



TRI CITY BANKSHARES CORPORATION

Dear Shareholders,

In February 2012, the Board of Directors was saddened by the loss of a long-time friend and member of the Board, Mr. Christ Krantz. Mr. Krantz served as a director since 1974 providing insight, knowledge and common sense acquired from running his own businesses in the Milwaukee area. A member of the audit and loan committees, his valuable contributions will be missed.

After two consecutive years in which the Corporation posted earnings which led banking companies of all sizes in the State of Wisconsin, I am pleased to report that Tri City Bankshares Corporation ended 2011 with continued strong net income of \$9.5 million. The 2011 performance can and should be positively viewed in two ways.

First, examining those record years you will recall shareholders were pleased with the \$12.9 million after-tax “bargain purchase gain” generated from the FDIC-assisted acquisition in 2009. Similarly, after-tax purchase accounting adjustments from the acquisition were \$3.4 million greater in 2010 than 2011. The basis of our expectation for enhanced future earnings has always been improved core income from the larger \$1.2 billion asset base the Corporation now enjoys.

Second, despite the largest (\$5.4 million after-tax) expense ever taken by the Corporation as a provision for loan losses, 2011 income exceeded earnings posted by the Corporation for all years prior to the Acquisition except 2007 and 2008, two years in which loan loss expense was \$0.3 million and \$0.7 million after-tax respectively. Our franchise has performed well and profited from the events of the last few years and it is poised to profit in the future.

That said, there are always challenges to be overcome. After the second full year of converting Acquired loans into the Bank’s portfolio or eliminating them, there remains \$101 million of such loans yet to be resolved. Originally estimated to be a three year project, this effort is likely to carry into 2013.

And certainly, not the least of challenges facing the Corporation is the economy. The Wisconsin Bankers Association recently stated “. . . while it would be nice to predict a strong U.S. and global economic recovery, a strong outlook for banking is necessarily tempered by relentless regulatory burdens, national and international dynamics and latent consumer confidence. . . expect to see slow positive improvement in the banking industry in 2012.”

We agree with that assessment and feel confident that your Corporation is prepared to take advantage of every opportunity in its market. Quality loan growth will remain our primary objective. The Board of Directors, management and every employee is prepared to hasten the projected “slow positive improvement” to enhance your shareholder value.

Very truly yours,

Tri City Bankshares Corporation

Ronald K. Puetz

Chairman of the Board
Chief Executive Officer

Directors and Officers of the Corporation

Directors

Frank J. Bauer	President of Frank Bauer Construction Company, Inc.
William N. Beres	Vice President of Structured Finance for the Global Energy Solutions division of Johnson Controls, Inc. since March 2010. Independent business and financial consultant from January 2009 through March 2010. Former Chief Financial Officer of Wisvest LLC and Vice President of Minergy LLC, both wholly owned subsidiaries of Wisconsin Energy Corporation, from January 1999 through December 2008
Sanford Fedderly	Retired Registered Pharmacist
Scott D. Gerardin	Senior Vice President and General Counsel of Tri City Bankshares Corporation and Senior Vice President and General Counsel of Tri City National Bank
William Gravitter	Retired President of Hy-View Mobile Home Court, Inc.
Brian T. McGarry	Retired Vice President of Tri City National Bank and Director of NDC LLC
Robert W. Orth	Executive Vice President of Tri City Bankshares Corporation and President of Tri City National Bank
Ronald K. Puetz	Chairman of the Board, President and Chief Executive Officer of Tri City Bankshares Corporation and Chairman of the Board and Chief Executive Officer of Tri City National Bank and Treasurer of NDC LLC
Agatha T. Ulrich	Chairman and Director of NDC LLC, President and Director of the David A. and Agatha T. Ulrich Foundation, Inc.
David A. Ulrich, Jr.	Independent Investor, Retired Vice President and Director of Mega Marts, Inc., Retired Vice President and Director of NDC, Inc., Director of NDC LLC and Director of the David A. and Agatha T. Ulrich Foundation, Inc.
William J. Werry	Retired Unit President of Tri City National Bank
Scott A. Wilson	Executive Vice President, Treasurer and Secretary of Tri City Bankshares Corporation, and Executive Vice President, CFO, Treasurer and Secretary of Tri City National Bank

Officers

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

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

The following discussion provides management's analysis of the audited consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") and should be read in conjunction with those financial statements. This discussion focuses on significant factors that affected the Corporation's financial performance in 2011 with comparisons to 2010 and to 2009 where applicable. For all periods presented, the operations of Tri City National Bank (the "Bank") contributed substantially all of the Corporation's revenue and expense for the year. Included in the operations of the Bank are the activities of its wholly-owned subsidiaries, Tri City Capital Corporation, Inc. and Title Service of Southeast Wisconsin, Inc.

Overview

On October 23, 2009 the Bank was the successful bidder for the Bank of Elmwood ("Acquired Bank") through an FDIC-assisted purchase (the "Acquisition"). The Acquisition was the result of a competitive bidding process facilitated by the FDIC. The Bank bid negative \$110.9 million and the FDIC estimated the net cost of the transaction to be \$101.1 million, deemed to be the "least costly" resolution for the FDIC. Earnings performance at the Bank as a result of the Acquisition has been positively impacted. In 2009, the Bank posted record earnings of \$22.1 million which included a \$12.9 million after-tax "bargain purchase gain" on the FDIC transaction. In 2010, earnings of \$14.3 million were buoyed by the first full year of enhanced core income of the larger \$1.1 billion asset base and purchase accounting income of \$7.2 million after-tax.

The Corporation posted after-tax earnings of \$9.5 million in 2011, a decrease of \$4.8 million or 33.5% compared to earnings of \$14.3 million in 2010. Operating earnings in 2011 were negatively affected by a decline in net interest income, a higher provision for loan losses and a decrease in non-interest income which were partially offset by a decline in non-interest expenses. Total assets increased \$73.5 million to \$1.2 billion at December 31, 2011. In addition, total loans decreased \$39.0 million during 2011, while deposits increased by \$52.0 million during the same period. Thus, the Corporation has a very strong balance sheet and liquidity position moving into 2012

Forward-Looking Statements

This report contains statements that may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, such as statements other than historical facts contained or incorporated by reference in this report. These statements speak of the Corporation's plans, goals, beliefs or expectations, refer to estimates or use similar terms. Future filings by the Corporation with the Securities and Exchange Commission, and statements other than historical facts contained in written material, press releases and oral statements issued by, or on behalf of the Corporation, may also contain forward-looking statements.

Forward-looking statements are subject to significant risks and uncertainties. The Corporation's actual results may differ materially from the results discussed in such forward-looking statements. Factors that might cause actual results to differ from the results discussed in forward-looking statements include, but are not limited to the factors set forth in Item 1A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011 (the "2011 Form 10-K").

All forward-looking statements contained in this report or that may be contained in future statements made for or on behalf of the Corporation are based upon information available at the time the statement is made and the Corporation assumes no obligation to update any forward-looking statement.

Critical Accounting Policies

Consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and reflect general practices in the banking industry. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on information available to management as of the date of the consolidated financial statements. Accordingly, as this information changes, future financial statements could reflect different estimates or judgments. Certain policies inherently have a greater reliance on the use of estimates, and as such have a greater possibility of producing results that could be materially different than originally reported. The most significant accounting policies followed are presented in Note 1 of the Notes to Consolidated Financial Statements and in Item 8 Financial Statements and Supplementary Data, herein. These policies, along with the disclosures presented in the other financial statement notes and other information presented herein, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how these values are determined. Management views critical accounting policies to be those that are highly dependent on subjective or complex judgments, estimates or assumptions, and where changes in those estimates and assumptions could have a significant impact on the consolidated financial statements. Management currently views the following items to be critical accounting policies.

Allowance for Loan Losses

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

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

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

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

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

Loans Acquired Through Purchase

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

Other Real Estate Owned

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

Income Taxes

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

Performance Summary

While the banking industry as a whole continued to struggle for the fourth consecutive year, the Corporation is pleased to report that its results for 2011 continued to be strong. The Corporation posted after tax earnings of \$9.5 million, a decrease of \$4.8 million or 33.5% compared to earnings of \$14.3 million in 2010 and earnings of \$22.1 million in 2009. Operating earnings in 2011 were negatively affected by a decline in net interest income, a higher provision for loan losses and a decrease in non-interest income which was partially offset by a decline in non-interest expenses. The decrease from 2009 to 2010 was primarily due to the one-time bargain purchase gain of \$12.9 million after tax recognized in 2009 which was partially offset in 2010 by increased core income and a significant increase in Acquisition-related purchase accounting income. Basic earnings per share for 2011 were \$1.07, a 33.5% decrease from 2010 basic earnings per share of \$1.61, while basic earnings per share in 2009 were \$2.48. Return on average assets and return on equity for 2011 were 0.85% and 8.10%, respectively, compared to 1.32% and 11.69%, respectively, for 2010 and 2.67% and 20.16%, respectively, for 2009. No dividends were paid in 2011. However, a quarterly dividend of \$0.21 per share was declared in December of 2011 and paid in January of 2012. Cash dividends of \$2.40 per share were paid in 2010, which included a prepayment of 2011 dividends of \$1.20 per share. Cash dividends were \$1.08 per share in 2009. Total assets increased \$73.5 million or 6.4% to \$1.22 billion in 2011. The increase was primarily due to core deposit growth.

Income Statement Summary

- Net interest income was \$48.6 million for 2011 compared to \$56.2 million in 2010 and \$37.4 million in 2009 while tax-equivalent net interest income was \$49.3 million for 2011 compared to \$57.0 million in 2010 and \$38.2 million in 2009. Growth in taxable investment securities more than offset a decline in loans which resulted in an increase in interest-earning assets in 2011 compared to 2010. However, tax-equivalent net interest income declined during the period as the yield on taxable investment securities is significantly less than the yield earned on loans and the yield on the loan portfolio decreased as maturing notes renewed at lower rates. In addition, interest expense on deposits declined in all areas but especially on fixed rate liabilities which continued to reprice downward during 2011. Included in the \$7.7 million decrease in net interest income during 2011 was the effect of discount accretion associated with Acquisition-related purchase accounting adjustments of \$5.6 million in 2011 compared to \$11.2 million in 2010. The resulting taxable equivalent net interest margin for 2011 was 4.69% compared to 5.61% for 2010. The increase in tax-equivalent net interest income for 2010 compared to 2009 was largely due to the Acquisition. Included in the \$18.8 million increase in net interest income was the effect of discount accretion associated with Acquisition-related purchase accounting adjustments that increased taxable equivalent net interest income by \$11.2 million in 2010 compared to \$1.9 million in 2009. As a result of the changes to yields on interest-earning assets and interest-bearing liabilities the tax-equivalent net interest margin for 2010 was 5.61% compared to 4.98% for 2009.
- The provision for loan losses (“PLL”) represents the amount periodically added to the Bank’s allowance for loan losses (“ALL”) and charged to earnings in the relevant period. The PLL for 2011 was \$8.4 million compared to \$6.9 million in 2010 and \$3.7 million in 2009. The increase in the PLL for 2011 compared to 2010 reflected the \$3.4 million increase in net loans charged off between the years which was primarily due to the negative effect of the economic downturn on the Bank’s loan portfolio. The increase in the PLL for 2010 compared to 2009 reflected an increase in the ALL due to \$26.2 million in non-credit impaired loans that were renewed since they were acquired in October of 2009. In the quarterly analysis of the ALL, these renewed loans exhibit a higher probability of loss, which is reflected in the ALL.

- Non-interest income was \$14.8 million in 2011, \$16.5 million in 2010 and \$36.1 million in 2009. The decrease in non-interest income during 2011 was primarily due to a decrease of \$1.3 million in the gain on sale of other real estate owned (“OREO”), net of carrying costs, compared to 2010. The non-accretable income, which is a result of the Acquisition related purchase accounting adjustments, was \$2.3 million in 2011, \$2.3 million in 2010 and \$0.7 million in 2009. Non-interest income in 2009 was also significantly impacted by the Acquisition-related bargain purchase gain of \$21.5 million.
- Non-interest expense was \$40.8 million in 2011, \$43.1 million in 2010 and \$34.1 million in 2009. The decrease in 2011 compared 2010 was primarily due to a \$1.2 million decrease in FDIC premiums resulting from a change in the assessment methodology during 2010 and 2011. In addition, the Bank did not have any Acquisition-related expense during 2011 compared to \$0.4 million incurred during 2010. The Acquisition on October 23, 2009 caused significant increases in many expense categories in 2010 compared to 2009, especially in salary and employee benefits. In addition, \$0.4 million of expenses were associated with the purchase accounting adjustments related to the amortization of the core deposit intangible during 2011 compared to \$0.6 million in 2010 and \$0.1 million in 2009.
- Income tax expense was \$4.7 million in 2011 compared to \$8.4 million in 2010 and \$13.6 million in 2009. The Corporation’s effective tax rate was 33.0% in 2011, 36.9% in 2010 and 38.2 in 2009.

Balance Sheet Summary

- Total loans were \$707.8 million at December 31, 2011, a decrease of \$39.0 million, or 5.2%, from \$746.8 million at December 31, 2010. The decrease in total loans during 2011 was attributable to new business production not offsetting the continued reduction of the Acquired Bank’s loan portfolio. The strategy for acquired loans involves three options: renewal of loans conforming to the underwriting guidelines of the Bank, pay-out of loans not meeting those guidelines or final resolution of impaired loans through a short sale with a cooperative borrower or a foreclosure when other options fail. Renewals neither increase nor decrease the portfolio while the other two options reduce total loans. This strategy, while necessary to integrate or eliminate the acquired loans, limits the Bank’s opportunity for portfolio growth. New loan business must offset both amortization of performing loans and the planned elimination of substandard and non-performing acquired loan balances. The goal is to grow the loan portfolio but marketing efforts by the Bank’s lenders in 2011 were negatively impacted for the third straight year by the sluggish economy.
- Asset quality in the Bank has been negatively affected by the difficult economic conditions from 2008 through 2011 as well as by the Acquired Bank’s loan portfolio. Nonperforming loans, not including purchased credit-impaired loans, were \$22.4 million or 3.2% of total loans at December 31, 2011 compared to \$24.6 million or 3.3% of total loans at December 31, 2010. Net charge offs were \$6.9 million in 2011 and \$3.4 million in 2010. Loans charged off are subject to continuous review and specific efforts are made to achieve maximum recovery of principal, accrued interest and related expenses. At December 31, 2011 the ALL was \$11.0 million compared to \$9.5 million at December 31, 2010. As of December 31, 2011 the ratio of the ALL to total loans was 1.56% compared to a ratio of 1.28% at December 31, 2010. As of December 31, 2011 the acquired credit impaired and non-credit impaired loans had contractually required payments of \$138.5 million and a fair value of \$101.1 million reflecting a discount of \$37.4 million. This compares to contractually required payment of \$195.9 million and a fair value of \$139.3 million reflecting a discount of \$56.6 million at December 31, 2010. The Bank held OREO of \$7.4 million at December 31, 2011 compared to \$5.4 million at December 31, 2010.
- Deposits increased \$52.0 million, or 5.1%, to \$1.07 billion at December 31, 2011. The increase in total deposits during 2011 was attributable to organic growth as the Bank continued its significant marketing activities aimed toward both current customers and potential new customers, especially in the Acquired Bank’s markets of Racine and Kenosha Wisconsin.
- As of December 31, 2011, the Corporation’s Tier 1 leverage ratio was 10.63%, the Tier 1 risk-based capital ratio was 15.84% and the total risk-based capital ratio was 17.08%. All ratios improved from 2010 levels due to the pre-payment of the 2011 dividend in 2010. All of the capital ratios significantly exceed minimum regulatory requirements for the Corporation to be deemed “well capitalized”. A bank is “well capitalized” if it maintains a minimum Tier 1 leverage ratio of 5.0%, a minimum Tier 1 risk based capital ratio of 6.0% and a minimum total risk based capital ratio of 10.0%.

INCOME STATEMENT ANALYSIS

Table 1 provides average balances of interest-earning assets and interest-bearing liabilities, the interest income and expense resulting from each, and the calculated interest rates earned and paid. The table further shows net interest income, interest rate spread, and the net interest margin on a tax-equivalent basis for the years ended December 31, 2011, 2010 and 2009.

Table 1

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

	2011			2010			2009		
	Average Balance	Interest	Yield or Cost	Average Balance	Interest	Yield or Cost	Average Balance	Interest	Yield or Cost
ASSETS									
Interest earning assets:									
Loans ⁽¹⁾	\$ 722,719	\$ 46,958	6.50%	\$ 771,428	\$ 56,722	7.35%	\$ 636,126	\$ 40,125	6.31 %
Taxable investment securities ⁽²⁾	256,707	4,824	1.88%	158,365	3,663	2.31%	72,764	2,827	3.89 %
Non taxable investment securities	47,050	2,102	4.47%	44,452	2,246	5.05%	39,943	2,141	5.36 %
Fed funds sold	25,268	28	0.11%	40,732	61	0.15%	17,885	22	0.12 %
Total interest earning assets	1,051,744	53,912	5.13%	1,014,977	62,692	6.18%	766,718	45,115	5.88 %
Noninterest-earning assets:									
Other assets	66,907			71,890			60,322		
TOTAL ASSETS	\$ 1,118,651			\$ 1,086,867			\$ 827,040		
LIABILITIES AND EQUITY									
Interest-bearing liabilities:									
Transaction accounts	\$ 256,241	\$ 485	0.19%	\$ 247,950	\$ 860	0.35%	\$ 171,761	\$ 981	0.57 %
Money market	199,816	1,011	0.51%	155,195	1,313	0.85%	101,811	1,272	1.25 %
Savings deposits	182,093	379	0.21%	164,378	508	0.31%	142,142	586	0.41 %
Other time deposits	193,147	2,696	1.40%	229,011	3,030	1.32%	165,088	4,084	2.47 %
Short-term borrowing	3,027	13	0.43%	1,583	1	0.06%	6,288	31	0.49 %
Total interest bearing liabilities	834,324	4,584	0.55%	798,117	5,712	0.72%	587,090	6,954	1.18 %
Noninterest bearing liabilities:									
Demand deposits	161,355			156,011			127,301		
Other	5,523			10,346			3,147		
Stockholders' equity	117,449			122,393			109,502		
Total liabilities and stockholders' equity	\$ 1,118,651			\$ 1,086,867			\$ 827,040		
Net interest earnings and interest rate spread ⁽³⁾		\$ 49,328	4.58%	\$ 56,980		5.46%	\$ 38,161		4.70 %
Net interest margin ⁽⁴⁾			4.69 %			5.61%			4.98 %

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

Net Interest Income

Interest income is the Corporation's primary source of revenue. Net interest income is the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing deposits and other borrowings, such as the Fed funds purchased through a correspondent bank. Net interest income is affected by increasing or decreasing interest rates, as well as by the mix and volume of both the interest-earning assets and interest-bearing liabilities. Additionally, the composition and characteristics of such assets and liabilities contribute to the sensitivity of the balance sheet to changes in interest rates. Examples of these characteristics include loans with floating rates tied to an index, such as the Bank's reference rate, and the contractual maturities of loans. Similarly, on the deposit side, the ratio of time deposits to deposits with no stated investment term impacts balance sheet sensitivity.

Net interest income in the consolidated statements of operations (which excludes the tax-equivalent adjustment) was \$48.6 million for 2011, compared to \$56.2 million for 2010. The tax equivalent adjustments (adjustments needed to bring tax-exempt interest to a level that would yield the same after-tax income had that income been subject to taxation using a 34% tax rate) of \$0.6 million for 2011 and \$0.8 million for 2010 resulting in a tax-equivalent net interest income of \$49.3 million and \$57.0 million, respectively.

Table 1 shows tax-equivalent net interest income of \$49.3 million for 2011, a decrease of \$7.7 million or 13.4% from \$57.0 million in 2010. Growth in taxable investment securities more than offset a decline in loans which resulted in an increase in interest-earning assets in 2011 compared to 2010. However, tax-equivalent net interest income declined during the period as the yield on taxable investment securities is significantly less than the yield earned on loans and the yield on the loan portfolio decreased as maturing notes renewed at lower rates. In addition, interest expense on deposits declined in all areas but especially on fixed rate liabilities which continued to reprice downward during 2011. Total interest income decreased \$8.8 million to \$53.9 million in 2011 from \$62.7 million in 2010. Interest income as well as the yield on the loan portfolio was negatively impacted by \$5.8 million of loan discount accretion recognized in 2011 compared to \$9.8 million recognized in 2010, a decrease of \$4.0 million. Management expects the loan discount accretion to continue to decline in future years as loans in the Acquired Bank's loan portfolio continue to pay down, mature, renew or pay off. Interest expense decreased \$1.1 million from \$5.7 million in 2010 to \$4.6 million in 2011. The interest expense and yield on time deposits during 2010 was positively impacted by the purchase accounting related to the amortization of deposit interest premium of \$1.4 million. All of the remaining benefit of this offset to interest expense was fully amortized during 2010 and therefore had no impact in reducing interest expense during 2011. The net effect of the Acquisition-related purchase accounting variances was a year-to-year decrease of \$2.6 million in tax-equivalent net interest income between 2011 and 2010.

Interest income on loans decreased \$9.8 million from \$56.7 million in 2010 to \$46.9 million in 2011, due to a \$48.7 million decrease in average loans, declining yields on the remaining loan portfolio as good customers garner rate concessions on loan renewals during this historically low interest rate environment and a \$4.0 million decrease in loan discount accretion income. When, in the opinion of management, serious doubt exists as to the collectability of a loan, the loan is placed on nonaccrual status and interest previously accrued but unpaid is deducted from interest income on loans. Nonaccrual loans are included in the calculations of both interest rate spread and net interest margin. Interest income on taxable investment securities increased \$1.1 million in 2011 to \$4.8 million from \$3.7 million in 2010. The increase was due to a \$98.3 million increase in the average balances of taxable investment securities from \$158.4 million in 2010 to \$256.7 million in 2011, which more than offset a decreased yield of 43 basis points ("bp," equal to 1/100 of 1 percent) to 1.88% in 2011 from 2.31% in 2010. Interest income on tax-exempt investment securities decreased \$0.1 million in 2011 to \$1.4 million from \$1.5 million in 2010. The decrease was due entirely to a 58bp decrease in yield on such securities as average balances of tax-exempt investment securities increase by \$2.6 million from \$44.4 million in 2010 to \$47.0 million in 2011. For the fourth consecutive year variable rate deposits all re-priced at lower rates while maturing time deposits remained at relatively low levels. Overall funding yields on interest-bearing liabilities decreased 17 bp from 0.72% in 2010 to 0.55% in 2011. The change in yields for all five of the interest-bearing liability categories as shown in Table 1 are as follows:

- Transaction account average yields decreased 16 bp to 0.19% in 2011 from 0.35% in 2010.
- Money market deposit average yields decreased 34 bp to 0.51% in 2011 from 0.85% in 2010.
- Savings deposit average yields including savings sweep accounts decreased 10 bp to 0.21% in 2011 from 0.31% in 2010.
- Time deposit average yields increased 8 bp to 1.40% in 2011 from 1.32% in 2010. Interest expense on time deposits was reduced by \$1.4 million during 2010 due to the amortization of the Acquired Bank's deposit interest premium, which reduced the time deposit yield by 61 bp in 2010.
- Short term rates on Fed funds borrowings continued to be insignificant as the Corporation had very small short-term borrowing balances during 2011.

All four of the deposit categories had a decrease in interest expense in 2011 compared to 2010 despite three out of four categories having increased average balances during the same period. Higher average balances were offset by the dramatic decrease in yields noted above, which caused the decrease in interest expense.

As a result of the changes to yields on interest-earning assets and interest-bearing liabilities the tax-equivalent net interest margin for 2011 was 4.69% compared to 5.61% for 2010. The change is attributable to an 88 bp contribution from a declining interest rate spread (the net effect of a 105 bp decrease on the yields of earning assets and a 17 bp decrease on the rates paid on deposits and borrowed funds) less a 4 bp increased contribution from net free funds. In addition, the benefit to the tax-equivalent net interest margin related to Acquisition-related purchase accounting adjustments decreased from 55 bp during 2011 compared to 110 bp during 2010.

Table 1 also shows tax-equivalent net interest income of \$57.0 million for 2010, an increase of \$18.8 million or 49.3% from \$38.2 million in 2009. The Acquisition led to growth in interest-earning assets resulting in additional tax-equivalent net interest income. In addition, interest expense declined in most areas, but especially on fixed-rate liabilities which continued to reprice downward during 2010. As a result of the changes to yields on interest-earning assets and interest-bearing liabilities the tax-equivalent net interest margin for 2010 was 5.61% compared to 4.98% for 2009. The change is attributable to a 76 bp contribution from an improved interest rate spread (the net effect of a 30 bp increase on the yields of earning assets and a 46 bp decrease in the rates paid on deposits and borrowed funds) less a 13 bp decreased contribution from net free funds. In addition, the tax-equivalent net interest margin related to Acquisition-related purchase accounting adjustments was 110 bp during 2010 compared to 25 bp during 2009.

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

Table 2

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

	2011 Compared to 2010 Increase (Decrease) Due to			2010 Compared to 2009 Increase (Decrease) Due to		
	Volume	Rate(1)	Net	Volume	Rate(1)	Net
Interest earned on:						
Loans	\$ (3,582)	\$ (6,182)	(9,764)	\$ 8,534	\$ 8,064	16,598
Taxable investment securities	2,275	(1,114)	1,161	3,326	(2,490)	836
Non-taxable investment	131	(274)	(143)	242	(138)	104
Fed funds sold	(23)	(10)	(33)	28	11	39
Total interest-earning assets	\$ (1,199)	\$ (7,580)	\$ (8,779)	\$ 12,130	\$ 5,447	\$ 17,577
Interest paid on:						
Transaction accounts	\$ 29	\$ (404)	\$ (375)	\$ 435	\$ (556)	\$ (121)
Money market	378	(680)	(302)	667	(626)	41
Savings deposits	55	(184)	(129)	92	(170)	(78)
Time deposits	(480)	146	(334)	1,595	(2,649)	(1,054)
Short-term borrowings	1	11	12	(23)	(7)	(30)
Total interest-bearing liabilities	\$ (17)	\$ (1,111)	\$ (1,128)	\$ 2,766	\$ (4,008)	\$ (1,242)
Increase (decrease) in net interest income			\$ (7,651)			\$ 18,819

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

Changes due to volume caused tax-equivalent net interest income to decrease by \$1.2 million from 2010 to 2011 while changes due to rate caused a \$7.6 million decrease for the same period, resulting in an aggregate \$8.8 million decrease from 2010 to 2011 in tax equivalent interest earned on total interest-earning assets. For interest paid on total interest-bearing liabilities, there was a nominal decrease due to volume from 2010 to 2011, while changes due to rate decreased funding costs by \$1.1 million, resulting in a decrease of \$1.1 million interest paid on total interest-bearing liabilities. The net effect of the foregoing was a decrease in net interest income of \$7.7 million.

A review of the changes to interest earned due to volume and rate for individual asset categories reveals a decrease due to loan volume of \$3.6 million and a decrease of \$6.2 million due to loan interest rates. From 2010 to 2011, interest earned on taxable investment securities increased \$2.3 million due to volume and decreased \$1.1 million due to rate. Non-taxable investment securities realized increases due to volume that were more than offset by decreases due to rate.

A review of the changes to interest paid on individual liability categories reveals the following trends.

- Lower rates reduced interest paid on transaction accounts by \$0.4 million which was partially offset by a nominal increase due to volume that resulted in a net decrease of \$0.4 million in interest paid on transaction accounts.
- Interest paid on money market accounts decreased \$0.3 million as the decrease due to interest rates of \$0.7 million was partially offset by additional interest of \$0.4 million paid due to increased volume.
- Lower interest rates reduced interest paid on savings accounts by \$0.2 million, partially offset by an increase of \$0.1 million due to volume which resulted in a net decrease of \$0.1 million in interest paid on savings accounts.
- A \$0.2 million increase due to rates paid on time deposits was offset by a \$0.5 million decrease due to volume, resulting in a \$0.3 million net decrease to interest paid on time deposits.
- Net interest paid on short term borrowings increased slightly due to both lower rates and decreased volume.

Changes due to volume caused tax-equivalent net interest income to increase by \$12.1 million from 2009 to 2010 while changes due to rate caused a \$5.5 million increase for the same period, resulting in a net \$17.6 million increase from 2009 to 2010 in tax equivalent interest earned on total interest-earning assets. For interest paid on total interest-bearing liabilities, there was an increase of \$2.8 million due to volume from 2009 to 2010, while changes due to rate decreased funding costs by \$4.0 million, resulting in a net decrease of \$1.2 million interest paid on total interest-bearing liabilities. The net effect of the foregoing was an increase in tax-equivalent net interest income of \$18.8 million.

Provision for Loan Losses

The PLL represents the amount periodically added to the Bank's ALL and charged to earnings in the relevant period. The PLL for 2011 was \$8.4 million, a substantial increase from \$6.9 million in 2010 and \$3.7 million in 2009. The Bank does not engage in lease financing and the PLL expense is entirely the result of estimated loan losses. The increase in the PLL for 2011 compared to 2010 reflected the \$3.4 million increase in net loans charged off which was primarily due to the negative effect of the economic downturn on the Bank's loan portfolio. The increase in the PLL for 2010 compared to 2009 reflected an increase in the ALL due to \$26.2 million in non-credit impaired loans that were renewed since they were acquired in October of 2009. In the quarterly analysis of the ALL, these renewed loans exhibit a higher probability of loss, which is reflected in the ALL.

Net loans charged off (total loans charged off less recoveries of prior loans charged off) for 2011 were \$6.9 million compared to \$3.4 million in 2010 and \$3.6 million in 2009. A significant portion of the net loans charged off in 2010 and 2011 was related to charge-offs over and above the discount applied to the Acquired Bank's loans as part of the purchase accounting fair value adjustments. Net loans charged off as a percent of average loans were 0.95%, 0.45% and 0.57% for 2011, 2010 and 2009, respectively. As of December 31, 2011 the ALL was \$11.0 million compared to \$9.5 million at December 31, 2010 and \$6.0 million at year end 2009. The ratio of the ALL to total loans was 1.56% at December 31, 2011, up from 1.28% at December 31, 2010 and 0.77% at December 31, 2009. As of December 31, 2011 the remaining acquired credit-impaired and non-credit impaired loans had contractually required payments of \$138.6 million and a carrying value of \$101.2 million reflecting a discount of \$37.4 million or 27.0% of the contractually required payments. As of December 31, 2010 the remaining acquired credit-impaired and non-credit impaired loans had contractually required payments of \$195.9 million and a carrying value of \$139.3 million reflecting a discount of \$56.6 million or 28.9% of the contractually required payments. As of December 31, 2009 the acquired credit-impaired and non-credit impaired loans had contractually required payments of \$266.0 million and a carrying value of \$189.5 million reflecting a discount of \$76.5 million or 28.8% of the contractually required payments. These acquired loans had ALL of \$2.2 million and \$1.4 million at December 31, 2011 and December 31, 2010, respectively, reflecting additional impairment over and above the discount. Nonperforming loans, excluding the acquired credit impaired nonperforming loans, at December 31, 2011 were \$22.4 million compared to \$24.6 million at December 31, 2010 and \$15.3 million at December 31, 2009. The elevated levels of nonperforming loans during 2010 and 2011 was due primarily to the prolonged economic downturn.

Table 4 summarizes the ALL at the beginning and end of each of the last five years; changes in the ALL arising from loans charged off and recoveries on loans previously charged-off, by loan category; additions to the allowance that have been charged to expense; and selected performance ratios.

Table 3

**SUMMARY OF LOAN CHARGE OFFS, RECOVERIES
AND PROVISIONS FOR LOAN LOSS
(Dollars in Thousands)**

	For the Years Ended December 31,				
	2011	2010	2009	2008	2007
Balance of allowance for loan losses at beginning of period	\$ 9,527	\$ 6,034	\$ 5,945	\$ 5,758	\$ 5,709
Loans charged-off:					
Commercial	(300)	(57)	(626)	(491)	(143)
Real Estate					
Construction	(256)	(300)	(386)	-	-
Commercial	(1,200)	(964)	(941)	(309)	(100)
Residential	(4,972)	(2,973)	(1,357)	(277)	(178)
Multifamily	(117)	(48)	(293)	-	-
Installment & Consumer	(283)	(209)	(137)	(152)	(176)
Total loans charged-off	<u>(7,128)</u>	<u>(4,551)</u>	<u>(3,740)</u>	<u>(1,229)</u>	<u>(597)</u>
Recoveries of loans previously charged-off:					
Commercial	10	428	20	22	24
Real Estate					
Construction	37	9	-	-	-
Commercial	86	507	33	-	-
Residential	88	113	17	-	-
Multifamily	-	6	-	-	-
Installment & Consumer	22	51	53	94	142
Total Recoveries	<u>243</u>	<u>1,114</u>	<u>123</u>	<u>116</u>	<u>166</u>
Net loans charged-off	(6,885)	(3,437)	(3,617)	(1,113)	(431)
Additions to allowance charged to expense	<u>8,370</u>	<u>6,930</u>	<u>3,706</u>	<u>1,300</u>	<u>480</u>
Balance at end of period	<u>\$ 11,012</u>	<u>\$ 9,527</u>	<u>\$ 6,034</u>	<u>\$ 5,945</u>	<u>\$ 5,758</u>
Ratio of net loans charged-off during the period to average loans outstanding	<u>0.95%</u>	<u>0.45%</u>	<u>0.57%</u>	<u>0.19%</u>	<u>0.08%</u>
Ratio of allowance at end of year to total loans	<u>1.56%</u>	<u>1.28%</u>	<u>0.77%</u>	<u>0.99%</u>	<u>0.98%</u>

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

Non-interest Income

A summary of non-interest income for the years ended December 31, 2009, 2010 and 2011 appears in Table 4 below:

Table 4

NON-INTEREST INCOME (Dollars in Thousands)

	For the Years Ended December 31,		
	2011	2010	2009
Service charges on deposits	\$ 9,987	\$ 10,181	\$ 9,921
Loan servicing income	318	350	(32)
Net gain on sale of loans	1,249	1,421	2,321
Increase in cash surrender value of life insurance	467	472	505
Non-accretable loan discount	2,247	2,269	662
Other income	522	1,784	1,220
Total non-interest income	<u>\$ 14,790</u>	<u>\$ 16,477</u>	<u>\$ 14,597</u>

Total non-interest income was \$14.8 million for 2011, a decrease of \$1.7 million or 10.2% from \$16.5 million in 2010. The decrease was primarily due to a \$1.3 million decrease in other non-interest income resulting from lower gains on the sale of OREO, net of carrying costs, in 2011 compared to 2010. In addition, revenue from service charges and fees on business and retail deposit accounts decreased \$0.2 million primarily driven by the number of accounts and the activity within those accounts. Net gain on sale of loans decreased \$0.2 million to \$1.2 million for 2011 as lower fixed-rate mortgage opportunities continued into 2011, but refinance activity in the secondary mortgage market was not as strong as in 2010. Non-accretable income, which is part of the Acquisition related purchase accounting, decreased \$0.1 million in 2010. This is income related to loans acquired in the Acquisition that were specifically identified as credit impaired loans pursuant to applicable guidance for accounting for acquired loans and were paid or charged off during the year. In future years, non-accretable income will be dependent on the difference between future contractual payments received and the carrying amount of the loans specifically impaired.

Total non-interest income was \$16.5 million for 2010, an increase of \$1.9 million or 12.9% from \$14.6 million in 2009, excluding the non-recurring bargain purchase gain of \$21.5 million in 2009. The increase was primarily due to a \$2.3 million increase in non-accretable income, which is part of the Acquisition-related purchase accounting, an increase of \$0.6 million in other non-interest income and a \$0.4 million increase in loan servicing income, comprising fees generated by payment collection, escrow collection and disbursement for loans serviced for the Federal Home Loan Mortgage Corporation ("FHLMC") and the Federal National Mortgage Association ("FNMA"). These increases were partially offset by a \$0.3 million or 2.6% decrease in revenue from service charges and fees on business and retail deposit accounts and a \$0.9 million decrease in the net gain on sale of loans for 2010, as lower fixed-rate mortgage opportunities continued into 2010, but refinance activity in the secondary mortgage market was not as strong as in 2009.

Non-interest Expense

A summary of non-interest expense for the years ended December 31, 2009, 2010 and 2011 appears in Table 5 below:

Table 5

NON-INTEREST EXPENSE (Dollars in Thousands)

	For the Years Ended December 31,		
	2011	2010	2009
Salaries and employee benefits	\$ 22,037	\$ 22,739	\$ 17,670
Occupancy	4,067	3,959	3,266
Furniture and equipment	1,887	2,201	1,896
Computer services	3,679	3,504	3,227
Advertising and promotional	1,033	1,173	976
Regulatory agency assessments	1,317	2,459	1,099
Office supplies	790	834	718
Acquisition expense	-	370	620
Core deposit intangible amortization	418	568	112
Other expenses	5,597	5,272	4,502
Total non-interest expense	<u>\$ 40,825</u>	<u>\$ 43,079</u>	<u>\$ 34,086</u>

Total non-interest expense for 2011 was \$40.8 million, a decrease of \$2.3 million or 5.2% over 2010, primarily resulting from a \$1.1 million decrease in regulatory assessments resulting from lower FDIC premiums due to a change in the assessment methodology during 2010 and 2011. In addition, salaries employee benefits decreased \$0.7 million or 3.1% due a decrease in bonus payments that was partially offset by both normal wage and salary increases as well as an increase in health insurance costs. Advertising expense decreased \$0.1 million or 13.6% to \$1.0 million in 2011 due to a reduction in special advertising during 2010 related to the integration of the acquisition in October of 2009. The Bank did not have any Acquisition-related expense during 2011 compared to \$0.4 million incurred during 2010. Finally, the Bank had core deposit amortization expense of \$0.4 million in 2011 compared to \$0.6 million in 2010. The core deposit amortization expense will decrease annually until it is fully amortized in 2017. These decreases were partially offset by a \$0.1 million increase in occupancy expenses and a \$0.3 million decrease in equipment expenses in 2011 compared to 2010. In addition, computer service expense increased \$0.2 million due to enhanced services for the Bank and additional new account volume. Finally, other non-interest expenses increased \$0.3 million in 2011.

Total non-interest expense for 2010 was \$43.1 million, an increase of \$9.0 million or 26.4% over 2009. The Acquisition resulted in significant increases across most non-interest expenses in 2010 but had the most significant impact on salary and employee benefits. Salaries and employee benefits increased \$5.1 million or 28.7% to \$22.7 million for 2010 due to the Acquisition, normal wage and salary increases, and an increase in bonus payments. Occupancy expenses increased \$0.7 million for 2010 primarily as a result of increased rent and utility expenses. Equipment expenses increased \$0.3 million and computer service expense increased \$0.3 million for 2010, due to the full-year impact of the Acquisition, enhanced services provided to the Bank and additional new account volume. Advertising expense was increased \$0.2 million in 2010 as the Bank continued to utilize direct mail as its primary marketing vehicle. Regulatory assessments increased significantly from \$1.1 million in 2009 to \$2.5 million in 2010 due to the Acquisition and increased FDIC premium due to increased assessment rates, a special assessment and the run-off of assessment credits used in prior years. In addition, the Bank had core deposit amortization expense of \$0.6 million in 2010 compared to \$0.1 million in 2009. The core deposit amortization expense will decrease annually until it is fully amortized in 2017. Finally, other non-interest expenses increased \$0.8 million in 2010. Nominally offsetting these increases, the Bank incurred lower Acquisition-related expenses of \$0.4 million in 2010 compared to \$0.6 million in 2009.

Income Taxes

Income tax expense was \$4.7 million in 2011 compared to \$8.4 million in 2010 and \$13.6 million in 2009. The Corporation's effective tax rate (income tax expense divided by income before income taxes) was 33.0% in 2011 compared to 36.9% in 2010 and 37.4% in 2009. The decrease in the effective tax rate in 2011 was due to both a true-up of taxes from prior years as well as a decrease in pre-tax income, which increases the effect of permanent non-taxable items on the effective tax rate.

BALANCE SHEET ANALYSIS

Loans

Total loans were \$707.8 million at December 31, 2011, a decrease of \$39.0 million, or 5.2%, from \$746.8 million at December 31, 2010. The decrease in total loans during 2011 was attributable to new business production not offsetting the continued reduction of the Acquired Bank's loan portfolio. The strategy for acquired loans involves three options: renewal of loans conforming to the underwriting guidelines of the Bank, pay-out of loans not meeting those guidelines or final resolution of impaired loans through a short sale with a cooperative borrower or a foreclosure when other options fail. Renewals neither increase nor decrease the portfolio while the other two options reduce total loans. This strategy, while necessary to integrate or eliminate the acquired loans, limits the Bank's opportunity for portfolio growth. New loan business must offset both amortization of performing loans and the planned elimination of substandard and non-performing acquired loan balances. The goal is to grow the loan portfolio but marketing efforts by the Bank's lenders in 2011 were negatively impacted for the third straight year by the sluggish economy.

Loans originated by the Bank are generally loans to small businesses and individuals in the communities served in the Southeastern Wisconsin market. Although the legal lending limit of the Bank was \$19.1 million per borrower as of December 31, 2011, the Bank's larger customers are borrowers with credit needs of \$10 million and less and, in fact, most borrowers' credit relationships total less than \$1 million. At December 31, 2011 there were three relationships in excess of \$10 million with aggregate exposure totaling \$33.8 million, fourteen relationships between \$5.0 and \$10 million with aggregate exposure totaling \$95.9 million and thirty-one relationships between \$2.0 and \$5.0 million with aggregate exposure totaling \$87.0 million. Of these forty-eight relationships with \$216.7 million committed the balance outstanding at December 31, 2011 was \$188.1 million. The remaining \$28.6 million represented unfunded liability on lines of credit to 27 of the borrowers.

As of October 23, 2009 (the "Acquisition Date") the Acquired Bank's loan portfolio was discounted \$85.1 million to reflect the estimated fair value of the acquired loans. Between the Acquisition Date and December 31, 2011 the discount has been significantly reduced as a result of activity in the Acquired Bank's loan portfolio including renewals, amortization, pay-offs and charge-offs. Thus, the Bank's total loans of \$707.8 million at December 31, 2011 include a discount of \$37.4 million reflecting the difference between cash flows expected to be received and contractually required payments on the acquired loans. Credit management to ensure credit quality of the acquired loans as they are integrated into the Bank's portfolio was a priority in 2011 and will remain so until the loans are completely transitioned. The aforementioned \$85.1 million loan portfolio discount was originally allocated to \$279.2 million of acquired (undiscounted) loans at the time of purchase. At December 31, 2011, the undiscounted loan total has been reduced by \$101.6 million as a result of payment, foreclosure or charge-off. Of the remaining undiscounted \$177.6 million, \$39.0 million has been restructured or renewed into the Bank's portfolio. Therefore to completely transition the acquired portfolio into the Bank's portfolio requires resolving \$138.5 million of undiscounted loans with \$37.4 of remaining discount or \$101.1 million of the Bank's \$707.8 portfolio. Management believes the remaining discount will be sufficient to cover the remaining credit losses related to the acquired loans.

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

Table 6

	LOAN PORTFOLIO COMPOSITION (Dollars in Thousands)									
	2011		2010		2009		2008		2007	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commercial, Real estate	\$ 19,956	2.82%	\$ 25,451	3.41%	\$ 28,481	3.62%	\$ 23,552	3.93%	\$ 27,927	4.76%
Construction	46,600	6.58%	55,974	7.49%	65,600	8.33%	47,726	7.96%	44,042	7.51%
Commercial	298,043	42.11%	285,863	38.28%	285,382	36.22%	246,660	41.13%	243,923	41.61%
Residential	288,609	40.78%	319,789	42.82%	349,904	44.41%	232,429	38.76%	227,362	38.78%
Multifamily	39,799	5.62%	41,074	5.50%	38,087	4.83%	35,306	5.89%	28,871	4.93%
Total real estate	673,051	95.09%	702,700	94.09%	738,973	93.79%	562,121	93.74%	544,198	92.83%
Installment and other	14,790	2.09%	18,678	2.50%	20,426	2.59%	13,973	2.33%	14,153	2.41%
Total loans	\$ 707,797	100.00%	\$ 746,829	100.00%	\$ 787,880	100.00%	\$ 599,646	100.00%	\$ 586,278	100.00%

As Table 6 indicates, commercial loans were \$20.0 million at December 31, 2011, down \$5.5 million or 21.6% from December 31, 2010 and comprised 2.8% of the total loan portfolio compared to \$25.5 million comprising 3.4% of the loan portfolio at December 31, 2010. Historically, commercial lending has been a small part of the Bank's portfolio which continues to be the case in 2011. Commercial balances have decreased during these difficult economic times. Reductions of outstanding balances on lines of credit have occurred as well as the demand for term financing as businesses made little, if any, investment in new equipment. Commercial loans are collateralized by general business assets such as accounts receivable, inventory and equipment and have no real estate component. During weak economic periods the Bank can be exposed to heightened risk if a business is out of compliance with debtor covenants supporting commercial loans. The Bank was active in policing such requirements and this segment of loans presents minimal risk going forward.

Real estate construction loans decreased \$9.4 million, or 16.8% to \$46.6 million, representing 6.6% of the total loan portfolio at December 31, 2011, compared to \$56.0 million or 7.5% of the total loan portfolio at December 31, 2010. The decrease from 2010 to 2011 was due primarily to repayment of the Bank's pre-Acquisition construction loan portfolio. New loans to individuals for construction of owner-occupied single family residences and loans to developers that provide financing for the acquisition or development of commercial real estate and residential subdivisions lagged well behind the boom years leading up to 2008. In the challenging climate of today's economy there were no significant new commercial real estate development loans financed by the Bank in 2011. Loans to residential real estate developers comprise most of the dollars outstanding in real estate construction loans. Historically, real estate construction loans have been made to developers who are well known to the Bank, have prior successful project experience and are well capitalized. Loans are made to customers in the Bank's Southeastern Wisconsin market with experience and knowledge of the local economy. Real estate construction loans of this type are generally larger in size and involve greater risks than residential mortgage loans because payments depend on the success of the project or in the case of commercial development, successful management of the property. The Bank will generally make credit extensions to borrowers with adequate outside liquidity to support the project in the event the actual performance is less than projected. Developers with which the Bank does business have the ability to service the development debt personally or through their companies, however, these individuals are not immune to a prolonged weak economy such as the Bank has experienced. Most of the Bank's real estate development loans are performing even three years into the economic downturn and borrowers' inventories are decreasing. The greatest risk to the Bank within this segment are loans secured by raw land and condominium development loans. These two groups have been most severely affected by the prolonged economic downturn. In the case of loans secured by undeveloped acreage, the price per acre has decreased dramatically as other lenders liquidate the collateral on these raw land or "dirt" loans. The Bank has a few customers continuing to service the debt from free cash flow, but this becomes more problematic as the housing market continues a slow recovery or in some cases a non-recovery. In the case of condominium loans, risk factors the Bank inherits upon the failure of a developer include the existence and/or control of the condo association, the availability of term financing to initial buyers of units and partial project completion for common use areas. The Bank does have condominium exposure in several smaller projects to the second developers following foreclosures. These are the Bank's customers who were able to buy incomplete developments at deep discounts from other banks that foreclosed on the original developer in 2010 and 2011. In all cases the selling banks also agreed to fixed-rate mortgage loans to qualified borrowers at prevailing rates to allow the second developer to sell units without the issue of term financing availability.

Commercial real estate loans increased \$12.1 million or 4.3% to \$298.0 million at December 31, 2011, compared to \$285.9 million at December 31, 2010. The increase is due to new business exceeding the portfolio amortization, pay-offs and elimination of nonperforming loans from the Acquisition. This category of loans made up the largest component of the total loan portfolio at 42.1% at December 31 2011 and 38.3% at December 31, 2010. The increase is attributable to an influx of new relationships as well as new projects with current customers which outpaced any run-off from the Acquired loan portfolio. The Bank's commercial real estate lending efforts are focused on owner occupied, improved property such as office buildings, warehouses, small manufacturing operations and retail facilities. The most significant risk factor in the third year of the financial crisis is occupancy. The fact that the Bank prefers owner occupied commercial real estate mitigates that risk, provided of course, the owner's business survives. The Bank's \$19.1 million per-borrower legal lending limit would permit it to compete for activity in the middle market, but management prefers to seek small businesses as its target borrowers. Loans to such businesses are approved based on the creditworthiness, economic feasibility and cash flow abilities of the borrower.

Residential real estate loans which include single family, 2-4 family dwellings and home equity lines of credit or "HELOCs" secured by real estate decreased \$31.2 million or 9.8% to \$288.6 million comprising 40.8% of the Bank's total loan portfolio at December 31, 2011 compared to \$319.8 million comprising 42.8% of the Bank's total loan portfolio at December 31, 2010. The decrease is primarily due to the elimination of nonperforming acquired loans. Loans in this segment of the portfolio have historically represented the lowest risk due to the large number of individual loans with relatively small average balances. The Bank considers owner-occupied one-to-four family loans to be low risk because underwriting has always required 20% equity and qualified borrowers with proper debt service coverage ratios. These loans provide a foundation for the sale of all other retail banking products and have always been a staple of the Bank's portfolio. However, the Acquired Bank's loan portfolio included a number of residential real estate loans that do not meet the Bank's underwriting standards and these borrowers were encouraged to bring loans current, pay delinquent taxes, and comply with the Bank's underwriting standards or refinance at another financial institution or face foreclosure. The greatest risks to the Bank in this segment are those one-to-four family residential real estate loans that are not owner occupied. Many of these scattered site owner's loans were generated by the Acquired Bank through its "Rehab and Go" and "Equity is Cash" programs. Often rehab dollars were not invested in the property, the properties were over-appraised and rental property damage was prevalent but no replacement reserves were required, as would be the case in a commercial real estate loan. The Bank is working to eliminate this group of acquired loans. As a result, the significant portfolio decreases experienced in 2010 and 2011 will continue into 2012. These loans were deeply discounted in the Bank's bid to the FDIC and the Bank believes the credit risk associated with these loans is mitigated by this discount.

Residential real estate loans in the portfolio have historically been originated with maturities of one, two or three years to provide a repricing opportunity to the Bank when rates change. Amortization periods offered to customers are 20-25 years depending on equity and loan-to-value ratios. Customers seeking long term rate locks choose the secondary market products offered by the Bank where rates can be fixed for 15, 20 or 30 years. These loans are then sold and as a result, do not impact the portfolio yields nor are they a factor in interest rate risk. Loans from the Acquisition are either one-, two- or three-year balloons or Adjustable Rate Mortgages ("ARMs"). While ARMs have not been the Bank's vehicle of choice for rate management, they serve the purpose of providing annual rate adjustments after an initial fixed rate period of three to five years. ARM loans from the Acquired Bank residential real estate loan portfolio have been repriced in 2010 and 2011 at the margin (2.625%) prescribed by Freddie Mac over their assigned indices. A typical ARM index is the one year US

Treasury note rate, which decreased to historic lows in 2011. This rate was near 0.25% during the first half of 2011 but decreased to 0.10% for most of the second half of the year resulting in adjusted rates below 3.0% for ARM mortgage customers. Of the variable rate mortgage loans repricable in Table 7, total ARM portfolio yields decreased 124 basis points to 4.78% at December 31, 2011 from 6.02% at December 31, 2010 as a result of these rate decreases. Even with today's low funding costs extremely low rates negatively impact the Bank's net interest margin.

Multi-family real estate loans decreased \$1.3 million or 3.1% to \$39.8 million, representing 5.6% of the total loan portfolio at December 31, 2011 compared to \$41.1 million comprising 5.5% of the total loan portfolio at December 31, 2010. The loans in this category are collateralized by properties with more than four family dwelling units. The Bank has always been conservative in requiring borrowers to be well-qualified and to provide their personal guaranty, as well as insisting on proper debt service coverage ratios and equity sufficient to sustain reasonable debt service in the event of interest rate pressure. Loans in this category typically have maturities of 3, 4 or 5 years and are amortized over 15 to 20 years. While any loan presents risk to the Bank, loans in this segment are performing quite well in the downturn because of the Bank's underwriting criteria and with significant foreclosure activity in the market, many former homeowners are back in the rental market.

In total real estate loans decreased \$29.6 million or 4.2% to \$673.1 million at December 31, 2011 compared to \$702.7 at December 31, 2010 primarily as result of the continued reduction in the Acquired Bank's nonperforming 1-4 family loans. Real estate loans accounted for 95.1% of the Bank's total loan portfolio at December 31, 2011 and compared to 94.1% of the Bank's total loan portfolio at December 31, 2010.

Installment loans decreased \$3.9 million, or 20.8%, to \$14.8 million at December 31, 2011 compared to \$18.7 million at December 31, 2010 and \$20.4 million at December 31, 2009 due to the elimination of acquired loans outpacing new business. These loans consist of auto loans, mobile home loans and unsecured consumer loans which have been decreasing at the Bank for several years. Auto loan volume decreased despite improved new car sales in 2011 because dealer incentive financing makes this non-competitive. The Bank has historically limited its exposure to mobile home loans and unsecured consumer loans. However, the Bank acquired a number of such consumer loans in the Acquisition, many of which continue to perform, despite not meeting the Bank's historical underwriting standards.

To ensure credit quality, overall credit management of portfolio loans in the Bank requires sound loan underwriting and administration, systematic monitoring of existing loans, effective loan review, early identification of problem loans, an adequate ALL and valid non-accrual and charge off policies. As the economy weakened loan underwriting was strengthened at the Bank by reducing delegated authority for lenders in the branch locations to ensure that appropriate standards would be met on every credit request. These precautions were extended through 2011 and deemed necessary as management believed many marketing opportunities were the result of marginally qualified borrowers, both commercial and consumer, attempting to leave their existing bank due to rate pressure, new requirements such as additional collateral or other restrictive terms.

The Bank's loan operations center occupies a facility in the lower level of the West Allis branch, which is centrally located for the suburban and metropolitan Milwaukee offices and provides support to lending officers and loan customers. Loan operations, documentation preparation, servicing and exception tracking take place in this facility. Remote distribution (print-back) of prepared documents to the Bank's branch locations via its wide area telecommunications network has made a positive contribution to loan efficiency since its roll-out and is a key factor in servicing the lenders in the Bank's Racine and Kenosha locations. Document preparation remains a centralized function, but electronic distribution eliminates the need for courier delivery of loan documents to the loan offices. The loan processing department of the Acquired Bank has been absorbed into the Bank's loan operations center. Conversely, retail mortgage functions (other than underwriting, document preparation and data entry) for Freddie Mac and Fannie Mae are performed in Racine for the entire Bank. This post-closing activity fits nicely into a separate group managed by the Bank's senior vice president in charge of loan operations.

The collection practices for the Bank were centralized to more efficiently handle increases in past dues, collection efforts, foreclosures and repossessions from both legacy loans and acquired loans. An executive vice president is now involved daily with debtors, attorneys, bankruptcy trustees, repossession companies, real estate agents and buyers of assets being liquidated. The Bank has three collection divisions reporting to the EVP; commercial loan workouts, retail loan collection and collection of the secondary market real estate loan portfolio serviced by the Bank. Loan losses and recoveries have been previously discussed in the narrative accompanying Table 3. However, it is worth noting the dramatic shift for the Corporation. At December 31, 2008, the Bank had no repossessed business assets, autos or trucks, boats or recreational vehicles in its possession and had only one parcel of foreclosed property, valued at \$109,500. At December 31, 2009, primarily due to the Acquisition, the Bank had 46 properties in OREO with book values aggregating \$4.7 million. At December 31, 2010, the Bank had 49 properties in OREO with book values of \$5.4 million and had 67 properties in OREO with book values of \$7.4 million at December 31, 2011. The increase of \$2.0 million during 2011 is due to the addition of one property for \$3.6 million. However, the effort to work through troubled loans continued at an aggressive pace during 2011, as 20 potential foreclosures/OREO were avoided with short sales of the underlying real estate collateral and 100 properties were liquidated from OREO during 2011. Indicative of the effort is the fact that of the 67 OREO properties at December 31, 2011, only 5 were also on the books as OREO at December 31, 2010. The current centralized structure is the reason collection, repossession and liquidation is efficient. The Bank's goal is to minimize the delay in liquidation. The Bank has used its own officers as the best source for identifying buyers for OREO. A list complete with color photos and summary information is published to all 90 banking officers bi-weekly. Management believes that these officers know which of the Bank's existing customers are in the market for real estate and thus far this strategy has proven successful, accounting for the majority of the properties sold. Management believes the significant number of foreclosure

confirmations and OREO liquidation will continue in 2012.

The loan maturity distribution and interest rate sensitivity as of December 31, 2011 are displayed in Table 7 below. The table displays the maturity distribution by loan classification. Since commercial loans of \$20.0 million and installment loans of \$14.8 million account for only 2.8% and 2.1%, respectively, of the total selected loans, the majority of the Bank's portfolio is collateralized by real estate. Although not displayed in Table 7, \$648.4 million or 91.6% of the total \$707.8 million loan portfolio will reprice within a three year period as a result of the Bank's use of one, two and three year notes as its primary borrowing agreement. Real estate construction loans are typically floating rate loans with one year notes as evidenced by the fact that \$23.1 million, or 49.6%, of loans in this class have maturities within one year. Other real estate mortgage loans are predominantly notes with maturities of five years or less with \$246.5 million, or 34.8%, repricing in one year or less, and an additional \$321.0 million, or 45.4%, maturing in more than one year but less than five years. The remaining \$59.0 million, or 8.3%, of other real estate mortgage loans mature after five years however, most of these loans have a floating or variable rate structure that allows the Bank to reprice the loan after one year through five years.

Table 7

**Maturities for Selected Loan Categories
(Dollars in Thousands)**

	At December 31, 2011			
	After			Total
	Within One Year	One year Through Five years	After Five Years	
Selected loan maturities:				
Commercial	\$ 11,059	\$ 8,880	\$ 17	\$ 19,956
Real estate construction	23,115	23,441	44	46,600
Other real estate mortgage	246,465	321,030	58,956	626,451
Installment and other loans	8,088	6,320	382	14,790
 Total selected loans	 \$ 288,727	 \$ 359,671	 \$ 59,399	 \$ 707,797
 Sensitivity of loans due after one year to changes in interest rates:				
Loans to fixed interest rates		\$ 311,601	\$ 3,250	
Loans at floating/variable interest rates		48,071	56,149	
 Total selected loans		 \$ 359,672	 \$ 59,399	

Allowance for Loan Losses

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

Table 8 summarizes the ALL balances at the beginning and end of each year from 2007 through 2011, changes in the ALL arising from loans charged off and recoveries on loans previously charged-off, additions to the allowance that have been charged to expense and selected performance ratios.

Table 8

SUMMARY OF ALLOWANCE FOR LOAN LOSSES
(Dollars in Thousands)

	For the Year Ended December 31,				
	2011	2010	2009	2008	2007
Balance of allowance for loan losses at beginning of period	\$ 9,527	\$ 6,034	\$ 5,945	\$ 5,758	\$ 5,709
Total loans charged-off	(7,128)	(4,551)	(3,740)	(1,229)	(597)
Total recoveries	243	1,114	123	116	166
Net loans charged-off	(6,885)	(3,437)	(3,617)	(1,113)	(431)
Additions to allowance charged to expense	8,370	6,930	3,706	1,300	480
Balance of allowance for loan losses at end of period	<u>\$ 11,012</u>	<u>\$ 9,527</u>	<u>\$ 6,034</u>	<u>\$ 5,945</u>	<u>\$ 5,758</u>
Total loans	\$ 707,7987	\$ 746,829	\$ 787,880	\$ 599,646	\$ 586,278
Total nonperforming loans ⁽¹⁾	\$ 22,405	\$ 24,615	\$ 15,328	\$ 8,613	\$ 5,612
Ratio of allowance for loan losses to total nonperforming loans	49.15%	38.70%	39.37%	69.02%	102.60%
Ratio of nonperforming loans to total loans	3.17%	3.30%	1.95%	1.44%	0.96%
Ratio of nonperforming assets to total assets	2.49%	2.63%	1.78%	1.10%	0.71%
Ratio of net loans charged-off during the period to average loans outstanding	0.95%	0.45%	0.57%	0.19%	0.07%
Ratio of allowance at end of year to total loans	1.56%	1.28%	0.77%	0.99%	0.98%

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

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

At December 31, 2011, the ALL was \$11.0 million, compared to \$9.5 million at December 31, 2010. As of December 31, 2011, the ratio of the ALL to total loans was 1.56% and covered 49.2% of nonperforming loans, compared to a ratio of 1.28% covering 38.7% of nonperforming loans at December 31, 2010. The increase in the ratio of ALL to total loans during 2011 was due to both an increase in the ALL as well as a decrease in total loans. Nonperforming loans, not including the acquired credit impaired nonperforming loans, were \$22.4 million, or 3.2% of total loans as of December 31, 2011, compared to \$24.6 million, or 3.3% of total loans at December 31, 2010. Total interest income that was accrued but never recorded as income on loans on non-accrual was \$2.7 million at December 31, 2011 and \$3.2 million at December 31, 2010. Net charge offs were \$6.9 million and \$3.4 million for 2011 and 2010, respectively. Loans charged-off are subject to continuous review and specific efforts are taken to achieve maximum recovery of principal, accrued interest and related expenses.

Table 9 summarizes the components of the ALL at December 31, 2011, 2010 2009, 2008 and 2007. Because assumptions and conditions used to estimate the ALL are subject to change, the components shown in Table 9 are not necessarily indicative of the trend of future loan losses in any particular loan category. The Bank's loans have historically been predominantly collateralized by real estate as shown in Table 6.

Table 9

ALLOWANCE FOR LOAN LOSS COMPONENTS
(Dollars in Thousands)

	December 31, 2011		December 31, 2010		December 31, 2009		December 31, 2008		December 31, 2007	
	Amount	% of Loans in each Category	Amount	% of Loans in each Category	Amount	% of Loans in each Category	Amount	% of Loans in each Category	Amount	% of Loans in each Category
Commercial, industrial, agricultural	\$ 165	2.8%	\$ 413	3.4%	\$ 340	3.6%	\$ 242	3.9%	\$ 467	4.8%
Real Estate										
Construction	586	6.6%	448	7.5%	518	8.4%	1,268	8.0%	837	7.5%
Commercial	3,730	42.1%	2,738	38.3%	1,712	36.2%	2,231	41.1%	2,756	41.6%
Residential	5,776	40.8%	4,594	42.8%	3,159	44.4%	2,134	38.8%	1,627	38.8%
Multifamily	595	5.6%	1,011	5.5%	245	4.8%	-	5.9%	-	4.9%
Installment loans to individuals	160	2.1%	242	2.5%	60	2.3%	70	2.3%	71	2.4%
Other Loans	-	-%	81	0.0%	-	0.3%	-	0.0%	-	0.0%
Total	\$ 11,012	100%	\$ 9,527	100.0%	\$ 6,034	100.0%	\$ 5,945	100.0%	\$ 5,758	100.0%

At December 31, 2011, as can be seen in Table 9 above, \$0.2 million of the ALL was allocated to potential losses on commercial, industrial or agricultural loans as a result of management's analysis of commercial loans that comprise 2.8% of total loans in the Bank's portfolio. This allocation represents a decrease of \$0.2 million from \$0.4 million at December 31, 2010 when the commercial category represented 3.4% of total loans. At December 31, 2011, \$0.6 million of the ALL was allocated to potential losses on real estate construction financing, an increase of \$0.1 million from \$0.5 million at December 31, 2010. Real estate construction financing represents 6.6% of total loans at December 31, 2011 compared to 7.5% of total loans at December 31, 2010. At December 31, 2011, \$3.7 million of the ALL was allocated to potential losses from commercial real estate loans, an increase of \$1.0 million from \$2.7 million at December 31, 2010. Commercial property in the market served by the Bank continued to struggle in 2011 warranting this increase. In addition, commercial real estate mortgage loans represented 42.1% of total loans at December 31, 2011, up from 38.3% at December 31, 2010. At December 31, 2011, \$5.8 million of the ALL was allocated to potential losses on residential real estate loans comprising 40.8% of total loans in the Bank's portfolio. This allocation represents an increase of \$1.2 million from \$4.6 million at December 31, 2010, when residential real estate mortgage loans represented 42.8% of total loans. As the economic slowdown persisted in 2011, management identified home mortgages requiring an additional reserve. The Bank works with borrowers where possible to restructure and avoid foreclosure. At December 31, 2011, \$0.6 million of the ALL was allocated to potential losses from multifamily real estate loans, a decrease of \$0.4 million from \$1.0 million at December 31, 2010. Multifamily real estate mortgage loans represented 5.6% of total loans at December 31, 2011 up from 5.5% at December 31, 2010. At December 31, 2011 the reserve for installment loans to individuals remained at \$0.2 million of the total ALL. Installment loans represented 2.1% of total loans at the Bank in 2011, down from 2.5% in 2010.

Total loans decreased during 2011 as the acquired loan portfolio issues were addressed and the bank maintained its historical conservative underwriting standards. Credit administration continues to remain a high priority, with management monitoring the Corporation's loan portfolio to identify potential loan loss situations and to address any weaknesses promptly. This will continue to be important going forward given the historical weak underwriting standards implicit in the loan portfolio of the Acquired Bank. Management believes the ALL to be adequate at December 31, 2011.

Potential Problem Loans

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

The determination as to the classification of assets and the amount of valuation allowance is subject to review by the Bank's regulator, the Office of the Comptroller of the Currency (the "OCC"), which can order the establishment of additional general or specific loss allowances. There can be no assurance that regulators, in reviewing the Bank's loan portfolio, will not request the Bank to materially adjust its allowance for loan losses. The OCC, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the ALLs. The policy statement provides guidance for financial institutions on both the responsibilities of management for

the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that (1) institutions have effective systems and controls to identify, monitor and address asset quality problems; (2) management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and (3) management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Management believes it has established an adequate ALL. The Bank analyzes its process regularly, with modifications made if needed, and reports those results four times per year at meetings of the Board of Directors. Although management believes that adequate specific and general loan loss allowances have been established, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary.

Investment Securities Portfolio

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

Table 10

INVESTMENT SECURITIES PORTFOLIO (Dollars in Thousands)

	December 31,					
	2011		2010		2009	
	Amortized Cost	Percentage of Total	Amortized Cost	Percentage of Total	Amortized Cost	Percentage of Total
Obligations of:						
States and political subdivisions (tax exempt)	\$ 51,028	14.2%	\$ 41,292	18.1%	\$ 42,834	22.6%
States and political subdivisions (taxable)	12,118	3.4%	10,023	4.4%	2,435	1.3%
U.S. government sponsored entities	261,602	72.6%	176,389	77.4%	144,270	76.0%
Collateralized mortgage obligations	17,069	4.7%	-	-%	-	-%
Mortgage-backed securities	18,699	5.1%	-	-%	-	-%
Other	50	-%	100	0.1%	250	0.1%
Total investment securities	<u>\$ 360,566</u>	<u>100.0%</u>	<u>\$ 227,804</u>	<u>100.0%</u>	<u>\$ 189,789</u>	<u>100.0%</u>
Fair value of investment securities	\$ 363,252		\$ 227,277		\$ 191,485	
Total assets at year end	\$ 1,215,143		\$ 1,141,687		\$ 1,125,709	
Average earning assets	\$ 1,051,744		\$ 1,014,977		\$ 766,717	

The total investment securities portfolio increased \$132.8 million or 58.3% to \$360.6 million at December 31, 2011 compared to \$227.8 million at December 31, 2010. At December 31, 2011, the total carrying value of investment securities represented 29.7% of total assets, compared to 20.0% at December 31, 2010. The increase in the investment securities portfolio during 2011 was due to the reinvestment of excess liquidity created by deposit growth and a decline in total loan balances during the year.

States and political subdivisions (tax-exempt) investment securities increased \$9.7 million or 23.6% to \$51.0 million at December 31, 2011 compared to \$41.3 million at December 31, 2010. States and political subdivisions (taxable) investment securities increased \$2.1 million or 20.9% to \$12.1 million at December 31, 2011 compared to \$10.0 million at year end 2010. Municipal investments (tax-exempt and taxable) represent 17.6% of total investment securities at December 31, 2011 compared to 22.5% at December 31, 2010. Management maintains overall quality as well as addresses its asset/liability management concerns by limiting purchases to rated investments of high quality or, on a limited basis, to well known local non-rated issues. Diversity in the securities portfolio is maintained by limiting the amount of investment to any single debtor in the municipal category. At December 31, 2011, the Bank's securities portfolio did not contain any obligations of any single issuer that were payable by the same source of revenue or taxing authority where the aggregate carrying value of such securities exceeded 2.7% of stockholders' equity.

Investments in securities of U.S. government sponsored entities (“GSEs”) increased \$85.2 million to \$261.6 million at December 31, 2011 compared to \$176.4 million at year end 2010. Investments include four GSEs; the Federal Farm Credit Bank, the Federal Home Loan Bank, the Federal National Mortgage Association (“Fannie Mae”), and the Federal Home Loan Mortgage Corporation (“Freddie Mac”). Investments in GSE securities represented 72.6% of total investment securities at December 31, 2011 compared to 77.4% in 2010. Many of the GSEs purchased during 2011 represented relatively attractive yields initially with step-up features in which the yields are scheduled to increase in future periods. Step-up provides the Bank the advantage of increasing yields in a rising rate environment. The issuer receives the advantage of a call option in return and therefore the ability to reprice the security in a falling rate environment. In 2011 the Bank’s portfolio experienced numerous calls as rates declined during the year. GSEs such as Fannie Mae and Freddie Mac are not explicitly guaranteed by the U.S. government. The U.S. government has, however, provided unlimited support to both entities since 2009. The Federal Home Loan Bank and the Federal Farm Credit Bank are also GSEs. To date neither of these GSEs has required support from the U.S. Government.

The Corporation diversified the investment portfolio in 2011 through the purchase of \$17.1 million of collateralized mortgage obligations and \$18.7 million of mortgage-backed securities. These investments are guaranteed by Fannie Mae, Freddie Mac and the Government National Mortgage Association (“Ginnie Mae”). Investments in collateralized mortgage obligations and mortgage-backed securities represented 4.7% and 5.1%, respectively, of the investment portfolio as of December 31, 2011. These bonds are structured to return principal in a principal window significantly shorter than the maturity of the underlying mortgages. The average life of the securities purchased is four to six years. The cash flow will enhance the yield of the investment portfolio when interest rates rise as the economy strengthens.

The following table sets forth the maturities of investment securities at December 31, 2011, the weighted average yields of such securities (calculated on the basis of the cost and effective yields weighted for the scheduled maturity of each security) and the tax-equivalent adjustment used in calculating the yields.

Table 11

**INVESTMENT SECURITIES PORTFOLIO MATURITY DISTRIBUTION
(Dollars in Thousands)**

	Within One Year		After One Within Five Years		More Than Five Years	
	Amount	Yield	Amount	Yield	Amount	Yield
Obligations of:						
States and political subdivisions (tax-exempt)	\$ 5,824	5.28%	\$ 29,301	4.41%	\$ 15,903	3.72%
States and political subdivision (taxable)	2,086	1.98%	7,457	2.47%	2,575	2.52%
U.S. government sponsored entities	-	-%	35,000	1.46%	226,602	2.08%
Collateralized mortgage obligations	-	-%	14,975	2.07%	2,094	2.37%
Mortgage-backed securities	-	-	11,534	2.58%	7,166	2.41%
Corporate entities	50	2.57%	-	-%	-	-%
	<u>\$ 7,960</u>		<u>\$ 98,267</u>		<u>\$ 254,340</u>	
Tax equivalent adjustment for calculation of yield	\$ 118		\$ 446		\$ 196	

Note: The weighted average yields on tax-exempt obligations have been computed on a fully tax-equivalent basis assuming a tax rate of 34%.

As indicated in Table 11, \$8.0 million or 2.2% of total investment securities mature within one year. An additional \$98.3 million or 27.3% matures after one year and within five years. The remaining \$254.3 million or 70.6% have stated maturities extending beyond 5 years. Expected maturities will differ from contractual maturities, as borrowers may have the right to call or repay obligations with or without call or prepayment penalties. Many of the GSEs purchased during 2011 have step-up features in which the interest rate paid on the security is scheduled to increase in future years. While these GSEs securities have an average stated maturity of 7.8 years, all of the GSEs securities are callable by the issuers. In addition, many of the collateralized mortgage obligations and mortgage backed securities have long stated maturities but have estimated average lives of 4.3 years and 3.9 years, respectively.

Deposits

Deposits are the Bank's largest source of funds. The Bank competes in Southeastern Wisconsin with other financial institutions such as banks, thrifts and credit unions, as well as non-bank institutions, for retail and commercial deposits. The Bank continues to market its checking accounts and had continued success in 2011 with completely free checking (non-interest-bearing), several options for interest-bearing checking and for Investor Checking, a tiered product. The interest-bearing checking options offered are desirable to the Bank as low cost core deposit growth. Depositors earn interest, but the yields paid on these products are low compared to other funding costs.

Table 12

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

	2011		2010		2009	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing demand deposits	\$ 161,355	-%	\$ 156,011	-%	\$ 127,301	-%
Transaction Accounts	256,241	0.19%	247,950	0.35%	171,761	0.57%
Money Market Accounts	199,816	0.51%	155,195	0.85%	101,811	1.25%
Savings	182,093	0.21%	164,378	0.31%	142,142	0.41%
Time deposits (excluding time certificates of deposit of \$100,000 or more)	120,793	1.41%	124,966	1.35%	65,039	4.47%
Time deposits (\$100,000 or more)	72,354	1.38%	104,045	1.30%	100,049	1.51%
	<u>\$ 992,652</u>		<u>\$ 952,545</u>		<u>\$ 708,103</u>	

For the year ended December 31, 2011 average daily deposits were \$992.7 million, an increase of \$40.1 million or 4.0% over \$952.6 million at December 31, 2010. The Bank continued to have substantial organic deposit growth across most of the branches, including those that it acquired, due to a strong product line, convenient hours and locations, and successful marketing campaigns.

Average non-interest-bearing demand deposits increased \$5.4 million or 3.4% to \$161.4 million at December 31, 2011 compared to \$156.0 million at December 31, 2010 as many customers opted for the safety of a fully guaranteed deposit solution over the nominal returns they would receive in an interest-bearing transaction account.

Transaction accounts consist of interest-bearing checking held by individuals, municipalities, non-profit organizations and sole proprietorships. Average transaction accounts increased \$8.3 million or 3.3% to \$256.2 million at December 31, 2011 compared to \$247.9 million on December 31, 2010. The blended rate for all transaction accounts in 2011 was 0.19% a decrease of 16 bp from 0.35% in 2010.

The daily average balance of money market deposit accounts increased \$44.6 million or 28.8% to \$199.8 million for 2011 compared to \$155.2 million in 2010. The increase in money market accounts during 2011 is due to the relatively attractive interest rates paid on this product compared to certain transaction accounts and longer term certificates of deposits. The yield on money market deposits decreased 34 bp to 0.51% for 2011 from 0.85% in 2010.

The daily average balance of savings accounts increased \$17.7 million or 10.8% to \$182.1 million for the year ended December 31, 2011 from \$164.4 million at December 31, 2010. The yield on basic savings was 0.15% in 2011 and 0.20% in 2010. Savings sweep accounts for businesses increased the blended savings yields to 0.21% and 0.31% for 2011 and 2010, respectively. The sweep rates are tied to the Fed funds rate and vary as that index moves.

The daily average balance of time deposits decreased by \$35.9 million, or 15.7% to \$193.1 million at December 31, 2011, from \$229.0 million at December 31, 2010. The decline was primarily due to deposits moving from fixed rate products with longer terms into floating interest rate products, such as money market accounts given the very low rates available in 2011. Within that total, time deposits \$100,000 or more decreased \$31.6 million or 30.5% to \$72.4 million at year-end 2011 from \$104.0 million at December 31, 2010. The yield on time deposits \$100,000 or more was 1.38% in 2011, up from 1.30% in 2010. The average yields increased as there was a higher proportion of longer term CD's with higher interest rates relative to the previous year. Time deposits less than \$100,000 decreased \$4.2 million or 3.3% to \$120.8 million at year-end 2011 from \$125.0 million at December 31, 2010. The yield on time deposits less than \$100,000 was 1.41% in 2011, up from 1.35% in 2010. The increase in the yield on time deposits less than \$100,000 was due to interest expense being reduced by \$1.4 million in 2010 due to the amortization of the deposit premium associated with the Acquisition. The premium was fully amortized during 2010 and therefore did not reduce interest expense in 2011.

A total of \$10.0 million or 13.8% of time deposits in amounts \$100,000 or more mature in three months or less, an additional \$17.1 million or 23.6% mature between 3 and 6 months, and \$23.6 million or 32.6% mature between 6 and 12 months, making the total maturing in one year or less \$50.7 million or 70.0%, as shown in Table 13 below. As a result, these investments earn a lower yield (being

on the short end of a normal yield curve) and because they mature faster, renew at lower rates given the relatively low interest rate environment of 2010. As shown in Table 12 above, the yield on time deposits excluding time deposits of \$100,000 or more was 1.41% in 2011, up from 1.30% in 2010. Certificate of deposits less than \$100,000 have a more even maturity distribution from short term to 60 months, which is the longest investment term offered by the Bank. Therefore, these depositors earn higher rates as deposits are spread evenly throughout the yield curve and do not reprice at lower rates as quickly.

The Bank has no brokered certificates of deposit and does not participate in any CDars programs. Certificate of deposits of \$100,000 or more are generally drawn from the Bank's market and from its customers. Core deposits are crucial to the success of a financial institution and the Corporation considers these certificates of deposit in amounts of \$100,000 or more to be core deposits.

Table 13

**MATURITY DISTRIBUTION
TIME DEPOSITS IN AMOUNTS OF \$100,000 AND OVER
(Dollars in Thousands)**

		December 31, 2011
Three months or less	\$	9,951
After 3 through 6 months		17,105
After 6 through 12 months		23,627
After 1 year through 2 years		10,811
After 2 years through 3 years		3,962
After 3 years through 4 years		4,342
After 4 years through 6 years		2,556
	\$	72,354

Liquidity

The objective of liquidity management is to ensure that the Corporation and the Bank have the ability to generate sufficient cash or cash equivalents in a timely and cost efficient manner to meet commitments as they come due. Funds are available from a number of sources, primarily from core deposits and loan and security repayments and/or maturities. If needed, additional liquidity can be obtained from the sale of portfolio securities or loans, lines of credit with major banks and the acquisition of deposits.

It has been management's practice not to sell portfolio loans or securities prior to maturity. The use of available credit facilities has been the principal source of liquidity when needed. At December 31, 2011, the Bank has a combined \$50.0 million approved Fed funds purchased facility with two correspondent banks. There were no Fed funds purchased outstanding at December 31, 2011 or 2010. Management has avoided the use of brokered deposits; however the Bank has, through its normal day-to-day activity, developed deposit relationships with a number of local government entities and has pledged securities and loans to these depositors to meet their collateral requirements. The Bank continues to attract deposits by offering competitive deposit rates and by offering a high level of service with extended hours, seven days per week banking and forty-four locations in Southeastern Wisconsin.

Other sources of liquidity consist of accounts due to the Federal Reserve Bank under a \$7,000,000 treasury, tax and loan depository agreement. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature on demand. The Bank did not have any Treasury, tax and loan account balances outstanding as of December 31, 2011. Treasury, tax and loan account balances totaled \$4.8 million at December 31, 2010. Such accounts generally are repaid within one to 120 days from the transaction date and are collateralized by a pledge of investment securities with a carrying value of \$7.0 million and \$7.2 million at December 31, 2011 and 2010, respectively.

The Bank may also borrow through securities sold under repurchase agreements (reverse repurchase agreements). Reverse repurchase agreements, which are classified as secured borrowings, generally mature within one to four days from the transaction date. They are reflected at the amount of cash received in connection with the transaction. The Bank had no borrowings outstanding under reverse repurchase agreements at December 31, 2011 and 2010, respectively and, accordingly, did not pledge any U.S. government -sponsored entity securities municipal obligations as collateral under its master repurchase agreement as of those dates. At December 31, 2011, however, the Bank could pledge up to \$182.9 million of securities as collateral under the existing agreements if needed to obtain additional borrowings. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. The Bank may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of \$52,708,500 and \$74,412,000 as of December 31, 2011 and 2010, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling \$58,565,000 and \$82,680,000 as of December 31, 2011 and 2010, respectively.

Capital

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

Table 14

CAPITAL
(Dollars and Share Numbers in Thousands)

	December 31,		
	2011	2010	2009
Total stockholders' equity	\$ 121,980	\$ 114,335	\$ 121,396
Tier 1 capital	\$ 120,816	\$ 112,741	\$ 119,226
Total capital	\$ 130,371	\$ 122,268	\$ 125,260
Book value per common share	\$ 13.70	\$ 12.84	\$ 13.63
Cash dividends declared per common share	\$ 0.21	\$ 2.40	\$ 1.08
Equity to assets ratio	10.50%	10.01%	10.78%
Tier 1 leverage ratio	10.63%	10.37%	12.03%
Tier 1 risk-based capital ratio	15.84%	14.52%	15.09%
Total risk-based capital ratio	17.08%	15.75%	15.86%
Shares outstanding (period end)	8,905	8,905	8,905
Basic shares outstanding (average)	8,905	8,905	8,905
Diluted shares outstanding (average)	8,905	8,905	8,905

Total stockholders' equity at December 31, 2011 increased \$7.7 million to \$122.0 million, or \$13.70 book value per common share compared with \$114.3 million, or \$12.84 book value per common share at December 31, 2010.

The increase in stockholders' equity during 2011 was the result of only one regular quarterly dividend declaration being made during 2011, as the Corporation declared a special dividend of \$1.20 per share paid on December 10, 2010 to shareholders of record date at November 30, 2010. This dividend was intended to prepay 2011 dividends due to the possibility of less favorable tax treatment of dividend income in 2011. As a result of the dividend paid in December 2010, the Board eliminated dividend payments for all of 2011. At the December 2011 meeting the Board resumed quarterly dividends by declaring a dividend of \$0.21 per share payable January 13, 2012 to shareholders of record January 3, 2012. The Board will continue to review earnings, monitor regulatory developments and consider other appropriate factors relative to declaring future dividends. Stockholders' equity to assets at December 31, 2011 was 10.50%, up from 10.01% at December 31, 2010. The increase was due to the growth in retained earnings exceeding dividends declared during 2011.

As previously discussed, there were no cash dividends paid during 2011 compared to \$2.40 per share of cash dividends paid in 2010 which consisted of regular dividends of \$1.20 per share and a special pre-paid dividend of \$1.20 per share.

As of December 31, 2011 the Corporation's Tier 1 leverage ratio was 10.63% compared to 10.37% at December 31, 2010. Tier 1 risk-based capital ratios were 15.84% and 14.52% at December 31, 2011 and 2010, respectively, and total risk-based capital ratios were 17.08% and 15.86% at December 31, 2011 and 2010, respectively. All ratios are significantly in excess of minimum regulatory requirements. A bank is "well capitalized" if it maintains a minimum Tier 1 leverage ratio of 5.0%, a minimum Tier 1 risk based capital ratio of 6.0% and a minimum total risk based capital ratio of 10.0%. Earnings continue to be stable and provide sufficient capital retention for anticipated growth. Management believes that the Corporation has a strong capital position and is positioned to take advantage of opportunities for profitable geographic and product expansion, and to provide depositor and investor confidence. Management actively reviews capital strategies for the Corporation and each of its subsidiaries in light of perceived business risks, future growth opportunities, industry standards and regulatory requirements.

Off-Balance Sheet Arrangements

The Bank uses certain derivative financial instruments to meet the ongoing credit needs of its customers and to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit and forward loan sale commitments. The Bank does not use interest rate contracts (e.g. swaps, caps or floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2011 or 2010. The Bank, through its normal operations, does have loan commitments and standby letters of credit outstanding as of December 31, 2011 and December 31, 2010 in the amount of \$109.9 million and \$110.3 million, respectively. These items are further explained in Note 15 of Notes to Consolidated Financial Statements.

Table 15

CONTRACTUAL OBLIGATIONS
PAYMENTS DUE BY PERIOD AT DECEMBER 31, 2011
(Dollars in Thousands)

	<u>Total</u>	<u>Less One One Year</u>	<u>One to Three Years</u>	<u>Three to Five Years</u>	<u>More than Five Years</u>
Certificates of Deposit and other time deposits	\$ 179,660	\$ 134,028	\$ 33,004	\$ 12,628	\$ -
Short-term debt obligations	-	-	-	-	-
Minimum operating lease obligations	<u>4,676</u>	<u>1,120</u>	<u>2,084</u>	<u>954</u>	<u>518</u>
Total	\$ <u>184,336</u>	\$ <u>135,148</u>	\$ <u>35,088</u>	\$ <u>13,582</u>	\$ <u>518</u>

Quantitative and Qualitative Disclosures about Market Risk

Market risk arises from exposure to changes in interest rates, exchange rates, commodity prices, and other relevant market rate or price risk. Market risk in the form of interest rate risk is measured and managed through the asset/liability management system. The Bank uses financial modeling techniques that measure the sensitivity of future earnings due to changing rate environments. Policies approved by the Board of Directors limit exposure of earnings at risk. General interest rate movements are used to develop sensitivity models and monitor earnings at risk. These limits are based on the Bank's exposure to a 100 bp and 200 bp immediate and sustained parallel rate move, either upward or downward.

The Bank's primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk. All of the Bank's transactions are denominated in U.S. dollars, with no specific foreign exchange exposure.

Interest Rate Risk

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

When assessing IRR, the Bank seeks to ensure that appropriate policies, procedures, management information systems and internal controls are in place to maintain IRR at prudent levels with consistency and continuity.

Evaluating the quantitative level of IRR exposure requires the Bank to assess the existing and potential future effects of changes in interest rates on its consolidated financial condition, including capital adequacy, earnings, liquidity and, where appropriate, asset quality.

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

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

In order to measure earnings sensitivity to changing rates, the Bank uses two different measurement tools: static gap analysis, and simulation of earnings. The static gap analysis starts with contractual repricing information for assets and liabilities. These items are then combined with repricing estimations for administered rate (interest-bearing demand deposits, savings, and money market accounts) and non-rate related products (demand deposit accounts, other assets and other liabilities) to create a baseline repricing balance sheet. In addition to the contractual information, residential mortgage whole loan products are adjusted based on industry estimates of prepayment speeds that capture the expected prepayment of principal above the contractual amount.

At December 31, 2011, the Bank's balance sheet was asset sensitive to interest rate movements for principal amounts maturing in one year. Asset sensitive means that assets will reprice faster than liabilities. In a rising rate environment, an asset sensitive bank will generally benefit. Liability sensitive means interest-bearing deposits will reprice faster than assets. In a rising rate environment a liability sensitive bank will generally not benefit.

Table 16

TRI CITY BANKSHARES CORPORATION
QUANTITATIVE DISCLOSURES OF MARKET RISK
December 31, 2011
(Dollars in Thousands)

	Principal Amount Maturing in:							Fair Value 12/31/11
	2012	2013	2014	2015	2016	Thereafter	Total	
Rate-sensitive assets:								
Fixed interest rate loans	\$ 204,333	\$ 145,761	\$ 130,170	\$ 17,575	\$ 20,119	\$ 7,204	\$ 525,162	\$ 528,433
Average interest rate	5.53%	6.01%	5.89%	5.75%	5.04%	5.75%	5.74%	
Variable interest rate loans	\$ 87,523	\$ 23,107	\$ 21,928	\$ 1,423	\$ 1,613	\$ 47,421	\$ 183,015	\$ 184,155
Average interest rate	4.11%	4.70%	4.24%	6.39%	5.39%	4.55%	4.34%	
Fixed interest rate securities	\$ 7,958	\$ 27,151	\$ 8,923	\$ 18,260	\$ 33,934	\$ 108,590	\$ 204,816	\$ 207,395
Average interest rate	4.51%	2.68%	4.53%	3.13%	2.19%	2.33%	2.60%	
Variable interest rate securities	\$ -	\$ -	\$ -	\$ -	\$ 10,000	\$ 145,750	\$ 155,750	\$ 156,018
Average interest rate	-%	-%	-%	-%	.75%	1.96%	1.88%	
Other interest bearing assets	\$ 55,121	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 55,121	\$ 55,121
Average interest rate	.11%	-%	-%	-%	-%	-%	.11%	
Rate-sensitive liabilities								
Savings and interest bearing checking	\$ 714,052	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 714,052	\$ 714,052
Average interest rate	.30%	-%	-%	-%	-%	-%	.30%	
Time deposits	\$ 134,028	\$ 25,630	\$ 7,374	\$ 6,907	\$ 5,721	\$ -	\$ 179,660	\$ 178,237
Average interest rate	.89%	2.17%	1.87%	2.09%	1.81%	-%	1.19%	
Variable interest rate								
Borrowings	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Average interest rate	-%	-%	-%	-%	-%	-%	-%	

TRI CITY BANKSHARES CORPORATION
QUANTITATIVE DISCLOSURES OF MARKET RISK
December 31, 2010
(Dollars in Thousands)

	Principal Amount Maturing in:						Fair Value 12/31/10	
	2011	2012	2013	2014	2015	Thereafter		Total
Rate-sensitive assets:								
Fixed interest rate loans	\$ 231,756	\$ 122,142	\$ 151,804	\$ 19,135	\$ 9,307	\$ 10,634	\$ 544,778	\$ 550,290
Average interest rate	6.44%	6.69%	6.53%	6.30%	6.47%	5.87%	6.51%	
Variable interest rate loans	\$ 90,376	\$ 14,458	\$ 16,326	\$ 9,806	\$ 1,418	\$ 69,667	\$ 202,051	\$ 204,095
Average interest rate	4.52%	4.67%	4.87%	4.47%	6.97%	6.20%	5.15%	
Fixed interest rate securities	\$ 51,474	\$ 11,778	\$ 16,459	\$ 8,175	\$ 10,235	\$ 8,593	\$ 106,714	\$ 108,137
Average interest rate	1.51%	2.63%	1.73%	3.15%	1.66%	1.60%	1.81%	
Variable interest rate securities	\$ -	\$ -	\$ 20,000	\$ -	\$ 20,000	\$ 81,090	\$ 121,090	\$ 119,139
Average interest rate	-%	-%	.50%	-%	1.00%	1.22%	1.06%	
Other interest bearing assets	\$ 88,222	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 88,222	\$ 88,222
Average interest rate	0.15%	-%	-%	-%	-%	-%	0.15%	
Rate-sensitive liabilities								
Savings and interest bearing checking	\$ 644,240	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 644,240	\$ 644,240
Average interest rate	0.47%	-%	-%	-%	-%	-%	0.47%	
Time deposits	\$ 174,628	\$ 15,770	\$ 11,030	\$ 2,959	\$ 6,699	\$ -	\$ 211,086	\$ 208,848
Average interest rate	1.36%	2.15%	3.91%	2.87%	2.20%	-%	1.60%	
Variable interest rate								
Borrowings	\$ 4,816	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,816	\$ 4,816
Average interest rate	0.05%	-%	-%	-%	-%	-%	0.05%	

As indicated in Table 16, the majority of the Bank's earning assets mature within the next three years. Fixed interest rate loans in the amount of \$204.3 million, \$145.8 million and \$130.2 million mature respectively in 2012, 2013 and 2014. These fixed rate loans total \$480.3 million or 92.8% of all fixed-rate loans at December 31, 2011. As of December 31, 2010 fixed rate loans maturing in three years or less were \$505.7 million or 91.2% of all fixed rate loans. Although there was a decline in fixed rate loans during 2011, the maturity distribution indicates very little change from December 31, 2010. The Bank's traditional vehicles for lending remain residential real estate loans and commercial real estate loans held in its portfolio with a note maturity of one to three years. The average interest rate on total fixed rate loans decreased 77 bp to 5.74% for 2011 from 6.51% in 2010 due to a decrease in rates on renewed loans.

The Bank offers lines of credit to businesses and HELOCs to consumers. These loans typically have floating rates indexed to the Bank's reference rate or, in the case of HELOCs, to the prime rate as published by the Wall Street Journal. The Bank also has variable rate ARM loans in the portfolio as a result of the Acquisition. ARM loans reprice at the margin prescribed by Freddie Mac over their assigned indices. Total variable interest rate loans decreased \$19.0 million or 9.4% to \$183.0 million at December 31, 2011 from \$202.0 million at December 31, 2010. The maturity distribution of variable interest rate loans is not a measure of interest rate risk, as interest rates are adjusted daily for most commercial lines and HELOCs when the associated index changes. The average interest rate on variable rate loans decreased to 4.34% as of December 31, 2011 compared to 5.15% as of December 31, 2010 due to a decrease in rates on renewed loans and historically low ARM index rates.

As indicated in Table 16, investment securities at December 31, 2011 comprised \$204.8 million in fixed rate investments and \$155.8 million in variable rate investment securities totaling \$360.6 million, an increase of \$132.8 million or 58.3% compared to \$227.8 million at December 31, 2010. The increase in investment securities was the result of the excess liquidity generated as total loans decreased while deposits increased during 2011.

Fixed rate investment securities increased \$98.1 million or 91.9% to \$204.8 million at December 31, 2011 compared to \$106.7 million at December 31, 2010 with the maturities well distributed. On December 31, 2011, \$108.6 million or 53.0% of the \$204.8 million of fixed-rate investment securities had maturities greater than five years (after 2016). On December 31, 2010, only \$8.6 million or 8.1% of a total of \$106.7 million fixed rate investment securities had maturities greater than five years (after 2015). As a result of investing in securities with longer term maturities, the average interest rate on the fixed rate investment securities increased 79 bp to 2.60% at December 31, 2011 from 1.81% at year-end 2010. Fixed rate securities in the Bank's portfolio issued by GSE's have call features providing additional yield to the investor. In return the issuer has the opportunity to reprice the investment in a declining rate environment. Call protection varies from three to twelve months from issuance. In 2011 a significant amount of the Bank's fixed rate investment portfolio was called necessitating reinvestment. During the year the Bank began a move into Mortgage Backed Securities ("MBS") which are fixed-rate investments with much longer maturities. However, the MBS have structured principal payments resulting in reinvestable cash flow much earlier than the maturity of the underlying mortgages. The fixed rate MBS investments purchased by the Bank have a weighted average life of two to six years.

Variable rate investment securities increased \$34.7 million or 28.6% to \$155.8 million at December 31, 2011 compared to \$121.1 million at December 31, 2010. While the amount of variable rate investment securities increased, the majority of the variable rate investment securities purchased in prior periods were called during the year as interest rates remained at very low levels. As a result, there was a significant amount of variable rate investment securities purchased during 2011 with similar structures to those that were called but with higher initial rates and more modest step-up features by which the yields are scheduled to increase in future periods. The maturity distribution of variable interest rate investment securities is not a measure of interest rate risk as a result of the step-up feature which will increase the interest rate received in future years but these securities are callable by the issuer. On December 31, 2011, \$145.8 million or 93.6% of a total of \$155.8 million of the variable rate investment securities had maturities greater than five years (after 2016). On December 31, 2010, \$81.1 million or 67.0% of a total of \$121.1 million of the variable rate investment securities had maturities greater than five years (after 2015). As a result of re-investing funds that were called into securities with higher initial yields, the average interest rate on the variable rate investment securities increased 82 bp to 1.88% at December 31, 2011 from 1.06% at year end 2010.

At December 31, 2011, other interest-bearing assets consisting of overnight funds invested as Fed funds sold to a correspondent bank were \$55.1 million with an average interest rate of 0.11% compared to other interest-bearing assets of \$88.2 million with an average rate of 0.15% at December 31, 2010.

Rate-sensitive liabilities create funding that is predominantly short term, with \$714.0 million in savings and interest bearing checking accounts at December 31, 2011 that have no stated maturity and are considered to be floating rate funds. This is a \$69.8 million or 10.8% increase from \$644.2 million in 2010, which is primarily due to core deposit growth as well as a seasonal increase in municipal deposits in the fourth quarter. Historically, the Bank has relied on core deposit growth in these areas because funding costs for both products are the lowest of the various interest bearing products offered by financial institutions. The average interest rate on savings and interest-bearing checking decreased 17 bp to 0.30% at December 31, 2011 from 0.47% at December 31, 2010. Time deposit balances maturing in one year or less decreased \$40.6 million or 23.3% to \$134.0 million at December 31, 2011 compared to \$174.6 million at December 31, 2010. Time deposit balances maturing in 2013 through 2016 at December 31, 2011 increased \$9.2 million or 25.2% from balances at December 31, 2010. There were no time deposit balances maturing after 2016 at December 31, 2011 or after 2015 at December 31, 2010. Total time deposits decreased \$31.4 million or 14.9% to \$179.7 million at December 31, 2011 compared to \$211.1 million at December 31, 2010 as customers moved funds out of fixed rate instruments into variable interest rate instruments during the bottom of the interest rate cycle. The average interest rate of time deposits decreased 41 bp to 1.19% at December 31, 2011 from 1.60% at December 31, 2010.

The Corporation's funding acquisition and deployment strategy, management reporting and board approved limits target a cumulative ratio of 1.0 for Rate Sensitive Assets vs. Rate Sensitive Liabilities ("RSA/RSL") at one year. The Bank RSA/RSL ratio is 1.20 at December 31, 2011 (where a cumulative ratio of 1.0 is balanced and neither asset nor liability sensitive after one year). The asset sensitive difference of 0.20 means that \$124.2 million more earning assets will be rate adjusted than interest bearing liabilities at December 31, 2011. As of December 31, 2011, the 12 month weighted liability gap is \$64.8 million, a decrease of \$12.6 million from a \$77.4 million weighted liability gap at December 31, 2010. The weighted gap indicates the excess average balance of liabilities (in the case of a liability sensitive company) subject to re-pricing earlier than assets. The ratio and analysis includes assumptions that closely follow the Bank's techniques for managing risk: lagged interest rate adjustments, administered rate products, rate adjustment of cash flow from amortization and prepayment of loans through reinvestment, and the reinvestment of maturing assets and liabilities. In this case, the 12 month weighted liability gap is due to more floating rate liabilities than floating rate assets that can be immediately repriced.

Along with the static gap analysis, determining the sensitivity of short-term future earnings to a hypothetical plus or minus 100 bp and 200 bp parallel rate shock can be accomplished through the use of simulation modeling. In addition to the assumptions used to create the static gap, simulation of earnings includes the modeling of the balance sheet as an ongoing entity. The model projects net interest income based on a hypothetical change in interest rates. The resulting net interest income for the next 12-month period is compared to the net interest income amount calculated using flat rates. Table 17 below represents the Corporation's earnings sensitivity to a plus or minus 100 and 200 bp parallel rate shock.

Table 17

	NET INTEREST INCOME OVER ONE YEAR HORIZON (Dollars in Thousands)		
	Amount	Dollar Change	Percentage Change
+200 bps	\$ 50,982	\$ 602	1.20 %
+100 bps	50,641	260	0.52 %
Base	50,381	-	- %
-100 bps	48,882	(1,499)	(2.97) %
-200 bps	45,732	(4,648)	(9.23) %

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

Tri City Bankshares Corporation
Selected Financial Data

	2011	2010	2009	2008	2007
<u>Results of Operations:</u>					
Total interest income	\$ 53,196,793	\$ 61,928,649	\$ 44,386,514	\$ 43,451,436	\$ 45,067,344
Total interest expense	4,583,358	5,712,618	6,953,466	9,517,508	12,574,378
Net interest income	48,613,435	56,216,031	37,433,048	33,933,928	32,492,966
Provision for loan losses	8,370,000	6,930,000	3,705,555	1,300,000	480,000
Net interest income after PLL	40,243,435	49,286,031	33,727,493	32,633,928	32,012,966
Non-interest income	14,790,163	16,476,536	14,597,386	12,885,068	11,264,942
Non-interest expense	40,824,792	43,078,525	34,086,548	29,202,122	28,017,292
Acquisition-related gain	-	-	21,474,123	-	-
Provision for income tax	4,692,601	8,374,000	13,635,000	5,292,500	5,284,000
Net income	<u>\$ 9,516,205</u>	<u>\$ 14,310,042</u>	<u>\$ 22,077,454</u>	<u>\$ 11,024,374</u>	<u>\$ 9,976,616</u>

Per Share Data:

Basic earnings per share	\$ 1.07	\$ 1.61	\$ 2.48	\$ 1.24	\$ 1.13
Cash dividends declared per share	\$ 0.21	\$ 2.40	\$ 1.08	\$ 1.04	\$ 1.00

Selected Financial Condition Data (at December 31):

(Dollars in Thousands)

Total assets	\$ 1,215,143	\$ 1,141,687	\$ 1,125,709	\$ 792,933	\$ 790,027
Total net loans	696,786	737,302	781,846	593,701	580,521
Held to maturity investment securities	360,566	227,804	189,789	106,651	110,551
Total deposits	1,070,480	1,018,447	987,984	677,678	665,804
Total stockholders' equity	121,981	114,335	121,396	108,936	106,767

Tri City Bankshares Corporation
Market for Corporation's Common Stock
And Related Stockholder Matters

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

Fiscal Quarter Ended	OTCQB Pink Quote	
	Bid Quotations	
	High	Low
March 31, 2010	\$ 19.50	\$ 17.01
June 30, 2010	19.50	18.00
September 30, 2010	19.25	18.25
December 31, 2010	22.75	17.55
March 31, 2011	18.85	17.50
June 30, 2011	18.00	17.25
September 30, 2011	17.25	15.35
December 31, 2011	18.45	16.60

As of December 31, 2011, the number of account holders of record of the Corporation's common stock was 580.

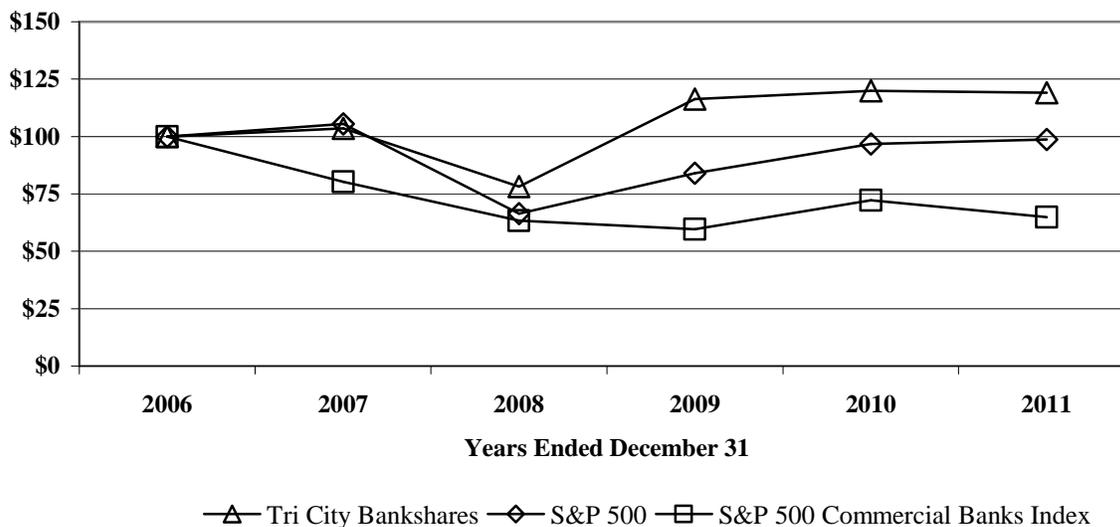
The Corporation declared one quarterly cash dividend in 2011 in the amount of 0.21 per share. This dividend was declared on December 9, 2011 and payable on January 13, 2012. Quarterly dividends of \$0.30 per share were paid each of the four quarters of 2010. An additional dividend was declared of \$1.20 per share on October 13, 2010, payable on December 10, 2010, in anticipation of potential tax law changes there were expected to but did not occur.

The Corporation is not party to any loan agreement, indenture or other agreement which restricts its ability to pay dividends; however, the Wisconsin Business Corporation Law authorizes directors to declare and pay cash dividends only out of the Corporation's unreserved and unrestricted earned surplus. See Note 20 to consolidated financial statements for restrictions imposed by regulatory agencies upon the Bank's ability to transfer funds to the parent corporation.

STOCK PERFORMANCE GRAPH

The following graph shows the cumulative total stockholder return on the Corporation's common stock over the last five fiscal years compared to the returns of the Standard & Poor's 500 Stock Index and S&P 500 Commercial Banks Index compiled by Standard & Poor's and consisting of 13 regional banks, assuming that \$100 is invested on December 31, 2006 with dividends reinvested.

**Tri City Five Year Stock Performance
With Dividend Reinvestment**



PERIOD (FISCAL YEAR COVERED)	S&P 500	S&P 500 COMMERCIAL BANKS	TRI CITY BANKSHARES
2006	100.00	100.00	100.00
2007	105.49	80.31	103.56
2008	66.46	63.40	78.12
2009	84.05	59.60	116.36
2010	96.71	72.20	119.95
2011	98.75	64.87	119.13

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Tri City Bankshares Corporation

We have audited the accompanying consolidated balance sheets of Tri City Bankshares Corporation and subsidiaries (the "Corporation") as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tri City Bankshares Corporation and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and cash flows for each of the three years ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

/s/ BAKER TILLY VIRCHOW KRAUSE, LLP

Milwaukee, Wisconsin

March 16, 2012

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31, 2011 and 2010

ASSETS

	2011	2010
Cash and due from banks	\$ 52,942,095	\$ 39,849,020
Federal funds sold	55,121,113	88,221,710
Cash and cash equivalents	<u>108,063,208</u>	<u>128,070,730</u>
Held to maturity securities, fair value of \$363,252,684 and \$227,276,572 as of 2011 and 2010, respectively	360,566,062	227,803,832
Loans held for investment, less allowance for loan losses of \$11,012,088 and \$9,526,592 as of 2011 and 2010, respectively	696,785,798	737,302,103
Premises and equipment - net	19,146,870	20,321,474
Cash surrender value of life insurance	12,491,722	12,024,264
Mortgage servicing rights - net	1,598,802	1,702,696
Core deposit intangible	1,005,135	1,423,354
Other real estate owned	7,350,678	5,407,205
Accrued interest receivable and other assets	8,134,624	7,631,485
TOTAL ASSETS	\$ <u>1,215,142,899</u>	\$ <u>1,141,687,143</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES

Deposits		
Demand	\$ 176,767,314	\$ 163,121,460
Savings and NOW	714,052,479	644,239,785
Other time	179,660,109	211,086,047
Total Deposits	<u>1,070,479,902</u>	<u>1,018,447,292</u>
Other borrowings	-	4,815,964
Payable for investments purchased	17,165,797	-
Other liabilities	5,516,471	4,089,334
Total Liabilities	<u>1,093,162,170</u>	<u>1,027,352,590</u>

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Cumulative preferred stock, \$1 par value, 200,000 shares authorized, no shares issued	-	-
Common stock, \$1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2011 and 2010	8,904,915	8,904,915
Additional paid-in capital	26,543,470	26,543,470
Retained earnings	86,532,344	78,886,168
Total Stockholders' Equity	<u>121,980,729</u>	<u>114,334,553</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ <u>1,215,142,899</u>	\$ <u>1,141,687,143</u>

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2011, 2010 and 2009

	<u>2011</u>	<u>2010</u>	<u>2009</u>
INTEREST INCOME			
Loans	\$ 46,957,702	\$ 56,721,563	\$ 40,125,009
Investment securities			
Taxable	4,804,949	3,643,942	2,792,315
Tax exempt	1,386,998	1,482,349	1,412,812
Federal funds sold	27,818	61,469	21,806
Other	<u>19,326</u>	<u>19,326</u>	<u>34,572</u>
Total Interest Income	<u>53,196,793</u>	<u>61,928,649</u>	<u>44,386,514</u>
INTEREST EXPENSE			
Deposits	4,570,769	5,711,774	6,922,648
Other borrowings	<u>12,589</u>	<u>844</u>	<u>30,818</u>
Total Interest Expense	<u>4,583,358</u>	<u>5,712,618</u>	<u>6,953,466</u>
Net Interest Income before Provision for Loan Losses	48,613,435	56,216,031	37,433,048
Provision for loan losses	<u>8,370,000</u>	<u>6,930,000</u>	<u>3,705,555</u>
Net Interest Income after Provision for Loan Losses	<u>40,243,435</u>	<u>49,286,031</u>	<u>33,727,493</u>
NONINTEREST INCOME			
Service charges on deposits	9,986,812	10,180,904	9,921,208
Loan servicing income	317,687	349,842	(31,636)
Net gain on sale of loans	1,248,797	1,421,550	2,320,738
Increase in cash surrender value of life insurance	467,458	471,581	505,093
Bargain purchase gain	-	-	21,474,123
Non-accretable loan discount	2,247,167	2,268,873	661,633
Other income	<u>522,242</u>	<u>1,783,786</u>	<u>1,220,350</u>
Total Noninterest Income	<u>14,790,163</u>	<u>16,476,536</u>	<u>36,071,509</u>
NONINTEREST EXPENSES			
Salaries and employee benefits	22,037,202	22,738,774	17,670,068
Net occupancy costs	4,067,094	3,958,806	3,266,406
Furniture and equipment expenses	1,886,925	2,200,688	1,895,944
Computer services	3,678,813	3,504,256	3,226,850
Advertising and promotional	1,033,215	1,173,330	976,295
FDIC and other regulatory assessments	1,316,754	2,459,307	1,098,865
Office supplies	790,283	834,013	717,815
Acquisition expenses	-	370,214	619,902
Core deposit intangible amortization	418,219	567,713	111,934
Other expenses	<u>5,596,287</u>	<u>5,271,424</u>	<u>4,502,469</u>
Total Noninterest Expenses	<u>40,824,792</u>	<u>43,078,525</u>	<u>34,086,548</u>
Total Income before Taxes	14,208,806	22,684,042	35,712,454
Less: Income tax expense	<u>4,692,601</u>	<u>8,374,000</u>	<u>13,635,000</u>
NET INCOME	<u>\$ 9,516,205</u>	<u>\$ 14,310,042</u>	<u>\$ 22,077,454</u>
Basic earnings per share	<u>\$ 1.07</u>	<u>\$ 1.61</u>	<u>\$ 2.48</u>
Dividends per share	<u>\$ 0.21</u>	<u>\$ 2.40</u>	<u>\$ 1.08</u>
Weighted average shares outstanding	<u>8,904,915</u>	<u>8,904,915</u>	<u>8,904,915</u>

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2011, 2010 and 2009

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total
BALANCES – January 1, 2009	\$ 8,904,915	\$ 26,543,470	\$ 73,487,881	\$ 108,936,266
Net income	-	-	22,077,454	22,077,454
Cash dividends - \$1.08 per share	-	-	(9,617,416)	(9,617,416)
	<u>8,904,915</u>	<u>26,543,470</u>	<u>85,947,919</u>	<u>121,396,304</u>
BALANCES – December 31, 2009	8,904,915	26,543,470	85,947,919	121,396,304
Net income	-	-	14,310,042	14,310,042
Cash dividends - \$2.40 per share	-	-	(21,371,793)	(21,371,793)
	<u>8,904,915</u>	<u>26,543,470</u>	<u>78,886,168</u>	<u>114,334,553</u>
BALANCES – December 31, 2010	8,904,915	26,543,470	78,886,168	114,334,553
Net income	-	-	9,516,205	9,516,205
Cash dividends - \$0.21 per share	-	-	(1,870,029)	(1,870,029)
	<u>8,904,915</u>	<u>26,543,470</u>	<u>86,532,344</u>	<u>121,980,729</u>
BALANCES – December 31, 2011	<u>\$ 8,904,915</u>	<u>\$ 26,543,470</u>	<u>\$ 86,532,344</u>	<u>\$ 121,980,729</u>

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	\$ 9,516,205	\$ 14,310,042	\$ 22,077,454
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Depreciation	2,149,444	2,250,653	2,247,216
(Accretion) amortization of servicing rights, premiums and discounts	(6,696,585)	(10,373,438)	928,315
Gain on sale of loans	(1,248,797)	(1,421,550)	(2,320,738)
Amortization of other intangibles	418,215	567,713	111,934
Provision for loan losses	8,370,000	6,930,000	3,705,555
Expense (Benefit) for deferred income taxes	(1,170,000)	(4,684,000)	7,405,000
Proceeds from sales of loans held for sale	56,224,575	66,009,353	120,244,292
Originations of loans held for sale	(55,365,375)	(64,983,128)	(118,815,640)
Increase in cash surrender value of life insurance	(467,458)	(471,581)	(505,093)
(Gain) loss on other real estate owned	(700,534)	(1,376,007)	377,876
Gain on disposal of premises and equipment	(26,250)	(72,109)	-
Net gain on acquisition	-	-	(21,474,123)
Net change in:			
Accrued interest receivable and other assets	(503,135)	6,298,979	(5,990,417)
Payable for investments purchased	17,165,797	-	-
Accrued interest payable and other liabilities	727,108	(5,743,500)	1,747,089
Net Cash Flows Provided by Operating Activities	28,393,210	7,241,427	9,738,720
CASH FLOWS FROM INVESTING ACTIVITIES			
Activity in held to maturity securities:			
Maturities, prepayments and calls	246,482,676	182,949,588	66,737,249
Purchases	(380,118,180)	(221,817,712)	(141,440,231)
Net decrease in loans	29,953,612	40,659,828	1,046,334
Purchases of premises and equipment – net	(987,490)	(2,858,680)	(1,163,882)
Proceeds from sale of other real estate owned	9,013,104	9,317,897	1,724,575
Proceeds from sales of premises and equipment	38,900	380,090	-
Net cash received in FDIC assisted transactions	-	-	58,550,538
Net Cash Flows Provided by (Used) in Investing Activities	(95,617,378)	8,631,011	(14,545,417)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in deposits	52,032,610	30,463,595	65,015,680
Net change in other borrowings	(4,815,964)	3,003,948	(3,450,858)
Dividends paid	-	(21,371,793)	(9,617,416)
Net Cash Flows Provided by in Financing Activities	47,216,646	12,095,750	51,947,406
Net Change in Cash and Cash Equivalents	(20,007,522)	27,968,188	47,140,709
CASH AND CASH EQUIVALENTS – BEGINNING OF YEAR	128,070,730	100,102,542	52,961,833
CASH AND CASH EQUIVALENTS – END OF YEAR	\$ 108,063,208	\$ 128,070,730	\$ 100,102,542

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011, 2010 and 2009
(continued)

	2011	2010	2009
SUPPLEMENTAL CASH FLOW DISCLOSURES			
Cash paid for interest	\$ 4,692,288	\$ 5,911,953	\$ 7,561,377
Cash paid for income taxes	5,480,000	13,835,860	5,817,207
Loans receivable transferred to other real estate owned	10,256,043	8,667,614	3,776,798
Mortgage servicing rights resulting from sales of loans	389,597	395,325	892,086
Dividends accrued not paid	1,870,029	-	-
 Acquisition			
Non cash assets acquired:			
Investment securities	\$ -	\$ -	\$ 8,755,001
Loans, net of discount	-	-	196,673,404
Other real estate owned	-	-	2,897,581
Other intangibles, net	-	-	2,103,000
Mortgage servicing assets	-	-	920,772
Other assets	-	-	1,172,786
Total noncash assets acquired	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 212,522,544</u>
Liabilities assumed:			
Deposits	\$ -	\$ -	\$ 245,289,855
Other borrowings	-	-	1,351,820
Accrued expenses and other liabilities	-	-	11,568,409
Total liabilities assumed	<u>-</u>	<u>-</u>	<u>258,210,084</u>
Net non-cash liabilities acquired	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (45,687,540)</u>
 Cash and cash equivalents acquired	 \$ -	 \$ -	 \$ 58,550,538
 After-tax gain recorded on acquisition	 \$ -	 \$ -	 \$ 12,862,998

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 1 - Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, and Title Service of Southeast Wisconsin, Inc., a title company subsidiary. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. The Corporation has evaluated the consolidated financial statements for subsequent events through the date of filing of this 10-K.

Nature of Banking Activities

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

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Cash and Cash Equivalents

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

Held to Maturity Securities

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

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

Loans

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

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

Loans Acquired Through Purchase

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

Loans Held for Sale

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

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

Allowance for Loan Losses

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

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

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

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

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

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

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

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

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

Premises and Equipment

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

Other Real Estate Owned

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

Intangible Assets

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

Federal Reserve Bank Stock

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

Off-Balance Sheet Financial Instruments

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

Derivative Financial Instruments

The Bank utilizes derivative financial instruments to meet the ongoing credit needs of its customers and in order to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit. The Bank does not use interest rate contracts (e.g. swaps, caps, floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2011 or 2010.

Advertising Costs

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

Income Taxes

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

TRI CITY BANKSHARES CORPORATION
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NOTE 1 - Summary of Significant Accounting Policies (cont.)

Earnings Per Share

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during any of the three years in the period ended December 31, 2011.

Segment Reporting

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

Employee Benefit Plan

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

Reclassifications

Certain 2010 and 2009 amounts have been reclassified to conform to the 2011 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

Recent Accounting Pronouncements

In April 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-02, Receivables (Topic 310): *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The ASU will improve financial reporting by creating greater consistency in the way GAAP is applied for various types of debt restructurings. The ASU clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. The new guidance was effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. The provisions of this guidance did not have a significant impact on our consolidated financial condition, results of operations or liquidity.

In May 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): *Reconsideration of Effective Control for Repurchase Agreements*. The ASU is intended to improve financial reporting of repurchase agreements ("repos") and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments to the codification in this ASU are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The provisions of this guidance are not expected to have a significant impact on our consolidated financial condition, results of operations or liquidity.

In June 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This ASU represents the converged guidance of the FASB and IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The provisions of this guidance are not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity.

TRI CITY BANKSHARES CORPORATION
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NOTE 2 – FDIC – Assisted Acquisition

On October 23, 2009 (the “Acquisition Date”), the Bank entered into a Purchase and Assumption Agreement (the “Agreement”) with the Federal Deposit Insurance Corporation (the “FDIC”), as receiver for Bank of Elmwood (“Acquired Bank”), pursuant to which the Bank acquired substantially all of the assets and assumed substantially all of the deposits and certain other liabilities of Bank of Elmwood, a Wisconsin state-chartered bank headquartered in Racine, Wisconsin (the “Acquisition”).

The Acquired Bank operated five branches in Southeast Wisconsin, which allowed the Bank to expand its presence in Southeast Wisconsin, primarily the Racine and Kenosha, Wisconsin markets.

The Bank acquired loans and OREO with estimated fair market values of \$196.7 million and \$2.9 million, respectively. The Bank also acquired \$30.4 million in cash, due from banks and deposits with the Federal Reserve Bank, \$8.8 million in investment securities and \$2.1 million in other assets. The Bank assumed \$245.3 million in deposits at estimated fair market value and \$4.3 million of other liabilities. The Bank recorded \$2.1 million in core deposit intangibles and recognized a pre-tax bargain purchase gain of \$21.5 million, resulting in an after-tax gain of \$12.9 million.

The assets acquired and liabilities assumed in the Acquisition are presented at estimated fair market values as of the Acquisition Date.

The Acquisition was completed as a whole bank purchase without any loss sharing provision on post acquisition loan losses between the Bank and the FDIC, such that the Bank bears all risk of future loan losses. The Acquisition was completed at a purchase discount of \$110.9 million, with the Bank receiving \$82.8 million of assets at the Acquired Bank’s net book value, \$27.5 million in cash from the FDIC and recording a settlement receivable of \$0.6 million from the FDIC. The cash assistance provided by the FDIC was an amount equal to the book value of liabilities assumed plus an agreed upon purchase discount, less the book value of assets acquired. A summary of the cash support received from the FDIC is as follows:

Assumed liabilities at Bank of Elmwood book value	\$ 247,866,961
Purchase discount	110,900,000
Assets acquired at Bank of Elmwood book value	(330,644,187)
FDIC cash support	<u>\$ 28,122,774</u>

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting. The application of the acquisition method of accounting resulted in a net after-tax gain of \$12.9 million. A summary of the net assets acquired from the FDIC and the estimated fair market value adjustments resulting in the net after-tax gain as of the Acquisition Date are as follows:

Net assets acquired at Bank of Elmwood book value	\$ 82,777,226
FDIC cash support	28,122,774
Purchase accounting fair value adjustments:	
Loans	(85,127,642)
OREO	(4,669,237)
Core deposit intangible	2,103,000
Time deposits	(1,732,000)
Deferred income tax liability	(8,611,123)
Net after-tax gain from Acquisition (net assets required)	<u>\$ 12,862,998</u>

TRI CITY BANKSHARES CORPORATION
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NOTE 3- Fair Value of Financial Instruments

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

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

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

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

Loans held for investment - The Bank does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. At December 31, 2011 and 2010, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with relevant accounting guidance, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as a nonrecurring Level 2 valuation. Valuations based on management estimates are recorded as nonrecurring Level 3. Mortgage loans available for sale and held for investment are valued using fair values attributable to similar mortgage loans. The fair value of the other loans is based on the fair value of obligations with similar credit characteristics.

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

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

As of December 30, 2011 and December 31, 2010 the Bank did not carry any assets that were measured at fair value on a recurring basis.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 3 - Fair Value of Financial Instruments – (cont.)

Assets measured at fair value on a nonrecurring basis

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

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

	Balance at 12/31/10		Level 1		Level 2		Level 3
Loans held for investment	\$ 12,630,600	\$	-	\$	-	\$	12,630,600
Other real estate owned	5,407,205		-		-		5,407,205
Totals	<u>\$ 18,037,805</u>	\$	<u>-</u>	\$	<u>-</u>	\$	<u>18,037,805</u>

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

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

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

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

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

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

Non-marketable equity securities – The fair value is estimated using values of comparable securities.

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 - Fair Value of Financial Instruments – (cont.)

Mortgage servicing rights - The Bank does not record MSR's at fair value on a recurring basis. However, from time to time, MSR's may be considered impaired and a valuation allowance is established. MSR's for which amortized cost exceeds fair value are considered impaired. The fair value of MSR's is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Bank's portfolio of serviced loans. The Bank records impaired MSR's as a nonrecurring Level 2 valuation.

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

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

The estimated fair values of financial instruments at December 31, 2011 and 2010 are as follows:

	December 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS				
Cash and due from banks	\$ 52,942,095	\$ 52,942,095	\$ 39,849,020	\$ 39,849,020
Federal funds sold	55,121,113	55,121,113	88,221,710	88,221,710
Held to maturity securities	360,566,062	363,252,684	227,803,832	227,276,572
Federal reserve stock	322,100	322,100	322,100	322,100
Loans held for investment, net	696,785,798	701,196,384	737,302,103	744,855,523
Cash surrender value of life insurance	12,491,722	12,491,722	12,024,264	12,024,264
Mortgage servicing rights	1,598,802	1,884,447	1,702,696	2,784,581
Accrued interest receivable	4,650,828	4,650,828	4,120,030	4,120,030
FINANCIAL LIABILITIES				
Deposits	\$ 1,070,479,902	\$ 1,069,056,674	\$ 1,018,447,292	\$ 1,016,209,456
Other borrowings	-	-	4,815,964	4,815,964
Accrued interest payable	251,243	251,243	360,173	360,173

The estimated fair value of fee income on letters of credit outstanding at December 31, 2011 and December 31, 2010 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2011 and December 31, 2010.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 4 - Cash and Due From Banks

The Bank is required to maintain vault cash and reserve balances with Federal Reserve Banks based upon a percentage of deposits. These requirements approximated \$12,308,000 and \$11,358,000 at December 31, 2011 and 2010, respectively.

NOTE 5 - Held to Maturity Securities

Amortized costs and fair values of held to maturity securities as of December 31, 2011 and 2010 are summarized as follows:

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

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of:				
States and political subdivisions	\$ 51,315,102	\$ 843,803	\$ (119,745)	\$ 52,039,160
U.S. government sponsored entities	176,388,730	704,904	(1,956,222)	175,137,412
Other	100,000	-	-	100,000
Totals	<u>\$ 227,803,832</u>	<u>\$ 1,548,707</u>	<u>\$ (2,075,967)</u>	<u>\$ 227,276,572</u>

The amortized cost and fair value of held to maturity securities at December 31, 2011, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 5 - Held to Maturity Securities (cont.)

	December 31, 2011	
	Amortized Cost	Fair Value
Due in one year or less	\$ 7,958,465	\$ 7,984,713
Due after one year less than 5 years	98,267,106	99,567,310
Due over 5 years	254,340,491	255,700,661
Totals	\$ 360,566,062	\$ 363,252,684

Held to maturity securities with an amortized cost of \$114,469,144 and \$150,489,312 at December 31, 2011 and 2010, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following tables summarize the portion of the Bank's held to maturity securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2011 and 2010.

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

	December 31, 2010					
	Continuous unrealized losses existing for less than 12 Months		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of:						
States and political Subdivisions	\$ 13,884,930	\$ 115,639	\$ 508,550	\$ 4,106	\$ 14,393,480	\$ 119,745
U.S. government sponsored entities	119,139,262	1,956,222	-	-	119,139,262	1,956,222
Totals	\$ 133,024,192	\$ 2,071,861	\$ 508,550	\$ 4,106	\$ 133,532,742	\$ 2,075,967

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 5 - Held to Maturity Securities (cont.)

Management does not believe any individual unrealized loss as of December 31, 2011 and 2010 represents other than temporary impairment. The Bank held no investment securities at December 31, 2011 that had unrealized losses existing for greater than 12 months. The Bank held one investment security at December 31, 2010 that had unrealized losses existing for greater than 12 months, which consisted of an obligation of states and political subdivisions. Management believes the temporary impairment in fair value was caused by market fluctuations in interest rates. Since securities are held to maturity, management does not believe that the Bank will experience any losses on this investment.

NOTE 6 - Loans

Major classification of loans are as follows at December 31:

	2011	2010
Commercial	\$ 19,956,000	\$ 25,451,474
Real Estate		
Construction	46,600,467	55,974,007
Commercial	298,042,808	285,862,944
Residential	288,609,383	319,789,488
Multifamily	39,798,866	41,073,712
Installment and other	14,790,362	18,677,070
	<u>\$ 707,797,886</u>	<u>\$ 746,828,695</u>
Less: Allowance for loan losses	(11,012,088)	(9,526,592)
Net Loans	<u>\$ 696,785,798</u>	<u>\$ 737,302,103</u>

Commercial loans - Historically commercial lending has been a small part of the Bank's portfolio which continues to be the case in 2011. Commercial balances have decreased during these difficult economic times. Reductions of outstanding balances on lines of credit have occurred as well as the demand for term financing as businesses made little, if any, investment in new equipment. Commercial loans are collateralized by general business assets such as accounts receivable, inventory and equipment and have no real estate component. During weak economic periods the Bank can be exposed to heightened risk if a business is out of compliance with debtor covenants supporting commercial loans.

Real estate construction loans - Loans to residential real estate developers comprise most of the dollars outstanding in real estate construction loans. Historically, real estate construction loans have been made to developers who are well known to the Bank, have prior successful project experience and are well capitalized. Loans are made to customers in the Bank's Southeastern Wisconsin market. Real estate construction loans of this type are generally larger in size and involve greater risks than residential mortgage loans because payments depend on the success of the project or in the case of commercial development, successful management of the property. The Bank will generally make credit extensions to borrowers with adequate outside liquidity to support the project in the event the actual performance is less than projected. Developers with which the Bank does business have the ability to service the development debt personally or through their companies, however, these individuals are not immune to a prolonged weak economy such as the Bank has experienced. Most of the Bank's real estate development loans are performing even three years into the economic downturn and the Bank's borrowers' inventories are decreasing. The greatest risk to the Bank within this segment are loans secured by raw land and condominium development loans. These two groups have been most severely affected by the prolonged economic downturn. In the case of loans secured by undeveloped acreage, the price per acre has decreased dramatically as other lenders liquidate the collateral on these raw land or "dirt" loans. The Bank has a few customers continuing to service the debt from free cash flow, but this becomes more problematic as the housing market continues a slow recovery or in some cases a non-recovery. In the case of condominium loans risk factors the Bank inherits upon the failure of a developer include the existence and/or control of the condo association, the availability of term financing to initial buyers of units and partial project completion for common use areas. The Bank does have condominium exposure in several smaller projects to the second developers following foreclosures. These are the Bank's customers who were able to buy incomplete developments at deep discounts from other banks that foreclosed on the original developer in 2010 and 2011. In all cases the selling banks also agreed to fixed-rate mortgage loans to qualified borrowers at prevailing rates to allow the second developer to sell units without the issue of term financing availability.

TRI CITY BANKSHARES CORPORATION
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NOTE 6 – Loans (cont.)

Commercial real estate loans - The Bank's commercial real estate lending efforts are focused on owner occupied, improved property such as office buildings, warehouses, small manufacturing operations and retail facilities. The most significant risk factor in the third year of the financial crisis is occupancy. The fact that the Bank prefers owner occupied commercial real estate mitigates that risk, provided of course, the owner's business survives. The Bank's \$19.1 million per-borrower legal lending limit would permit it to compete for activity in the middle market, but management prefers to seek small businesses as its target borrowers. Loans to such businesses are approved based on the creditworthiness, economic feasibility and cash flow abilities of the borrower.

Residential real estate loans - Loans in this segment of the portfolio have historically represented the lowest risk due to the large number of individual loans with relatively small average balances. The Bank considers owner-occupied one-to-four family loans to be low risk because underwriting has always required 20% equity and qualified borrowers with proper debt service coverage ratios. These loans provide a foundation for the sale of all other retail banking products and have always been a staple of the Bank's portfolio. However, in the Acquisition, the Bank acquired a number of residential real estate loans that do not meet the Bank's underwriting standards and these borrowers were encouraged to bring loans current, pay delinquent taxes, refinance at another financial institution and comply with the Bank's underwriting standards or face foreclosure. The greatest risks to the Bank in this segment are those one-to-four family residential real estate loans that are not owner occupied. Many of these scattered site owner's loans were generated by the Acquired Bank through their "Rehab and Go" and "Equity is Cash" programs. Often rehab dollars were not invested in the property, the properties were over-appraised and as rental property damage was prevalent but no replacement reserves were required as would be in a commercial real estate loan.

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

Installment and other loans - These loans consist of auto loans, mobile home loans and unsecured consumer loans which have been decreasing at the Bank for several years. Auto loan volume decreased despite improved new car sales in 2011 because dealer incentive financing makes this non-competitive. The Bank has historically limited its exposure to mobile home loans and unsecured consumer loans. However, the Bank acquired a number of such consumer loans in the Acquisition, many of which continue to perform, despite not meeting the Bank's historical underwriting standards.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (con't)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31, 2011 and 2010:

	December 31, 2011	
	Nonaccrual	Past due 90 days or more and accruing
Commercial	\$ 393,391	\$ 47,156
Real estate		
Construction	1,101,343	732,911
Commercial	7,455,567	426,242
Residential	15,931,722	757,514
Multifamily	1,990,563	-
Installment and other	62,742	412,039
Total Loans	<u>26,935,328</u>	<u>2,375,862</u>
Purchase Credit Impaired Loans:		
Commercial	(2,919)	(12,749)
Real estate		
Construction	-	-
Commercial	(1,602,816)	-
Residential	(4,671,780)	(12,914)
Multifamily	(603,395)	-
Installment & Other	-	-
Total Purchased Credit-Impaired Loans	<u>(6,880,910)</u>	<u>(25,663)</u>
Total Loans, excluding Purchase Credit Impaired Loans	<u>\$ 20,054,418</u>	<u>\$ 2,350,199</u>
	December 31, 2010	
	Nonaccrual	Past due 90 days or more and accruing
Commercial	\$ 70,042	\$ 4,339
Real estate		
Construction	1,485,837	246,743
Commercial	13,034,876	114,159
Residential	17,147,454	2,732,296
Multifamily	3,196,937	-
Installment and other	80,570	377,491
Total Loans	<u>35,015,716</u>	<u>3,475,028</u>
Purchase Credit Impaired Loans:		
Commercial	(16,822)	-
Real estate		
Construction	(235,598)	-
Commercial	(4,440,670)	-
Residential	(6,537,049)	(2,041,589)
Multifamily	(603,395)	-
Installment & Other	-	-
Total Purchased Credit-Impaired Loans	<u>(11,833,534)</u>	<u>(2,041,589)</u>
Total Loans, excluding Purchase Credit Impaired Loans	<u>\$ 23,182,182</u>	<u>\$ 1,433,439</u>

TRI CITY BANKSHARES CORPORATION
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December 31, 2011, 2010 and 2009

NOTE 6 – Loans (con't)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. At the quarterly meetings, the Board of Directors of the Bank reviews trends for loans classified as “Special Mention,” “Substandard” and “Doubtful” for the previous twelve months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. A Special Mention loan has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and viewed as non-bankable assets, worthy of charge-off. Assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that may or may not be within the control of the customer are classified as “Pass.” The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31, 2011 and December 31, 2010:

December 31, 2011					
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 17,834,473	\$ 1,192,000	\$ 895,121	\$ 34,406	\$ 19,956,000
Real estate					
Construction	41,739,351	555,665	4,140,419	165,032	46,600,467
Commercial	270,211,863	10,912,130	16,864,133	54,682	298,042,808
Multifamily	34,959,277	2,849,026	1,874,115	116,448	39,798,866
Total	<u>\$ 364,744,964</u>	<u>\$ 15,508,821</u>	<u>\$ 23,773,788</u>	<u>\$ 370,568</u>	<u>\$ 404,398,141</u>
Current	\$ 361,193,743	15,233,112	\$ 13,013,980	\$ 165,032	\$ 389,605,867
30-59	3,052,889	-	644,399	-	3,697,288
60-89	320,762	275,709	1,033,738	-	1,630,209
Over 90	177,570	-	9,081,671	205,536	9,464,777
Total	<u>\$ 364,744,964</u>	<u>\$ 15,508,821</u>	<u>\$ 23,773,788</u>	<u>\$ 370,568</u>	<u>\$ 404,398,141</u>
December 31, 2010					
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 23,375,444	\$ 1,665,817	\$ 396,098	\$ 14,115	\$ 25,451,474
Real estate					
Construction	44,791,225	8,293,423	2,889,359	-	55,974,007
Commercial	241,042,464	19,435,523	25,254,718	130,239	285,862,944
Multifamily	36,404,929	1,003,816	3,664,967	-	41,073,712
Total	<u>\$ 345,614,062</u>	<u>\$ 30,398,579</u>	<u>\$ 32,205,142</u>	<u>\$ 144,354</u>	<u>\$ 408,362,137</u>
Current	\$ 342,900,085	\$ 28,567,600	\$ 13,914,866	\$ -	\$ 385,382,551
30-59	2,037,955	468,067	2,659,426	-	5,165,448
60-89	522,361	1,362,912	112,836	-	1,998,109
Over 90	153,661	-	15,518,014	144,354	15,816,029
Total	<u>\$ 345,614,062</u>	<u>\$ 30,398,579</u>	<u>\$ 32,205,142</u>	<u>\$ 144,354</u>	<u>\$ 408,362,137</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (con't)

For residential real estate and installment loan classes, the Bank also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in those loan classes based on payment activity as of December 31, 2011 and 2010:

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

	December 31, 2010		
	Performing	Nonperforming	Total
Residential Real Estate	\$ 299,909,738	\$ 19,879,750	\$ 319,789,488
Installment & Other	18,219,011	458,059	18,677,070
Total	<u>\$ 318,128,749</u>	<u>\$ 20,337,809</u>	<u>\$ 338,466,558</u>

At December 31, 2011, the Corporation has identified \$48.5 million of loans as impaired, including \$21.6 million of performing troubled debt restructurings. A loan is identified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing troubled debt restructuring consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans follows:

	December 31, 2011	December 31, 2010
Loans for which there was a related allowance for loan loss	\$ 24,368,902	\$ 16,617,148
Impaired loans with no related allowance	24,144,704	16,112,165
Total Impaired Loans	<u>\$ 48,513,606</u>	<u>\$ 32,729,313</u>
Average quarterly balance of impaired loans	\$ 46,524,919	\$ 24,470,966
Related allowance for loan losses	6,466,579	3,986,548
Interest income recognized while impaired	842,282	392,826

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (con't)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2011 and 2010:

	December 31, 2011			
	Unpaid Principal Balance	Partial Charge- offs	Allowance For Loan Losses Allocation	Recorded Investment
Loans with no related allowance recorded:				
Commercial	\$ 366,920	\$ 11,218	\$ -	\$ 355,702
Real estate				
Construction	1,481,875	13,850	-	1,468,025
Commercial	7,968,827	1,034,776	-	6,934,051
Residential	14,640,519	82,953	-	14,557,566
Multifamily	734,274	5,508	-	728,766
Installment & Other	100,594	-	-	100,594
Total	<u>25,293,009</u>	<u>1,148,305</u>	<u>-</u>	<u>24,144,704</u>
Loans with a related allowance recorded:				
Commercial	37,396	-	24,175	13,221
Real estate				
Construction	774,837	14,643	274,218	485,976
Commercial	8,066,785	185,080	1,743,062	6,138,643
Residential	14,715,142	376,919	3,847,056	10,491,167
Multifamily	1,279,699	17,902	523,481	738,316
Installment & Other	89,587	-	54,587	35,000
Total	<u>24,963,446</u>	<u>594,544</u>	<u>6,466,579</u>	<u>17,902,323</u>
Total Impaired Loans	<u>\$ 50,256,455</u>	<u>\$ 1,742,849</u>	<u>\$ 6,466,579</u>	<u>\$ 42,047,027</u>
	December 31, 2010			
	Unpaid Principal Balance	Partial Charge- offs	Allowance For Loan Losses Allocation	Recorded Investment
Loans with no related allowance recorded:				
Commercial	\$ -	\$ -	\$ -	\$ -
Real estate				
Construction	2,005,213	-	-	2,005,213
Commercial	6,497,934	-	-	6,497,934
Residential	7,478,138	-	-	7,478,138
Multifamily	130,880	-	-	130,880
Installment & Other	-	-	-	-
Total	<u>16,112,165</u>	<u>-</u>	<u>-</u>	<u>16,112,165</u>
Loans with a related allowance recorded:				
Commercial	14,115	-	14,115	-
Real estate				
Construction	1,002,247	-	113,964	888,283
Commercial	7,653,948	175,000	1,211,358	6,267,590
Residential	8,098,270	606,300	2,406,059	5,085,911
Multifamily	549,300	-	222,483	326,817
Installment & Other	80,568	-	18,568	62,000
Total	<u>17,398,448</u>	<u>781,300</u>	<u>3,986,547</u>	<u>12,630,601</u>
Total Impaired Loans	<u>\$ 33,510,613</u>	<u>\$ 781,300</u>	<u>\$ 3,986,547</u>	<u>\$ 28,742,766</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (con’t)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2011 and 2010:

	December 31, 2011						
	Commercial	Construction	Commercial Real Estate	Residential Real Estate	Multifamily	Consumer	Total
Allowance for loan losses:							
Beginning balance	\$ 412,745	\$ 447,955	\$ 2,819,054	\$ 4,593,811	\$ 1,010,978	\$ 242,049	\$ 9,526,592
Charge-offs	(299,829)	(256,279)	(1,199,872)	(4,971,619)	(117,115)	(283,184)	(7,127,898)
Recoveries	10,232	36,965	86,453	88,024	-	21,720	243,394
Provision	40,717	355,143	2,043,222	5,859,527	(106,944)	178,335	8,370,000
Ending Balance	<u>\$ 163,865</u>	<u>\$ 583,784</u>	<u>\$ 3,748,857</u>	<u>\$ 5,569,743</u>	<u>\$ 786,919</u>	<u>\$ 158,920</u>	<u>\$ 11,012,088</u>
Loans:							
Ending balance	\$ 19,956,000	\$ 46,600,467	\$ 298,042,808	\$ 288,609,383	\$ 39,798,866	\$ 14,790,362	\$ 707,797,886
Allowance for loan losses;							
Individually evaluated for impairment	24,176	274,218	1,741,553	2,767,300	523,481	54,586	5,385,314
Collectively evaluated for impairment	139,689	309,566	2,005,795	1,722,687	263,438	104,334	4,545,509
Acquired	-	-	1,509	1,079,756	-	-	1,081,265
Total allowance for loan losses	<u>163,865</u>	<u>583,784</u>	<u>3,748,857</u>	<u>5,569,743</u>	<u>786,919</u>	<u>158,920</u>	<u>11,012,088</u>
Recorded Investment	<u>\$ 19,792,135</u>	<u>\$ 46,016,683</u>	<u>\$ 294,293,951</u>	<u>\$ 283,039,640</u>	<u>\$ 39,011,947</u>	<u>\$ 14,631,442</u>	<u>\$ 696,785,798</u>
Ending Balance:							
Individually evaluated for impairment	\$ 393,391	\$ 2,227,927	\$ 14,815,756	\$ 28,895,790	\$ 1,990,563	\$ 190,179	\$ 48,513,606
Collectively evaluated for impairment	19,526,299	43,272,500	280,378,746	240,804,604	36,824,488	14,587,610	635,394,247
Acquired	36,310	1,100,040	2,848,306	18,908,989	983,815	12,573	23,890,033
Total ending balance	<u>\$ 19,956,000</u>	<u>\$ 46,600,467</u>	<u>\$ 298,042,808</u>	<u>\$ 288,609,383</u>	<u>\$ 39,798,866</u>	<u>\$ 14,790,362</u>	<u>\$ 707,797,886</u>
December 31, 2010							
	Commercial	Construction	Commercial Real Estate	Residential Real Estate	Multifamily	Consumer	Total
Loans:							
Ending balance	\$ 25,451,474	\$ 55,974,007	\$ 285,862,944	\$ 319,789,488	\$ 41,073,712	\$ 18,677,070	\$ 746,828,695
Allowance for loan losses;							
Individually evaluated for impairment	14,115	113,964	1,211,358	2,406,059	222,483	18,568	3,986,547
Collectively evaluated for impairment	398,630	333,991	1,607,696	1,458,116	788,495	223,481	4,810,409
Acquired	-	-	-	729,636	-	-	729,636
Total allowance for loan losses	<u>412,745</u>	<u>447,955</u>	<u>2,819,054</u>	<u>4,593,811</u>	<u>1,010,978</u>	<u>242,049</u>	<u>9,526,592</u>
Recorded Investment	<u>\$ 25,038,729</u>	<u>\$ 55,526,052</u>	<u>\$ 283,043,890</u>	<u>\$ 315,195,677</u>	<u>\$ 40,062,734</u>	<u>\$ 18,435,021</u>	<u>\$ 737,302,103</u>
Ending Balance:							
Individually evaluated for impairment	\$ 14,115	\$ 3,007,460	\$ 13,976,882	\$ 14,970,108	\$ 680,180	\$ 80,568	\$ 32,729,313
Collectively evaluated for impairment	24,892,894	44,664,827	263,312,796	273,659,587	38,576,591	18,596,502	663,703,197
Acquired	544,465	8,301,720	8,573,266	31,159,793	1,816,941	-	50,396,185
Total ending balance	<u>\$ 25,451,474</u>	<u>\$ 55,974,007</u>	<u>\$ 285,862,944</u>	<u>\$ 319,789,488</u>	<u>\$ 41,073,712</u>	<u>\$ 18,677,070</u>	<u>\$ 746,828,695</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (cont.)

The Corporation continues to evaluate loans purchased in conjunction with the Acquisition for impairment in accordance with GAAP. The purchased loans were considered impaired at the Acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31, 2011 and December 31, 2010

	December 31, 2011		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Commercial	\$ 235,856	\$ 972,354	\$ 828,188
Real Estate			
Construction	3,676,897	44,697	2,191,129
Commercial	10,509,579	12,485,797	15,459,924
Residential	48,061,689	56,780,596	79,049,005
Multifamily	2,302,782	-	1,587,210
Installment and Consumer	18,223	3,485,572	2,018,806
Total	<u>\$ 64,805,026</u>	<u>\$ 73,769,016</u>	<u>\$ 101,134,262</u>
	December 31, 2010		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Commercial	\$ 1,163,657	\$ 3,374,952	\$ 3,431,480
Real Estate			
Construction	13,895,239	357,379	8,605,686
Commercial	17,679,889	16,580,216	22,774,024
Residential	62,201,020	72,406,187	99,498,903
Multifamily	2,644,213	422,239	2,154,090
Installment and Consumer	6,836	5,213,526	2,879,377
Total	<u>\$ 97,590,854</u>	<u>\$ 98,354,499</u>	<u>\$ 139,343,560</u>

As of December 31, 2011, the estimated contractually-required payments receivable on credit impaired and non-credit impaired loans was \$64.8 million and \$73.8 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2011 on all purchased loans is \$101.1 million. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows at December 31, 2011. The difference between the contractually required payments at Acquisition and the cash flow expected to be collected at Acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows will result in a reversal of the provision for loan losses charged to earnings to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

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

	For Twelve Months Ended December 31,		For Three Months Ended March 31,	
	2011	2010	2011	2010
Beginning Balance	\$ 14,414,324	\$ 23,859,358	\$ 9,760,544	\$ 14,414,324
Additions	1,162,403	335,430	-	-
Accretion ⁽¹⁾	(5,816,183)	(9,780,464)	1,354,334	1,095,427
Ending Balance	<u>\$ 9,760,544</u>	<u>\$ 14,414,324</u>	<u>\$ 8,406,210</u>	<u>\$ 13,318,897</u>

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 6 – Loans (cont.)

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

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of \$8.6 million and \$8.4 million at December 31, 2011 and 2010, respectively. During 2011 and 2010, \$0.02 million and \$0.2 million of new loans were made and repayments totaled \$0.1 million and \$0.8 million, respectively. Management believes these loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectibility or present other unfavorable features.

Residential and commercial real estate loans approximating \$128.4 million and \$113.2 million at December 31, 2011 and 2010, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 7 – Allowance for Loan Losses

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

	2011	2010	2009
Balance at beginning of year	\$ 9,526,592	\$ 6,034,187	\$ 5,945,162
Charge-offs	(7,127,898)	(4,551,517)	(3,739,631)
Recoveries	243,394	1,113,922	123,101
Provision charged to operation	8,370,000	6,930,000	3,705,555
Balance at end of year	<u>\$ 11,012,088</u>	<u>\$ 9,526,592</u>	<u>\$ 6,034,187</u>

NOTE 8 - Other Real Estate Owned

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

The following is a summary of the activity in OREO for the years ended December 31, 2011 and 2010:

	2011	2010
Beginning Balance	\$ 5,407,205	\$ 4,681,481
Additions	10,256,043	8,667,614
Valuation Adjustments	-	-
Sales	(8,312,570)	(7,941,890)
Ending Balance	<u>\$ 7,350,678</u>	<u>\$ 5,407,205</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

NOTE 9 - Troubled Debt Restructuring

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

A summary of troubled debt restructurings as of December 31, 2011 and December 31, 2010 is noted in the table below. All troubled debt restructurings are considered impaired loans and, as of December 31, 2011, the allowance associated with those loans was \$1.9 million.

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

	December 31, 2010			
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation	Recorded Investment
Commercial	-	\$ -	\$ -	\$ -
Real estate				
Construction	3	2,005,213	-	2,005,213
Commercial	19	11,510,812	793,960	10,716,852
Residential	42	7,478,138	-	7,478,138
Multifamily	1	130,880	-	130,880
Installment & Other	-	-	-	-
Total Loans	65	\$ 21,125,043	\$ 793,960	\$ 20,331,083

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 9 - Troubled Debt Restructuring (cont.)

The following is a summary of troubled debt restructurings as of December 31, 2011 and December 31, 2010 that were in default. Troubled debt restructures in default are past due 90 days or more at the end of the period.

	December 31, 2011		December 31, 2010	
	Number of Modifications	Total in Default	Number of Modifications	Total in Default
Commercial	-	\$ -	-	\$ -
Real estate				
Construction	-	-	-	-
Commercial	-	-	-	-
Residential	18	2,860,627	2	223,376
Multifamily	-	-	-	-
Installment & Other	-	-	-	-
Total Loans	<u>18</u>	<u>\$ 2,860,627</u>	<u>2</u>	<u>\$ 223,376</u>

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

	For the Year Ended December 31, 2011									
	Modification of Terms		Reduction of Interest Rate		Modification to Interest-only Payments		Forgiveness of Debt		Total	
	Count	Balance	Count	Balance	Count	Balance	Count	Balance	Count	Balance
Commercial	-	\$ -	-	\$ -	-	\$ -	2	\$ 85,000	2	\$ 85,000
Real estate										
Construction	-	-	1	165,032	-	-	3	3,518,007	4	3,683,039
Commercial	-	-	-	-	4	801,112	1	427,300	5	1,228,412
Residential	4	439,326	47	6,678,519	5	2,486,920	2	2,717,078	58	12,321,843
Multifamily	-	-	1	415,821	-	-	-	-	1	415,821
Installment & Other	2	31,526	7	104,885	-	-	-	-	9	136,411
Total Loans	<u>6</u>	<u>\$ 470,852</u>	<u>56</u>	<u>7,364,257</u>	<u>9</u>	<u>\$ 3,288,032</u>	<u>8</u>	<u>\$ 6,747,385</u>	<u>79</u>	<u>\$ 17,870,526</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 10 - Core Deposit Intangible Asset

Estimated future amortization expense as of December 31, 2011 by year is as follows:

2012	\$	310,213
2013		230,381
2014		172,613
2015		130,381
2016		98,275
Thereafter		63,272
Total	\$	<u>1,005,135</u>

NOTE 11 - Mortgage Servicing Rights

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

	2011	2010	2009
Balance at beginning of year	\$ 1,702,696	\$ 1,794,635	\$ 590,224
Additions of mortgage servicing rights	389,597	395,325	892,086
Additions from the acquisition	-	-	920,772
Amortization	<u>(493,491)</u>	<u>(487,264)</u>	<u>(608,447)</u>
Balance at end of year	<u>\$ 1,598,802</u>	<u>\$ 1,702,696</u>	<u>\$ 1,794,635</u>

The carrying value of MSR's is determined in accordance with relevant accounting guidance. This guidance permits capitalized MSR's to be amortized in proportion to and over the period of estimated net servicing income and to be assessed for impairment. The Bank relies on industry data to estimate the initial fair value of MSR's to be capitalized as a percentage of the principal balance of the loans sold. The Bank adjusts the carrying value monthly for reductions due to normal amortization and actual prepayments, including defaults. The Bank assesses its MSR's for impairment each reporting period using the most recent statistical data published by a third party source. At December 31, 2011 and 2010, the weighted average coupon rates of mortgage loans underlying the MSR's were 4.56% and 4.77%, respectively, and the weighted average remaining maturity of the mortgage loans underlying the MSR's were 209 months and 211 months, respectively. The estimated fair values of MSR's were \$1,884,447 and \$2,784,581 at December 31, 2011 and 2010, respectively. As the carrying value of the Bank's MSR's was less than the estimated fair value at December 31, 2011 and 2010, no impairment existed.

The carrying value of MSR's was \$1,598,802, or 0.50% of loans serviced at December 31, 2011 compared with \$1,702,696, or 0.51% of loans serviced at December 31, 2010.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 11 - Mortgage Servicing Rights (cont.)

The projections of amortization expense shown below for mortgage servicing rights are based on existing asset balances and the existing interest rate environment at December 31, 2011. Future amortization may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates and market conditions.

Estimated future amortization by year is as follows:

2012	\$	245,772
2013		223,122
2014		210,225
2015		198,234
2016		142,598
Thereafter		<u>578,851</u>
	\$	<u><u>1,598,802</u></u>

The unpaid principal balance of mortgage loans serviced for others, which is not included in the accompanying consolidated balance sheets, was \$320,325,961 and \$334,913,058 at December 31, 2011 and 2010, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing and included in demand deposits were \$1,390,998 and \$800,970 at December 31, 2011 and 2010, respectively.

NOTE 12 - Premises and Equipment

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

	2011	2010
Land	\$ 6,347,851	\$ 6,338,079
Buildings and leasehold improvements	30,536,256	30,066,701
Furniture and equipment	<u>13,194,847</u>	<u>12,998,521</u>
Total	50,078,954	49,403,301
Less: Accumulated depreciation	(30,932,084)	(29,081,827)
Net Premises and Equipment	<u>\$ 19,146,870</u>	<u>\$ 20,321,474</u>

Depreciation expense amounted to \$2,149,444, \$2,250,653 and \$2,247,216 in 2011, 2010 and 2009, respectively.

NOTE 13 – Accrued Interest Receivable and Other Assets

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

	2011	2010
Accrued interest receivable	\$ 4,650,828	\$ 4,120,030
Federal Reserve Stock	322,100	322,100
Prepaid expenses and other assets	<u>3,161,696</u>	<u>3,189,355</u>
Total	<u>\$ 8,134,624</u>	<u>\$ 7,631,485</u>

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 14 - Deposits

The aggregate amount of time deposits, each with a minimum denomination of \$100,000, was \$72,353,997 and \$88,033,902 at December 31, 2011 and 2010, respectively.

Scheduled maturities of time deposits at December 31 are:

	2011	2010
Due within one year	\$ 134,027,779	\$ 174,627,722
After one year but within two years	25,630,007	15,770,177
After two years but within three years	7,374,224	11,030,336
After three years but within four years	6,906,562	2,958,523
After four years but within five years	5,721,537	6,699,289
	<u>\$ 179,660,109</u>	<u>\$ 211,086,047</u>

The Bank had no customers with a deposit balance in excess of 5% of total deposits at December 31, 2011 and one customer amounting to \$57,057,652 at December 31, 2010.

NOTE 15 - Other Borrowings

Other borrowings consist of accounts due to the Federal Reserve Bank under a \$7,000,000 treasury, tax and loan depository agreement. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature on demand. There were no treasury, tax and loan account balances as of December 31, 2011 compared to \$4,815,964 at December 31, 2010. Such accounts generally are repaid within one to 120 days from the transaction date and are collateralized by a pledge of investment securities with a carrying value of \$7,036,880 and \$7,170,150 at December 31, 2011 and 2010, respectively.

The Bank has the ability to borrow (purchase) federal funds of up to \$50,000,000 under a revolving line-of-credit. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature daily. There were no federal funds purchased outstanding at December 31, 2011 or 2010.

The Bank may also borrow through securities sold under repurchase agreements (reverse repurchase agreements). Reverse repurchase agreements, which are classified as secured borrowings, generally mature within one to four days from the transaction date. They are reflected at the amount of cash received in connection with the transaction. The Bank had no borrowings outstanding under reverse repurchase agreements at December 31, 2011 and 2010, respectively and, accordingly, the Bank did not pledge any U.S. government sponsored entity securities and municipal obligations at December 31, 2011 or 2010 as collateral under the master repurchase agreement. At December 31, 2011, the Bank could pledge up to \$182,950,649 of additional securities as collateral under the existing agreements if needed to obtain additional borrowings. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. The Bank may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of \$52,708,500 and \$74,412,000 as of December 31, 2011 and 2010, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling \$58,565,000 and \$82,680,000 as of December 31, 2011 and 2010, respectively.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 16 - Income Taxes

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

	2011	2010	2009
Current tax expense			
Federal	\$ 4,691,821	\$ 10,559,058	\$ 4,402,480
State	1,171,394	2,500,277	1,827,001
Total current expense	5,863,215	13,059,335	6,229,481
Deferred income taxes expense (benefit)			
Federal	(885,799)	(3,731,054)	6,441,308
State	(284,815)	(954,281)	964,211
Total deferred expense (benefit)	(1,170,614)	(4,685,335)	7,405,519
Total income tax expense	\$ 4,692,601	\$ 8,374,000	\$ 13,635,000

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

	2011	2010
Deferred income tax assets:		
Allowance for loan losses	\$ 4,421,342	\$ 3,825,138
Reserve for health plan	341	94,502
Depreciation	-	665,180
Non-accrual interest	959,819	1,274,174
Loss carryforwards	43,295	43,295
Other	200,963	164,807
Deferred tax assets before valuation allowance	5,625,760	6,067,096
Valuation allowance	(43,294)	(43,295)
Net deferred income tax assets	5,582,465	6,023,801
Deferred income tax liabilities		
Loan acquisition fair market valuation	(3,198,822)	(4,477,574)
Other real estate owned	(45,531)	(226,115)
Core deposit intangible asset	(403,411)	(571,263)
Deferred loan fees	(221,156)	(230,816)
Mortgage servicing rights	(638,336)	(680,033)
Depreciation	(1,184)	-
Other	(65,411)	-
Total deferred income tax liabilities	(4,573,851)	(6,185,801)
Net deferred income tax asset (liability)	\$ 1,008,614	\$ (162,000)

The Corporation has state net business loss carryforwards of approximately \$843,000 as of December 31, 2011 and 2010, respectively. The net business loss carryforwards expire in varying amounts between 2017 and 2024.

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 16 - Income Taxes (cont.)

A valuation allowance has been established against state deferred income tax assets for those entities which have state net business loss carryforwards in which management believes that it is more likely than not that the state deferred income tax assets will not be realized.

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

	2011		2010		2009	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income taxes at statutory rate	\$ 4,973,083	35.00%	\$ 7,939,415	35.00%	\$ 12,499,359	35.00%
Adjustments for:						
Tax exempt interest on municipal obligations	(485,449)	(3.41)	(518,822)	(2.29)	(494,308)	(1.38)
Increase in taxes resulting from state income taxes, net of federal tax benefit	709,205	4.99	1,004,897	5.07	1,814,150	5.08
Increase in cash surrender value of life insurance	(163,610)	(1.15)	(165,053)	(0.73)	(176,331)	(0.49)
Permanent items prior years	(238,071)	(1.68)	-	-	-	-
Other – net	(102,557)	(0.72)	113,563	0.14	(7,870)	(0.03)
Income tax expense	<u>\$ 4,692,001</u>	<u>33.03%</u>	<u>\$ 8,374,000</u>	<u>36.91%</u>	<u>13,635,000</u>	<u>38.18%</u>

As of December 31, 2011, 2010 and 2009, the Corporation had no uncertain tax positions. The Corporation, along with its subsidiaries, files U.S. Federal and Wisconsin income tax returns. The Corporation's federal tax returns for 2007 and prior and its 2006 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

NOTE 17 - Employee Benefit Plans

The Bank has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21 and completed one year of service. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Bank may make regular and matching contributions to the plan each year. In 2011, 2010 and 2009, the Bank provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. Participants direct the investment of their contributions into one or more investment options. The Bank recorded contribution expense of \$629,577, \$562,593, and \$415,807 in 2011, 2010 and 2009, respectively.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 18 - Operating Leases

The Bank leases various banking facilities under operating lease agreements from various companies. Three of these facilities are leased from companies owned by a director and major shareholder of the Corporation. All of the agreements include renewal options and one agreement requires the Bank to pay insurance, real estate taxes and maintenance costs associated with the lease. Rental amounts are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to \$1,357,715, \$1,239,981 and \$915,849 in 2011, 2010 and 2009 respectively, including \$449,474, \$362,645 and \$302,524, respectively, on facilities leased from companies owned by a director and major shareholder of the Corporation.

At December 31, 2011, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

2012	\$	1,120,098
2013		1,077,714
2014		1,006,567
2015		653,668
2016		299,718
Thereafter		518,465
	\$	<u>4,676,230</u>

Office space at certain facilities is leased to outside parties. Rental income included in net occupancy costs was \$933,267, \$987,826 and \$1,131,209 for the years ended December 31, 2011, 2010 and 2009, respectively.

NOTE 19 - Commitments and Contingencies

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 19 - Commitments and Contingencies (cont.)

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

A summary of the contract or notional amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2011 and 2010 is as follows:

	2011	2010
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 106,156,733	106,923,506
Standby letters of credit	3,746,445	3,405,208
Forward commitment to sell mortgage loans	3,208,503	3,109,127

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties. The Bank also enters into forward commitments to sell mortgage loans to a secondary market agency.

NOTE 20 - Stockholders' Equity

Cumulative Preferred Stock

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

Retained Earnings

The principal source of income and funds of the Corporation are dividends from the Bank. Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies. Under this formula, dividends of approximately \$13,004,071 may be paid without prior regulatory approval. Maintenance of adequate capital at the Bank effectively restricts potential dividends to an amount less than \$13,004,071.

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

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 21 - Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table that follows) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2011 and 2010 the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the regulatory agencies categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since these notifications that management believes have changed the institution's category.

Listed below is a comparison of the Corporation's and the Bank's actual capital amounts with the minimum requirements for well capitalized and adequately capitalized banks, as defined by the federal regulatory agencies' Prompt Corrective Action Rules, as of December 31, 2011 and 2010.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 21 - Regulatory Capital Requirements (cont.)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011						
Total capital (to risk weighted assets)						
Tri City Bankshares Corporation	\$ 130,371,000	17.1%	\$ 61,037,000	8.0%	\$ n/a	n/a
Tri City National Bank	\$ 125,937,000	16.6%	\$ 60,783,000	8.0%	\$ 75,979,000	10.0%
Tier 1 capital (to risk weighted assets)						
Tri City Bankshares Corporation	\$ 120,816,000	15.8%	\$ 30,414,000	4.0%	\$ n/a	n/a
Tri City National Bank	\$ 116,421,000	15.5%	\$ 30,392,000	4.0%	\$ 45,588,000	6.0%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	\$ 120,816,000	10.6%	\$ 45,524,000	4.0%	\$ n/a	n/a
Tri City National Bank	\$ 116,421,000	10.2%	\$ 45,515,000	4.0%	\$ 56,894,000	5.0%
As of December 31, 2010						
Total capital (to risk weighted assets)						
Tri City Bankshares Corporation	\$ 122,268,000	15.8%	\$ 62,107,000	8.0%	\$ n/a	n/a
Tri City National Bank	\$ 117,822,000	15.2%	\$ 62,011,000	8.0%	\$ 77,514,000	10.0%
Tier 1 capital (to risk weighted assets)						
Tri City Bankshares Corporation	\$ 112,741,000	14.5%	\$ 31,053,000	4.0%	\$ n/a	n/a
Tri City National Bank	\$ 108,295,000	14.0%	\$ 31,006,000	4.0%	\$ 46,509,000	6.0%
Tier 1 capital (to average assets)						
Tri City Bankshares Corporation	\$ 112,741,000	10.4%	\$ 43,566,000	4.0%	\$ n/a	n/a
Tri City National Bank	\$ 108,295,000	10.0%	\$ 43,298,000	4.0%	\$ 54,122,000	5.0%

NOTE 22 - Concentration of Credit Risk

Practically all of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area, Southeastern Wisconsin. Although the Bank has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of the counties surrounding the Bank. The concentration of credit by type of loan is set forth in Note 6.

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011, 2010 and 2009

NOTE 23 - Tri City Bankshares Corporation (Parent Company Only) Financial Information

CONDENSED BALANCE SHEETS

	December 31,	
	2011	2010
ASSETS		
Cash on deposit with subsidiary Bank	\$ 3,186,504	\$ 3,294,753
Premises and equipment - net	1,136,526	1,207,077
Investment in subsidiary Bank	116,624,361	108,870,875
Other assets - net	1,033,338	961,848
TOTAL ASSETS	\$ 121,980,729	\$ 114,334,553
STOCKHOLDERS' EQUITY		
Cumulative preferred stock, \$1 par value, 200,000 shares authorized, no shares issued	\$ -	\$ -
Common stock, \$1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding as of 2011 and 2010, respectively	8,904,915	8,904,915
Additional paid-in capital	26,543,470	26,543,470
Retained earnings	86,532,344	78,886,168
TOTAL STOCKHOLDERS' EQUITY	\$ 121,980,729	\$ 114,334,553

CONDENSED STATEMENTS OF INCOME

	Years Ended December 31,		
	2011	2010	2009
INCOME			
Dividends from subsidiary Bank	\$ 1,876,000	\$ 21,437,898	\$ 9,688,000
Interest income from subsidiary Bank	20,895	39,416	64,889
Management fees from subsidiary Bank	900,325	720,011	668,690
Total income	2,797,220	22,197,325	10,421,579
EXPENSES			
Administrative and general - net	1,100,835	1,146,824	900,106
Income before income taxes and equity in undistributed earnings of subsidiary Bank	1,696,385	21,050,501	9,521,473
Plus: Income tax benefit	66,336	154,500	50,000
Income before equity in undistributed earnings of subsidiary	1,762,721	21,205,001	9,571,473
Equity in undistributed earnings of subsidiary bank	7,753,484	(6,894,959)	12,505,981
NET INCOME	\$ 9,516,205	\$ 14,310,042	\$ 22,077,454

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 23 - Tri City Bankshares Corporation (Parent Company Only) Financial Information (cont.)

CONDENSED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	\$ 9,516,205	\$ 14,310,042	\$ 22,077,454
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation	85,451	83,112	91,902
Equity in undistributed income of subsidiary Bank	(7,753,486)	6,894,959	(12,505,981)
Other	(71,490)	(144,935)	(134,610)
Net Cash Flows Provided by Operating Activities	1,776,680	21,143,178	9,528,765
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of premises and equipment – net	(14,900)	(21,269)	(19,246)
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends declared	(1,870,029)	(21,371,793)	(9,617,416)
Common stock issued - net	-	-	-
Net Cash Flows Used in Financing Activities	(1,870,029)	(21,371,793)	(9,617,416)
Net Change in Cash	(108,249)	(249,884)	(107,897)
CASH – BEGINNING OF YEAR	3,294,753	3,544,637	3,652,534
CASH – END OF YEAR	\$ 3,186,504	\$ 3,294,753	\$ 3,544,637

TRI CITY BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011, 2010 and 2009

NOTE 24 - Quarterly Results of Operations (Unaudited)

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

The following is a summary of the quarterly results of operations for the years ended December 31, 2011 and 2010:

	(Dollars in Thousands, except per share data)			
	Three Months Ended			
	December 31	September 30	June 30	March 31
2011				
Interest income	\$ 13,804	\$ 12,955	\$ 13,594	\$ 12,843
Interest expense	(989)	(1,086)	(1,180)	(1,328)
Net interest income	12,815	11,869	12,414	11,515
Provision for loan losses	(3,000)	(2,050)	(1,920)	(1,400)
Noninterest income	3,548	4,161	3,704	3,376
Noninterest expense	(10,156)	(10,239)	(10,098)	(10,331)
Income before income taxes	3,207	3,741	4,100	3,160
Income taxes	(1,074)	(1,297)	(1,447)	(874)
Net income	<u>\$ 2,133</u>	<u>\$ 2,444</u>	<u>\$ 2,653</u>	<u>\$ 2,286</u>
Basic earnings per share	\$ 0.24	\$ 0.28	\$ 0.29	\$ 0.26
2010				
Interest income	\$ 13,890	\$ 15,400	\$ 16,087	\$ 16,551
Interest expense	(1,486)	(1,301)	(1,372)	(1,553)
Net interest income	12,404	14,099	14,715	14,998
Provision for loan losses	(2,800)	(1,400)	(950)	(1,780)
Noninterest income	4,043	3,739	3,913	4,781
Noninterest expense	(11,122)	(10,482)	(11,023)	(10,451)
Income before income taxes	2,525	5,956	6,655	7,548
Income taxes	844	2,202	2,477	2,851
Net income	<u>\$ 1,681</u>	<u>\$ 3,754</u>	<u>\$ 4,178</u>	<u>\$ 4,697</u>
Basic earnings per share	\$ 0.19	\$ 0.42	\$ 0.47	\$ 0.53