settlement offer that we made to the IRS in an attempt to resolve the audit. The issues being challenged mainly involve the timing of income recognition and would normally result in an increase in the deferred tax asset. However, the Company is maintaining a valuation allowance against 100% of its deferred tax asset, so the estimated tax adjustment must be expensed. No income tax benefit or expense was recorded in the first six months of 2011 due to the net operating loss carry forwards and the uncertainty of our expected ability to utilize our existing deferred tax assets. The Net profit for the first six months of 2012 was $1,470,000, compared to a net loss of $4,825,000 in the first six months of 2011.

Cash Flows

Cash flows provided by operating activities increased $4.4 million compared to the first six months of 2011 as the net income increased mainly due to the decreases in the provision for loan losses and other non interest expenses. Cash flows from investing activities increased $13.5 million in the first six months of 2012 compared to the first six months of 2011 as less of the cash provided by sales and redemptions of investment securities was reinvested. The amount of cash used for financing activities decreased $22.3 million in the first six months of 2012 compared to the first six months of 2011 as the decrease in deposits was smaller in 2012 but the company repaid $13.5 million in non deposit funding in the first six months of 2011. Total cash and cash equivalents increased $29.9 million as of June 30, 2012 compared to June 30, 2011.

Liquidity and Capital

The Company believes it has sufficient liquidity to fund its lending activity and allow for fluctuations in deposit levels. Internal sources of liquidity include the maturities of loans and securities in the ordinary course of business as well as our available for sale securities portfolio. External sources of liquidity include a line of credit with the Federal Home Loan Bank of Indianapolis, the Federal funds line that has been established with our correspondent bank, and Repurchase Agreements with money center banks that allow us to pledge securities as collateral for borrowings. As of June 30, 2012, the Bank utilized $107.0 million of its authorized limit of $265 million with the Federal Home Loan Bank of Indianapolis, none of its $10 million overdraft line of credit with the Federal Home Loan Bank of Indianapolis, and none of its $25 million of federal funds line with a correspondent bank.

The Company’s Funds Management Policy includes guidelines for desired amounts of liquidity and capital. The Funds Management Policy also includes contingency plans for liquidity and capital that specify actions to take if liquidity and capital ratios fall below the levels contained in the policy. Throughout the first six months of 2012 the Company was in compliance with its Funds Management Policy regarding liquidity and capital.

Total stockholders’ equity of the Company was $76.8 million at June 30, 2012 and $75.7 million at December 31, 2011. The ratio of equity to assets was 6.22% at June 30, 2012 and 6.12% at December 31, 2011. Federal bank regulatory agencies have set capital adequacy standards for Total Risk Based Capital, Tier 1 Risk Based Capital, and Leverage Capital. These standards require banks to maintain Leverage and Tier 1 ratios of at least 4% and a Total Capital ratio of at least 8% to be adequately capitalized. The regulatory agencies consider a bank to be well capitalized if its Total Risk Based Capital is at least 10% of Risk Weighted Assets, Tier 1 Capital is at least 6% of Risk Weighted Assets, and the Leverage Capital Ratio is at least 5%.

The following table summarizes the capital ratios of the Company and the Bank:

	Actual		Minimum to Qualify as Well Capitalized	
	Amount	Ratio	Amount	Ratio
As of June 30, 2012:				
Total Capital to Risk-Weighted Assets				
Consolidated	$86,320	10.91 %	$ 79,145	10 %
Monroe Bank & Trust	85,858	10.86 %	79,093	10 %
Tier 1 Capital to Risk-Weighted Assets				
Consolidated	76,287	9.64 %	47,487	6 %
Monroe Bank & Trust	75,766	9.58 %	47,456	6 %
Tier 1 Capital to Average Assets				
Consolidated	76,287	6.18 %	61,696	5 %
Monroe Bank & Trust	75,766	6.14 %	61,667	5 %

	Actual		Minimum to Qualify as Well Capitalized	
	Amount	Ratio	Amount	Ratio
As of December 31, 2011:				
Total Capital to Risk-Weighted Assets				
Consolidated	$84,970	10.48 %	$ 81,084	10 %
Monroe Bank & Trust	84,441	10.42 %	81,033	10 %
Tier 1 Capital to Risk-Weighted Assets				
Consolidated	74,695	9.21 %	48,650	6 %
Monroe Bank & Trust	74,106	9.15 %	48,620	6 %
Tier 1 Capital to Average Assets				
Consolidated	74,695	6.07 %	61,505	5 %
Monroe Bank & Trust	74,106	6.03 %	61,481	5 %

On July 12, 2010, the Bank entered into a Consent Order with its state and federal regulators. While the Bank is under the Consent Order, it is classified as “adequately capitalized” even if its ratios meet the “well capitalized” guidelines. The Consent Order requires the Bank to raise its Tier 1 Leverage ratio to 9% and its Total Risk Based Capital Ratio to 12%. As of June 30, 2012, the Bank is not in compliance with the capital requirements of the Consent Order. The table below indicates the amount of capital the Bank needed to be in compliance with the Consent Order as of June 30, 2012:

	Actual Capital		Minimum Capital Required by Consent Order		Additional Capital Required to Comply with Consent Order
	Amount	Ratio	Amount	Ratio	

Total Capital to Risk-Weighted Assets	$85,858	10.86	%	$ 94,912	12	%	$	9,054
Tier 1 Capital to Average Assets	$75,766	6.14	%	$ 111,001	9	%	$	35,235

The Company increased its common shares authorized in 2011 and is monitoring the capital market conditions. Currently, the Company does not believe that the market conditions are suitable for a bank holding company of our size located in the Midwest to conduct an offering large enough to generate the amount of capital required to comply with the Consent Order. While we continue to monitor the capital market conditions, we are focusing our efforts to improve our capital position on generating capital by improving our earnings. We are also improving our capital ratios by reducing the size of our balance sheet by repaying our non deposit funding as it matures.

Market risk for the Bank, as is typical for most banks, consists mainly of interest rate risk and market price risk. The Bank's earnings and the economic value of its equity are exposed to interest rate risk and market price risk, and monitoring this risk is the responsibility of the Asset/Liability Management Committee (ALCO) of the Bank. The Bank's market risk is monitored monthly and it has not changed significantly since year-end 2011.

Internal Revenue Service Audit

Since the fourth quarter of 2010, the Internal Revenue Service (IRS) has been conducting an audit of our tax returns for the 2004, 2005, 2007, 2008, and 2009 tax years. The IRS is nearing completion of the audit and has proposed adjustments to our taxable income, mainly challenging our treatment of interest on non accrual loans, OREO valuations, OREO carrying costs, and loan charge-offs. Although our loan charge-offs were in compliance with state and federal bank regulatory agency guidelines, the IRS examining agent conducting the audit has called into question the deductibility of certain charge-offs for income tax purposes based on the facts and circumstances of a loan at the time of the charge-off and certain differences between tax and financial accounting for charge-offs. We believe that the charge-off deductions were proper when taken, and our belief is supported by confirmation of our charge off methodology by our federal and state banking regulators.

According to ASC 740, Accounting for Uncertainty in Income Taxes, an entity is required to evaluate the validity of uncertain tax positions and determine if the relevant taxing authority would conclude that it is more likely than not (greater than fifty percent) that the position taken will be sustained, based upon technical merits, upon examination. We have reviewed our tax positions and have concluded that it is appropriate to record a liability for potential reimbursement to the IRS. We have concluded, based on all relevant facts at the present time that the potential tax liability from the current audit ranges from $0.9 million to $3.1 million.

As of June 30, 2012, the Company has calculated the potential tax liability to be $0.9 million, based on allowance of the deduction for bad debt losses and the corresponding OREO valuations. The IRS has proposed a resolution of the audit that the Company estimates would result in the Company having to pay a net amount of $3.1 million in federal income tax for the years under audit after taking into account a carry back of losses from later tax years to offset a portion of the deductions disallowed by the IRS.

Since the audit began in 2010, the Company has incurred nearly $200,000 of professional fees expenses with its accountants and lawyers for assistance in resolution. In order to resolve the audit without incurring significant additional expenses, the Company has offered a settlement proposal to the IRS. The Company's proposal would result in a current tax liability of $2.0 million. The Company has concluded that its latest offer to settle of $2.0 million is the best estimate of potential liability at this time. The Company intends to appeal the audit if its offer to settle is not accepted.

During the three months ended June 30, 2012, the Company accrued an additional $1.4 million in federal income tax expense. This brings the Company's federal tax liability accrual to $2.0 million as of June 30, 2012. In addition, during the second quarter of 2012, the Company recorded $0.2 million for the anticipated interest charge by the IRS for the underpayment of tax. Management has concluded that there is no need to accrue for the payment of penalties at this time.

Although the timing of the resolution and/or closure of the audit is highly uncertain, the Company believes it is reasonably possible that the IRS will conclude this audit within the next six months. Adjustments could be necessary in future periods to the estimated range of the potential federal income tax payable noted above based on issues raised by the IRS. Any such adjustment could be material to the results of operations for any given quarterly or annual period, based in part upon the results of operations for the given period. Management will re-evaluate the estimate quarterly based on current, relevant facts.

Forward-Looking Statements

Certain statements contained herein are not based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements, due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, changes in the financial and securities markets, including changes with respect to the market value of our financial assets, the availability of and costs associated with sources of liquidity, and the ability of the Company to resolve or dispose of problem loans.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Bank faces market risk to the extent that the fair values of its financial instruments are affected by changes in interest rates. The Bank does not face market risk due to changes in foreign currency exchange rates, commodity prices, or equity prices. The asset and liability management process of the Bank seeks to monitor and manage the amount of interest rate risk. This is accomplished by analyzing the differences in repricing opportunities for assets and liabilities, by simulating operating results under varying interest rate scenarios, and by estimating the change in the net present value of the Bank’s assets and liabilities due to interest rate changes.

Each month, the Asset and Liability Committee (ALCO), which includes the senior management of the Bank, estimates the effect of interest rate changes on the projected net interest income of the Bank. The sensitivity of the Bank’s net interest income to changes in interest rates is measured by using a computer based simulation model to estimate the impact on earnings of both gradual and sudden increases or decreases of 100, 200, 300, and 400 basis points in the interest rates. The net interest income projections are compared to a base case projection, which assumes no changes in interest rates.

The Bank’s ALCO has established limits in the acceptable amount of interest rate risk, as measured by the change in the Bank’s projected net interest income, in its policy. Throughout the first six months of 2012, the Bank’s interest rate risk has remained within its policy limits.

The ALCO also monitors interest rate risk by estimating the effect of changes in interest rates on the economic value of the Bank's equity each month. The economic value of the Bank's equity is first determined by subtracting the fair value of the Bank's liabilities from the fair value of the Bank's assets. The Bank estimates the interest rate risk by calculating the effect of market interest rate changes on that economic value of its equity. For this analysis, the Bank assumes immediate parallel shifts of plus or minus 100, 200, and 300 basis points in interest rates. The discount rates used to determine the present values of the loans and deposits, as well as the prepayment rates for the loans, are based on Management's expectations of the effect of the rate changes on the market for loans and deposits. In addition, each quarter, the Bank conducts additional analyses that utilize other rate scenarios, such as larger shifts in rates and changes in the shape of the yield curve, to assess the Bank's exposure to interest rate risk in stress scenarios.

The Bank's interest rate risk, as measured by the net interest income and economic value of equity simulations, has not changed significantly from December 31, 2011.

Item 4. Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2012, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2012, in alerting them in a timely manner to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

There was no change in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended June 30, 2012, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

MBT Financial Corp. and its subsidiaries are not a party to, nor is any of their property the subject of any material legal proceedings other than ordinary routine litigation incidental to their respective businesses, nor are any such proceedings known to be contemplated by governmental authorities.

Item 1A. Risk Factors

Not applicable for smaller reporting companies.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

No matters to be reported.

Item 6. Exhibits

3.1	Articles of Incorporation of MBT Financial Corp. Previously filed as Exhibit 3.1 to MBT Financial Corp.'s Form 10-Q for its quarter ended June 30, 2011.
3.2	Amended and Restated Bylaws of MBT Financial Corp. Previously filed as Exhibit 3.2 to MBT Financial Corp.'s Form 10-Q for its quarter ended March 31, 2008.
31.1	Certification by Chief Executive Officer required by Securities and Exchange Commission Rule 13a-14.
31.2	Certification by Chief Financial Officer required by Securities and Exchange Commission Rule 13a-14.
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following material from the Corporation's Form 10-Q Report for the quarterly period ended June 30, 2012, formatted in XBRL: (1) Unaudited Condensed Consolidated Balance Sheets, (2) Unaudited Condensed Consolidated Statements of Operations, (3) Unaudited Condensed Consolidated Statement of Changes in Shareholders' Equity, (4) Unaudited Condensed Consolidated Statements of Cash Flows, and (5) the Notes to Unaudited Condensed Consolidated Financial Statements.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	MBT Financial Corp. (Registrant)
August 14, 2012 Date	By/s/ H. Douglas Chaffin H. Douglas Chaffin President & Chief Executive Officer
August 14, 2012 Date	By/s/ John L. Skibski John L. Skibski

Executive Vice President
and
Chief Financial Officer

Exhibit Index

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** Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, and are otherwise not subject to liability under these sections.