AMES NATIONAL CORP
Form 10-K
March 13, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2011. Commission File Number 0-32637.

AMES NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

IOWA	42-1039071
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
405 5TH STREET, AMES, IOWA	50010
(Address of principal executive offices)	(Zip Code)

(515) 232-6251
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act:

COMMON STOCK, $2.00 PAR VALUE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

the preceding 12 months (of for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

As of June 30, 2011, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sale price for the registrant's common stock in the NASDAQ Capital Market, was $165,435,403. Shares of common stock beneficially owned by each executive officer and director of the Company have been excluded on the basis that such persons may be deemed to be an affiliate of the registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

The number of shares outstanding of the registrant's common stock on February 28, 2012, was 9,310,913.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement, as filed with the Securities and Exchange Commission on March 19, 2012, are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1.BUSINESS

General

Ames National Corporation (the "Company") is an Iowa corporation and bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company owns 100% of the stock of five banking subsidiaries consisting of two national banks and three state-chartered banks, as described below. All of the Company’s operations are conducted in the State of Iowa and primarily within the central Iowa counties of Boone, Marshall, Polk and Story where the Company’s banking subsidiaries are located. The Company does not engage in any material business activities apart from its ownership of its banking subsidiaries. The principal executive offices of the Company are located at 405 5th Street, Ames, Iowa 50010. The Company’s telephone number is (515) 232-6251 and website address is www.amesnational.com.

The Company was organized and incorporated on January 21, 1975 under the laws of the State of Iowa to serve as a holding company for its principal banking subsidiary, First National Bank, Ames, Iowa ("First National") located in Ames, Iowa. In 1983, the Company acquired the stock of the State Bank & Trust Co. ("State Bank") located in Nevada, Iowa; in 1991, the Company, through a newly-chartered state bank known as Boone Bank & Trust Co. ("Boone Bank"), acquired certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company located in Boone, Iowa; in 1995, the Company acquired the stock of the Randall-Story State Bank (”Randall-Story Bank”) located in Story City, Iowa; and in 2002, the Company chartered and commenced operations of a new national banking organization, United Bank & Trust NA (“United Bank”), located in Marshalltown, Iowa. First National, State Bank, Boone Bank, Randall-Story Bank and United Bank are each operated as a wholly owned subsidiary of the Company. These five financial institutions are referred to in this Form 10-K collectively as the “Banks” and individually as a “Bank”.

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

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The Banks' lending activities consist primarily of short-term and medium-term commercial real estate loans, residential real estate loans, agricultural and business operating loans and lines of credit, equipment loans, vehicle loans, personal loans and lines of credit, home improvement loans and origination of mortgage loans for sale into the secondary market. The Banks also offer a variety of demand, savings and time deposits, cash management services, merchant credit card processing, safe deposit boxes, wire transfers, direct deposit of payroll and social security checks and automated teller machine access. Four of the five Banks also offer trust services.

The Company provides various services to the Banks which include, but are not limited to, management assistance, internal auditing services, human resources services and administration, compliance management, marketing assistance and coordination, loan review and support with respect to computer systems and related procedures.

Banking Subsidiaries

First National Bank, Ames, Iowa. First National is a nationally-chartered, commercial bank insured by the Federal Deposit Insurance Corporation (the "FDIC"). It was organized in 1903 and became a wholly owned subsidiary of the Company in 1975 through a bank holding company reorganization whereby the then shareholders of First National exchanged all of their First National stock for stock in the Company. First National provides full-service banking to businesses and residents within the Ames community and surrounding area. It provides a variety of products and services designed to meet the needs of the market it serves. It has an experienced staff of bank officers including many who have spent the majority of their banking careers with First National and who emphasize long-term customer relationships. First National conducts business out of three full-service offices, all located in the city of Ames and a full-service office in Ankeny, Iowa.

As of December 31, 2011, First National had capital of $61,741,000 and 94 full-time equivalent employees. Full-time equivalents represent the number of people a business would employ if all its employees were employed on a full-time basis. It is calculated by dividing the total number of hours worked by all full and part-time employees by the number of hours a full-time individual would work for a given period of time. First National had net income for the years ended December 31, 2011, 2010 and 2009 of approximately $7,517,000, $6,869,000 and $5,309,000, respectively. Total assets as of December 31, 2011, 2010 and 2009 were approximately $560,753,000, $519,836,000 and $471,243,000, respectively.

State Bank & Trust Co., Nevada, Iowa. State Bank is an Iowa, state-chartered, FDIC insured commercial bank. State Bank was acquired by the Company in 1983 through a stock transaction whereby the then shareholders of State Bank exchanged all their State Bank stock for stock in the Company. State Bank was organized in 1939 and provides full-service banking to businesses and residents within the Nevada area from its main Nevada location and one office in Colo, Iowa. It has a strong presence in agricultural, commercial and residential real estate lending.

As of December 31, 2011, State Bank had capital of $15,697,000 and 25 full-time equivalent employees. State Bank had net income for the years ended December 31, 2011, 2010 and 2009 of approximately $2,059,000, $2,465,000 and $1,462,000, respectively. Total assets as of December 31, 2011, 2010 and 2009 were approximately $148,839,000, $135,695,000 and $134,947,000, respectively.

Boone Bank & Trust Co., Boone, Iowa. Boone Bank is an Iowa, state-chartered, FDIC insured commercial bank. Boone Bank was organized in 1992 by the Company under a new state charter in connection with a purchase and assumption transaction whereby Boone Bank purchased certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company in exchange for a cash payment. It provides full service banking to businesses and residents within the Boone community and surrounding area. It is actively engaged in agricultural, consumer and commercial lending, including real estate, operating and equipment loans. It conducts business from its main office and a full service office, both located in Boone.

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As of December 31, 2011, Boone Bank had capital of $13,915,000 and 26 full-time equivalent employees. Boone Bank had net income for the years ended December 31, 2011, 2010 and 2009 of approximately $1,828,000, $1,736,000 and $1,473,000, respectively. Total assets as of December 31, 2011, 2010 and 2009 were approximately $118,345,000, $105,089,000 and $104,957,000, respectively.

Randall-Story State Bank, Story City, Iowa. Randall-Story Bank is an Iowa, state-chartered, FDIC insured commercial bank. Randall-Story Bank was acquired by the Company in 1995 through a stock transaction whereby the then shareholders of Randall-Story Bank exchanged all their Randall-Story Bank stock for stock in the Company. Randall-Story Bank was organized in 1928 and provides full-service banking to Story City and the surrounding area. While its primary emphasis is in agricultural lending, Randall-Story Bank also provides the traditional lending services typically offered by community banks.

As of December 31, 2011, Randall-Story Bank had capital of $9,896,000 and 13 full-time equivalent employees. Randall-Story Bank had net income for the years ended December 31, 2011, 2010 and 2009 of approximately $1,234,000, $1,144,000 and $888,000, respectively. Total assets as of December 31, 2011, 2010 and 2009 were approximately $91,279,000, $85,062,000 and $79,497,000, respectively.

United Bank & Trust NA, Marshalltown, Iowa. United Bank is a nationally-chartered, commercial bank insured by the FDIC. It was newly chartered in June of 2002 and offers a broad range of deposit and loan products, as well as trust services to customers located in the Marshalltown and surrounding Marshall County area.

As of December 31, 2011, United Bank had capital of $12,285,000 and 24 full-time equivalent employees. United Bank had net income for the years ended December 31, 2011, 2010 and 2009 of approximately $1,228,000, $1,205,000 and $387,000, respectively. Total assets as of December 31, 2011, 2010 and 2009 were approximately $107,555,000, $106,819,000 and $112,441,000, respectively.

Business Strategy and Operations

As a locally owned, multi-bank holding company for five community banks, the Company emphasizes strong personal relationships to provide products and services that meet the needs of the Banks' customers. The Company seeks to achieve growth and maintain a strong return on equity. To accomplish these goals, the Banks focus on small-to-medium size businesses that traditionally wish to develop an exclusive relationship with a single bank. The Banks, individually and collectively, have the size to give the personal attention required by business owners, in addition to the credit expertise to help businesses meet their goals.

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The Banks offer a full range of deposit services that are typically available in most financial institutions, including checking accounts, savings accounts and time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. One major goal in developing the Banks' product mix is to keep the product offerings as simple as possible, both in terms of the number of products and the features and benefits of the individual services. The transaction accounts and time certificates are tailored to each Bank's principal market area at rates competitive in that Bank's market. In addition, retirement accounts such as IRAs (Individual Retirement Accounts) are available. The FDIC insures all deposit accounts up to the maximum amount. The Banks solicit these accounts from small-to-medium sized businesses in their respective primary trade areas, and from individuals who live and/or work within these areas. No material portion of the Banks' deposits has been obtained from a single person or from a few persons. Therefore, the Company does not believe that the loss of the deposits of any person or of a few persons would have an adverse effect on the Banks' operations or erode their deposit base.

Loans are provided to creditworthy borrowers regardless of their race, color, national origin, religion, sex, age, marital status, disability, receipt of public assistance or any other basis prohibited by law. The Banks intend to fulfill this commitment while maintaining prudent credit standards. In the course of fulfilling this obligation to meet the credit needs of the communities which they serve, the Banks give consideration to each credit application regardless of the fact that the applicant may reside in a low to moderate income neighborhood, and without regard to the geographic location of the residence, property or business within their market areas.

The Banks provide innovative, quality financial products, such as Internet banking and trust services that meet the banking needs of their customers and communities. The loan programs and acceptance of certain loans may vary from time-to-time depending on the funds available and regulations governing the banking industry. The Banks offer all basic types of credit to their local communities and surrounding rural areas, including commercial, agricultural and consumer loans. The types of loans within these categories are as follows:

Commercial Loans. Commercial loans are typically made to sole proprietors, partnerships, corporations and other business entities such as municipalities where the loan is to be used primarily for business purposes. These loans are typically secured by assets owned by the borrower and often times involve personal guarantees given by the owners of the business. The types of loans the Banks offer include:

- financing guaranteed under Small Business Administration programs
- operating and working capital loans
- loans to finance equipment and other capital purchases
- commercial real estate loans
- business lines of credit
- term loans
- loans to professionals
- letters of credit

Agricultural Loans. The Banks, by nature of their location in central Iowa, are directly and indirectly involved in agriculture and agri-business lending. This includes short-term seasonal lending associated with cyclical crop and livestock production, intermediate term lending for machinery, equipment and breeding stock acquisition and long-term real estate lending. These loans are typically secured by the crops, livestock, equipment or real estate being financed. The basic tenet of the Banks' agricultural lending philosophy is a blending of strong, positive cash flow supported by an adequate collateral position, along with a demonstrated capacity to withstand short-term negative impact if necessary. Applicable governmental subsidies and affiliated programs are utilized if warranted to accomplish these parameters. Approximately 19% of the loan portfolio consists of loans made for agricultural purposes.

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Consumer Loans. Consumer loans are typically available to finance home improvements and consumer purchases, such as automobiles, household furnishings and boats. These loans are made on both a secured and an unsecured basis. The following types of consumer loans are available:

- automobiles and trucks
- boats and recreational vehicles
- personal loans and lines of credit
- home equity lines of credit
- home improvement and rehabilitation loans
- consumer real estate loans

Other types of credit programs, such as loans to nonprofit organizations, to public entities, for community development and to other governmental programs also are available.

First National, Boone Bank, State Bank and United Bank offer trust services typically found in a commercial bank with trust powers, including the administration of estates, conservatorships, personal and corporate trusts and agency accounts. The Banks also provide farm management, investment and custodial services for individuals, businesses and non-profit organizations.

The Banks earn income from the origination of residential mortgages that are sold in the secondary real estate market without retaining the mortgage servicing rights.

The Banks offer traditional banking services, such as safe deposit boxes, wire transfers, direct deposit of payroll and social security checks, automated teller machine access and automatic drafts (ACH) for various accounts.

Credit Management

The Company strives to achieve sound credit risk management. In order to achieve this goal, the Company has established uniform credit policies and underwriting criteria for the Banks' loan portfolios. The Banks diversify in the types of loans offered and are subject to regular credit examinations, annual internal and external loan audits and annual review of large loans, as well as quarterly reviews of loans experiencing deterioration in credit quality. The Company attempts to identify potential problem loans early, charge off loans promptly and maintain an adequate allowance for loan losses. The Company has established credit guidelines for the Banks' lending portfolios which include guidelines relating to the more commonly requested loan types, as follows:

Commercial Real Estate Loans - Commercial real estate loans, including agricultural real estate loans, are normally based on loan to appraisal value ratios of not to exceed 80% and secured by a first priority lien position. Loans are typically subject to interest rate adjustments no less frequently than 5 years from origination. Fully amortized monthly repayment terms normally do not exceed twenty years. Projections and cash flows that show ability to service debt within the amortization period are required. Property and casualty insurance is required to protect the Banks' collateral interests. Commercial and agricultural real estate loans represent approximately 40% of the loan portfolio. Major risk factors for commercial real estate loans, as well as the other loan types described below, include a geographic concentration in central Iowa; the dependence of the local economy upon several large governmental entities, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that is dependent on weather conditions and government programs.

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Commercial and Agricultural Operating Lines - These loans are made to businesses and farm operations with terms up to twelve months. The credit needs are generally seasonal with the source of repayment coming from the entity's normal business cycle. Cash flow reviews are completed to establish the ability to service the debt within the terms of the loan. A first priority lien on the general assets of the business normally secures these types of loans. Loan to value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s).

Commercial and Agricultural Term Loans – These loans are made to businesses and farm operations to finance equipment, breeding stock and other capital expenditures. Terms are generally the lesser of five years or the useful life of the asset. Term loans are normally secured by the asset being financed and are often additionally secured with the general assets of the business. Loan to value is generally 75% of the cost or value of the assets. Loans are normally guaranteed by the principal(s). Commercial and agricultural operating and term loans represent approximately 29% of the loan portfolio.

Residential First Mortgage Loans – Proceeds of these loans are used to buy or refinance the purchase of residential real estate with the loan secured by a first lien on the real estate. Most of the residential mortgage loans originated by the Banks (including servicing rights) are sold in the secondary mortgage market due to the higher interest rate risk inherent in the 15 and 30 year fixed rate terms consumers prefer. Loans that are originated and not sold in the secondary market generally have higher interest rates and have rate adjustment periods of no longer than seven years. The maximum amortization of first mortgage residential real estate loans is 30 years. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. Property insurance is required on all loans to protect the Banks' collateral position. Loans secured by one to four family residential properties represent approximately 21% of the loan portfolio.

Home Equity Term Loans – These loans are normally for the purpose of home improvement or other consumer purposes and are secured by a junior mortgage on residential real estate. Loan-to-value ratios normally do not exceed 90% of market value.

Home Equity Lines of Credit - The Banks offer a home equity line of credit generally with a maximum term of 60 months. These loans are secured by a junior mortgage on the residential real estate and normally do not exceed a loan-to-market value ratio of 90% with the interest adjusted quarterly.

Consumer Loans – Consumer loans are normally made to consumers under the following guidelines. Automobiles - loans on new and used automobiles generally will not exceed 90% and 75% of the value, respectively. Recreational vehicles and boats – 90% and 66% of the value, respectively. Mobile home - maximum term on these loans is 180 months with the loan-to-value ratio generally not exceeding 66%. Each of these loans is secured by a first priority lien on the assets and requires insurance to protect the Banks' collateral position. Unsecured - The term for unsecured loans generally does not exceed 12 months. Consumer and other loans represent approximately 5% of the loan portfolio.

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Employees

At December 31, 2011, the Banks had a total of 182 full-time equivalent employees and the Company had an additional 11 full-time employees. The Company and Banks provide their employees with a comprehensive program of benefits, including comprehensive medical and dental plans, long-term and short-term disability coverage, and a 401(k) profit sharing plan. Management considers its relations with employees to be satisfactory. Unions represent none of the employees.

Market Area

The Company operates five commercial banks with locations in Story, Boone, Polk and Marshall Counties in central Iowa.

First National is located in Ames, Iowa with a population of 58,965. The major employers are Iowa State University, Ames Laboratories, Iowa Department of Transportation, Mary Greeley Medical Center, Ames Community Schools, City of Ames, Sauer-Danfoss and McFarland Clinic. First National's primary business includes providing retail banking services and business and consumer lending. First National has a minimum exposure to agricultural lending.

Boone Bank is located in Boone, Iowa with a population of 12,661. Boone is the county seat of Boone County. The major employers are Fareway Stores, Inc., Iowa National Guard, Union Pacific Railroad, Boone County Hospital and Communication Data Services. Boone Bank provides lending services to the agriculture, commercial and real estate markets.

State Bank is located in Nevada, Iowa with a population of 6,798. Nevada is the county seat of Story County. The major employers are Print Graphics, General Financial Supply, Mid-American Manufacturing, Mid-States Millwright & Builders, Inc., Burke Corporation and Almaco. State Bank provides various types of loans with a major agricultural presence. It provides a wide variety of banking services including trust, deposit, ATM, and merchant card processing.

Randall-Story Bank is located in Story City, Iowa with a population of 3,431. The major employers are Bethany Manor, American Packaging, M.H. Eby, Inc. and Record Printing. Located in a major agricultural area, it has a strong presence in this type of lending. As a full service commercial bank, it provides a full line of products and services.

United Bank is located in Marshalltown, Iowa with a population of 27,552. The major employers are Iowa Veterans Home, Marshalltown School District, JBS Swift & Co., Emerson Process Management/Fisher Division, Lennox Industries and Marshalltown Medical & Surgical Center. The Bank offers a full line of loan, deposit, and trust services. Loan services include primarily commercial and consumer types of credit including operating lines, equipment loans, automobile financing and real estate loans.

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Competition

The geographic market area served by the Banks is highly competitive with respect to both loans and deposits. The Banks compete principally with other commercial banks, savings and loan associations, credit unions, mortgage companies, finance divisions of auto and farm equipment companies, agricultural suppliers and other financial service providers. Some of these competitors are local, while others are statewide or nationwide. The major commercial bank competitors include Great Western Bank, U.S. Bank National Association and Wells Fargo Bank, each of which have a branch office or offices within the Banks' primary trade areas. Among the advantages such larger banks have are their ability to finance extensive advertising campaigns and to allocate their investment assets to geographic regions of higher yield and demand. These larger banking organizations have much higher legal lending limits than the Banks and thus are better able to finance large regional, national and global commercial customers.

In order to compete with the other financial institutions in their primary trade areas, the Banks use, to the fullest extent possible, the flexibility which is accorded by independent status. This includes an emphasis on specialized services, local promotional activity and personal contacts by the Banks' officers, directors and employees. In particular, the Banks compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services. The Banks compete for loans primarily by offering competitive interest rates, experienced lending personnel and quality products and services.

As of December 31, 2011, there were 37 FDIC insured institutions having approximately 89 offices or branch offices within Boone, Story, Polk and Marshall County, Iowa where the Banks' offices are primarily located. First National, State Bank and Randall-Story Bank together have the largest percentage of deposits in Story County.

The Banks also compete with the financial markets for funds. Yields on corporate and government debt securities and commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for funds with equity, money market, and insurance products offered by brokerage and insurance companies. This competitive trend will likely continue in the future.

The Company anticipates bank competition will continue to change materially over the next several years as more financial institutions, including the major regional and national banks, continue to consolidate. Credit unions, which are not subject to income taxes, have a significant competitive advantage and provide additional competition in the Company's local markets.

Supervision and Regulation

The following discussion generally refers to certain statutes and regulations affecting the banking industry. These references provide brief summaries and therefore do not purport to be complete and are qualified in their entirety by reference to those statutes and regulations. In addition, due to the numerous statutes and regulations that apply to and regulate the banking industry, many are not referenced below.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("the Dodd-Frank Act"). In response to the recent national and international economic recession and to strengthen supervision of financial institutions and systemically important nonbank financial institutions, Congress and the U.S. government have taken a variety of actions, including the enactment of the Dodd-Frank Act on July 21, 2010. The Dodd-Frank Act represents the most comprehensive change to banking laws since the Great Depression of the 1930s and mandates changes in several key areas: regulation and compliance (both with respect to financial institutions and systemically important nonbank financial companies), securities regulation, executive compensation, regulation of derivatives, corporate governance, transactions with affiliates, deposit insurance assessments and consumer protection. While the changes in the law required by the Dodd-Frank Act will most significantly have a major impact on large institutions, even relatively

small institutions such as the Company will be affected.

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Pursuant to the Dodd-Frank Act, the Banks are subject to regulations promulgated by a new consumer protection bureau housed within the Federal Reserve, known as the Bureau of Consumer Financial Protection (the "Bureau" or "BCFP"). The Bureau promulgates rules and orders with respect to consumer financial products and services and has substantial power to define the rights of consumers and responsibilities of lending institutions, such as the Banks. The Bureau will not, however, examine or supervise the Banks for compliance with such regulations; rather, enforcement authority will remain with the Banks' primary federal regulator although the Banks may be required to submit reports or other materials to the Bureau upon its request.

The Dodd-Frank Act also included a provision that supplements the Federal Trade Commission Act's (the "FTC Act") prohibitions against practices that are unfair or deceptive by also prohibiting practices that are "abusive." This term has not yet been defined by implementing regulations but, once it is defined, the Banks will be required to evaluate all of their consumer financial products and services to ensure they are in compliance with this provision.

In addition, the Dodd-Frank Act requires the Company and Banks to: (1) be subject to a new assessment model from the FDIC based upon assets, not deposits (as described herein) and (2) be subject to enhanced executive compensation and corporate governance requirements.

The Dodd-Frank Act also lifts the prohibition on paying interest on demand deposits effective July 21, 2011. This may change the nature of some of the products and services that financial institutions have traditionally used, such as earnings credits.

The extent to which the new legislation and existing and planned governmental initiatives thereunder will succeed in ameliorating tight credit conditions or otherwise result in an improvement in the national economy is uncertain. In addition, because most of the component parts of the Dodd-Frank Act will be subject to intensive agency rulemaking and subsequent public comment, it is difficult to predict the ultimate effect of the Dodd-Frank Act on the Company or the Banks at this time. Operational expenses of the Company may increase as a result of new compliance requirements.

Emergency Economic Stabilization Act of 2008. On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 ("EESA"), giving the US Treasury authority to take certain actions to restore liquidity and stability to the U.S. banking markets. Based upon the authority contained in the EESA, a number of programs to implement the EESA have been established. Those programs include the following:

Temporary Liquidity Guarantee Program ("TLGP"). This program contains both a debt guarantee component, whereby the FDIC will guarantee until June 30, 2012, the senior unsecured debt issued by eligible financial institutions between October 14, 2008 and June 30, 2009, and an account transaction guarantee component, whereby the FDIC will insure 100% of non-interest bearing deposit transaction accounts held at eligible financial institutions, such as payment processing accounts, payroll accounts and working capital accounts, through June 30, 2010. The Banks have opted out of the debt guarantee component and opted into the transaction guarantee component of this program. Importantly, however, the Dodd-Frank Act requires all insured financial institutions, such as the Banks, to provide such products with FDIC insurance from December 31, 2010 until December 31, 2012. This protection will also apply to interest-bearing NOW accounts or Interest on Lawyers Trust Accounts. The FDIC has not stated that deposit insurance premiums will increase because of the provision.

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Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "S.A.F.E. Act" Requirements). The S.A.F.E. Act requires residential mortgage loan originators who are employees of regulated financial institutions, such as the Banks, to be registered with the Nationwide Mortgage Licensing System and Registry, a database created by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to support the licensing of mortgage loan originators by the states (the "Registry"). Employees of regulated financial institutions are generally prohibited from originating residential mortgage loans unless they are registered. Federal registrants were permitted to register January 1, 2011.

USA Patriot Act. The USA Patriot Act was enacted in 2001 which, together with regulations issued pursuant to this act, substantially broadened previously existing anti-money laundering laws and regulations, increased compliance, due diligence and reporting obligations for financial institutions, created new crimes and penalties and required federal banking agencies, in reviewing mergers and other acquisition transactions, to consider the effectiveness of the parties in combating money laundering activities. The act requires all financial institutions to establish certain anti-money laundering compliance and due diligence programs that are reasonably designed to detect and report instances of money laundering. The Company believes its compliance policies, procedures and controls satisfy the material requirements of the Patriot Act and regulations.

Sarbanes-Oxley Act. The Sarbanes-Oxley Act was enacted in 2002 to, among other things, increase corporate responsibility and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the federal securities laws. This act generally applies to all companies that are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The act implements significant changes in the responsibilities of officers and directors of public companies and makes certain changes to the corporate reporting obligation of those companies and their external auditors. Among the requirements and prohibitions addressed by the act are certifications required by CEOs and CFOs of periodic reports filed with the SEC; accelerated reporting of stock transactions by directors, officers and large shareholders; prohibitions against personal loans from companies to directors and executive officers (except loans made in the ordinary course of business); requirements for public companies' audit committees; requirements for auditor independence; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and executive officers in the 12-month period following initial publication of any financial statements that later require restatement; various increased criminal penalties for violations of securities laws; and the creation of a public company accounting oversight board. Rules adopted by the SEC to implement various provisions of the act include CEO and CFO certifications related to fair presentation of financial statements and financial information in public filings, as well as management's evaluation of disclosure controls and procedures; disclosure of whether any audit committee members qualify as a "financial expert"; disclosures related to audit committee composition and auditor pre-approval policies; disclosure related to adoption of a written code of ethics; reconciling non-GAAP financial information with GAAP in public communications; disclosure of off-balance sheet transactions; and disclosure related to director independence and the director nomination process. The Company has adopted modifications to its corporate governance procedures to comply with the provisions of the act and regulations.

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Incentive Compensation Regulation. The regulators issued on June 21, 2010 final guidance to ensure that incentive compensation arrangements at financial institutions take into account risk and are consistent with safe and sound banking practices. The guidance was designed to ensure that incentive compensation arrangements appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of the entity or create undue risks to the financial system. As a result of this guidance, the Company and the Banks will incorporate the risks related to incentive compensation into their broader risk-management framework.

The Company and the Banks are subject to extensive federal and state regulation and supervision. Regulation and supervision of financial institutions is primarily intended to protect depositors and the FDIC rather than shareholders of the Company. The laws and regulations affecting banks and bank holding companies have changed significantly over recent years, particularly with the passage of the Financial Services Modernization Act. There is reason to expect that similar changes will continue in the future. Any change in applicable laws, regulations or regulatory policies may have a material effect on the business, operations and prospects of the Company. The Company is unable to predict the nature or the extent of the effects on its business and earnings that any fiscal or monetary policies or new federal or state legislation may have in the future.

The Company

The Company is a bank holding company by virtue of its ownership of the Banks, and is registered as such with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), which subjects the Company and the Banks to supervision and examination by the Federal Reserve. Under the BHCA, the Company files with the Federal Reserve annual reports of its operations and such additional information as the Federal Reserve may require.

Source of Strength to the Banks. The Federal Reserve takes the position that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve's position that in serving as a source of strength to its subsidiary banks, bank holding companies should use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. It should also maintain the financial flexibility and capital raising capacity to obtain additional resources for providing assistance to its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice, or a violation of the Federal Reserve's regulations, or both.

Federal Reserve Approval. Bank holding companies must obtain the approval of the Federal Reserve before they: (i) acquire direct or indirect ownership or control of any voting stock of any bank if, after such acquisition, they would own or control, directly or indirectly, more than 5% of the voting stock of such bank; (ii) merge or consolidate with another bank holding company; or (iii) acquire substantially all of the assets of any additional banks.

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Non-Banking Activities. With certain exceptions, the BHCA also prohibits bank holding companies from acquiring direct or indirect ownership or control of voting stock in any company other than a bank or a bank holding company unless the Federal Reserve finds the company's business to be incidental to the business of banking. When making this determination, the Federal Reserve in part considers whether allowing a bank holding company to engage in those activities would offer advantages to the public that would outweigh possible adverse effects. A bank holding company may engage in permissible non-banking activities on a de novo basis, if the holding company meets certain criteria and notifies the Federal Reserve within ten (10) business days after the activity has commenced.

Under the Financial Services Modernization Act, eligible bank holding companies may elect (with the approval of the Federal Reserve) to become a "financial holding company." Financial holding companies are permitted to engage in certain financial activities through affiliates that had previously been prohibited activities for bank holding companies. Such financial activities include securities and insurance underwriting and merchant banking. At this time, the Company has not elected to become a financial holding company, but may choose to do so at some time in the future.

Control Transactions. The Change in Bank Control Act of 1978, as amended, requires a person or group of persons acquiring "control" of a bank holding company to provide the Federal Reserve with at least 60 days prior written notice of the proposed acquisition. Following receipt of this notice, the Federal Reserve has 60 days to issue a notice disapproving the proposed acquisition, but the Federal Reserve may extend this time period for up to another 30 days. An acquisition may be completed before the disapproval period expires if the Federal Reserve issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, would constitute the acquisition of control. In addition, any "company" would be required to obtain the approval of the Federal Reserve under the BHCA before acquiring 25% (or 5% if the "company" is a bank holding company) or more of the outstanding shares of the Company, or otherwise obtain control over the Company.

Affiliate Transactions. The Company and the Banks are deemed affiliates within the meaning of the Federal Reserve Act, and transactions between affiliates are subject to certain restrictions. Generally, the Federal Reserve Act: (i) limits the extent to which the financial institution or its subsidiaries may engage in "covered transactions" with an affiliate; and (ii) requires all transactions with an affiliate, whether or not "covered transactions," to be on terms substantially the same, or at least as favorable to the institution or subsidiary, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar transactions.

State Law on Acquisitions. Iowa law permits bank holding companies to make acquisitions throughout the state. However, Iowa currently has a deposit concentration limit of 15% on the amount of deposits in the state that any one banking organization can control and continue to acquire banks or bank deposits (by acquisitions), which applies to all depository institutions doing business in Iowa.

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Banking Subsidiaries

Applicable federal and state statutes and regulations governing a bank's operations relate, among other matters, to capital adequacy requirements, required reserves against deposits, investments, loans, legal lending limits, certain interest rates payable, mergers and consolidations, borrowings, issuance of securities, payment of dividends, establishment of branches and dealings with affiliated persons.

First National and United Bank are national banks subject to primary federal regulation and supervision by the OCC. The FDIC, as an insurer of the deposits, also has some limited regulatory authority over First National and United Bank. State Bank, Boone Bank and Randall-Story Bank are state banks subject to regulation and supervision by the Iowa Division of Banking. The three state Banks are also subject to regulation and examination by the FDIC, which insures their respective deposits to the maximum extent permitted by law. The federal laws that apply to the Banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for loans. The laws and regulations governing the Banks generally have been promulgated to protect depositors and the deposit insurance fund of the FDIC and not to protect stockholders of such institutions or their holding companies.

The OCC and FDIC each have authority to prohibit banks under their supervision from engaging in what it considers to be an unsafe and unsound practice in conducting their business. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires federal banking regulators to adopt regulations or guidelines in a number of areas to ensure bank safety and soundness, including internal controls, credit underwriting, asset growth, management compensation, ratios of classified assets to capital and earnings. FDICIA also contains provisions which are intended to change independent auditing requirements, restrict the activities of state-chartered insured banks, amend various consumer banking laws, limit the ability of "undercapitalized banks" to borrow from the Federal Reserve's discount window, require regulators to perform periodic on-site bank examinations and set standards for real estate lending.

Borrowing Limitations. Each of the Banks is subject to limitations on the aggregate amount of loans that it can make to any one borrower, including related entities. Subject to numerous exceptions based on the type of loans and collateral, applicable statutes and regulations generally limit loans to one borrower of 15% of total equity and reserves. Each of the Banks is in compliance with applicable loans to one borrower requirements.

FDIC Insurance. Under the Dodd-Frank Act, a permanent increase in deposit insurance was authorized to $250,000. The coverage limit is per depositor, per insured depository institution for each account ownership category. The FDIC has adopted a risk-based insurance assessment system under which depository institutions contribute funds to the FDIC insurance fund based on their risk classification. The FDIC may terminate the deposit insurance of any insured depository institution if it determines after an administrative hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law.

The FDIC imposes an assessment against all depository institutions for deposit insurance. This assessment is based on the risk category of the institution. The FDIC issued a final rule on February 7, 2011, effective April 1, 2011, that redefines the deposit insurance assessment base as average consolidated total assets minus average tangible equity and adopted a new assessment rate schedule effective April 1, 2011. The total base assessment rate will range from 2.5 to 45 basis points based upon an institutions risk category. Calculated assessment rates are based upon an institution’s assessment base.

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The FDIC announced on November 12, 2009, that insured depository institutions were required to prepay three years of deposit insurance premiums on December 30, 2009. Under the rule, the prepaid amount was based on an estimate of the institution's assessment rate in effect on September 30, 2009, its third quarter 2009 assessment base, and an estimated rate of increase in that assessment base. As of December 31, 2011, approximately $2,716,000 of prepaid FDIC deposit insurance premiums were included in other assets.

The Dodd-Frank Act also set a new minimum Deposit Insurance fund ("DIF") reserve ratio at 1.35% of estimated insured deposits. The Board of Directors of the FDIC on December 14, 2010 issued a final rule to set the insurance fund's designated reserve ratio (DRR) at 2.00% of estimated insured deposits. The FDIC is required to attain this ratio by September 30, 2020. In addition, the Dodd-Frank Act has an impact on the calculation of deposit insurance assessment premiums. Specifically, the Dodd-Frank Act generally requires the FDIC to define the deposit insurance assessment base for an insured depository institution as an amount equal to the institution's average consolidated total assets during the assessment period minus average tangible equity.

The FDIC rules also provide the FDIC's board with the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment if certain restrictions are met.

Capital Adequacy Requirements. The Federal Reserve, the FDIC and the OCC (collectively, the "Agencies") have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and account for off-balance sheet items. Failure to achieve and maintain adequate capital levels may give rise to supervisory action through the issuance of a capital directive to ensure the maintenance of required capital levels. Each of the Banks is in compliance with applicable risk-based capital level requirements as of December 31, 2011.

The current guidelines require all federally regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders' equity, qualifying perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles and the allowance for loan and lease losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term preferred stock, 45% of unrealized gain of equity securities and general reserve for loan and lease losses up to 1.25% of risk weighted assets.

Under these guidelines, banks' assets are given risk weights of 0%, 20%, 50% or 100%. Most loans are assigned to the 100% risk category, except for first mortgage loans fully secured by residential property and, under certain circumstances, residential construction loans (both carry a 50% rating). Most investment securities are assigned to the 20% category, except for municipal or state revenue bonds (which have a 50% rating) and direct obligations of or obligations guaranteed by the United States Treasury or United States Government Agencies (which have a 0% rating).

The Agencies have also implemented a leverage ratio, which is equal to Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk based guidelines. The principal objective of the leverage ratio is to limit the maximum degree to which a bank may leverage its equity capital base. The minimum required leverage ratio for top rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points. Any institution operating at or near the 3% level is expected to be a strong banking organization without any supervisory, financial or operational weaknesses or deficiencies. Any institutions experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

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Prompt Corrective Action. Regulations adopted by the Agencies impose even more stringent capital requirements. The FDIC and other Agencies must take certain "prompt corrective action" when a bank fails to meet capital requirements. The regulations establish and define five capital levels: (i) "well-capitalized," (ii) "adequately capitalized," (iii) "undercapitalized," (iv) "significantly undercapitalized" and (v) "critically undercapitalized." Increasingly severe restrictions are imposed on the payment of dividends and management fees, asset growth and other aspects of the operations of institutions that fall below the category of being "adequately capitalized". Undercapitalized institutions are required to develop and implement capital plans acceptable to the appropriate federal regulatory agency. Such plans must require that any company that controls the undercapitalized institution must provide certain guarantees that the institution will comply with the plan until it is adequately capitalized. As of December 31, 2011 each of the Banks was categorized as “well capitalized” under regulatory prompt corrective action provisions.

Restrictions on Dividends. The dividends paid to the Company by the Banks are the major source of Company cash flow. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National Bank and United Bank, as a national bank, generally may pay dividends, without obtaining the express approval of the OCC, in an amount up to its retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Randall-Story Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

Reserves Against Deposits. The Federal Reserve requires all depository institutions to maintain reserves against their transaction accounts (primarily checking accounts) and non-personal time deposits. Generally, reserves of 3% must be maintained against total transaction accounts of $71,000,000 or less (subject to an exemption not in excess of the first $11,500,000 of transaction accounts). A reserve of $2,130,000 plus 10% of amounts in excess of $71,000,000 must be maintained in the event total transaction accounts exceed $71,000,000. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy applicable liquidity requirements. Because required reserves must be maintained in the form of vault cash or a noninterest bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce the earning assets of the Banks.

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Regulatory Enforcement Authority

The enforcement powers available to federal and state banking regulators are substantial and include, among other things, the ability to assess civil monetary penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, enforcement actions must be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions, or inactions, may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Applicable law also requires public disclosure of final enforcement actions by the federal banking agencies.

National Monetary Policies

In addition to being affected by general economic conditions, the earnings and growth of the Banks are affected by the regulatory authorities' policies, including the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply, credit conditions and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government securities, changes in reserve requirements against bank deposits and the Federal Reserve Discount Rate, which is the rate, charged member banks to borrow from the Federal Reserve Bank. These instruments are used in varying combinations to influence overall growth and distribution of credit, bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid on deposits.

The monetary policies of the Federal Reserve have had a material impact on the operating results of commercial banks in the past and are expected to have a similar impact in the future. Also important in terms of effect on banks are controls on interest rates paid by banks on deposits and types of deposits that may be offered by banks. The Depository Institutions Deregulation Committee, created by Congress in 1980, phased out ceilings on the rate of interest that may be paid on deposits by commercial banks and savings and loan associations, with the result that the differentials between the maximum rates banks and savings and loans can pay on deposit accounts have been eliminated. The effect of deregulation of deposit interest rates has been to increase banks' cost of funds and to make banks more sensitive to fluctuation in market rates.

Availability of Information on Company Website

The Company files periodic reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The Company makes available on or through its website free of charge all periodic reports filed by the Company with the SEC, including any amendments to such reports, as soon as reasonably practicable after such reports have been electronically filed with the SEC. The address of the Company's website on the Internet is: www.amesnational.com.

The Company will provide a paper copy of these reports free of charge upon written or telephonic request directed to John P. Nelson, Vice President and Secretary, 405 5th Street, Ames, Iowa 50010 or (515) 232-6251 or by email request at info@amesnational.com. The information found on the Company's website is not part of this or any other report the Company files with the SEC.

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Executive Officers of Company and Banks

The following table sets forth summary information about the executive officers of the Company and certain executive officers of the Banks. Unless otherwise indicated, each executive officer has served in his current position for the past five years.

Name	Age	Position with the Company or Bank and Principal Occupation and Employment During the Past Five Years
Kathy L. Baker	65	Named President and Director of United Bank on January 1, 2008. Previously served as a Vice President in the lending department of United Bank.
Scott T. Bauer	49	Named President of First National in 2007. Previously served as Executive Vice President and Senior Vice President of First National. Director of First National.
Kevin G. Deardorff	57	Vice President & Technology Director of the Company.
Stephen C. McGill	57	President of State Bank since 2003. Previously served as Senior Vice President of State Bank. Director of State Bank.
John P. Nelson	45	Vice President, Secretary and Treasurer of Company. Director and Chairman of Randall-Story Bank.
Thomas H. Pohlman	61	Named President of the Company in 2007. Previously served as Chief Operating Officer of the Company in 2006 and President of First National from 1999 to 2007. Director of the Company and Director and Chairman of First National, State Bank, Boone Bank and United Bank.
Jeffrey K. Putzier	50	President of Boone Bank since 1999. Director of Boone Bank.
Richard J. Schreier	44	Named President of Randall-Story in May, 2008. Director of Randall-Story. Previously served as Senior Vice President of lending at Randall-Story and State Bank.
Terrill L. Wycoff	69	Executive Vice President of First National since 2000. Director of First National.

ITEM 1A.RISK FACTORS

Set forth below is a description of risk factors related to the Company's business, provided to enable investors to assess, and be appropriately apprised of, certain risks and uncertainties the Company faces in conducting its business. An investor should carefully consider the risks described below and elsewhere in this Report, which could materially and adversely affect the Company's business, results of operations or financial condition. The risks and uncertainties discussed below are also applicable to forward-looking statements contained in this Report and in other reports filed by the Company with the Securities and Exchange Commission. Given these risks and uncertainties, investors are cautioned not to place undue reliance on forward-looking statements.

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General Business, Economic and Political Conditions.

The Company's earnings and financial condition are affected by general business, economic and political conditions. For example, a depressed economic environment increases the likelihood of lower employment levels and recession, which could adversely affect the Company's earnings and financial condition. General business and economic conditions that could affect the Company include short-term and long-term interest rates, inflation, fluctuations in both debt and equity capital markets and the strength of the national and local economies in which the Company operates. Political conditions can also affect the Company's earnings through the introduction of new regulatory schemes and changes in tax laws.

The recent national and global economic downturn resulted in extreme levels of market volatility locally, nationally and internationally. This downturn has depressed the overall market value of financial institutions, and may limit or impede industry access to capital, or have a material adverse effect on the financial condition or results of operations of banking companies in general, including the Company, with respect to, for example, the establishment of reserves should conditions deteriorate further.

In this respect, while the duration and severity of the adverse economic cycle appears to be lessening at the moment, and although the U.S. Department of the Treasury and the FDIC, among others, have implemented programs in an effort to stabilize the national economy, the ultimate effectiveness of these programs remains uncertain at this time.

The recent economic downturn has caused many lending institutions to experience declines in the performance of their loans. The values of real estate collateral supporting mortgage loans have declined and may continue to do so, providing less security for those loans. Across the industry, bank holding companies and bank stock prices have been volatile, as has the ability of banks to raise capital and borrow. Because of the uncertainty and upheaval within the financial markets and industry, there is a potential for new federal and/or state laws and regulations regarding lending, funding and liquidity practices of banks. Any new legislation or regulations could negatively impact the Company's operations.

Risks Associated with Loans

A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Company has underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying the Company's loan portfolio. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect results of operations. During 2011, the Company's allowance for loan losses and its level of impaired loans increased by $385,000 and $1,371,000, respectively, over 2010 figures. These amounts may increase during 2012, if economic conditions do not improve or deteriorate, which would adversely impact the Company's borrowers.

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Bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for loan losses, an increase in loans considered to be "impaired" or the recognition of further loan charge-offs, based on current economic conditions. Any increases in the allowance for loan losses will result in a decrease in net income and capital and may have a material adverse effect on the Company's financial condition, results of operations and cash flows.

The Company makes various assumptions and judgments about the collectability of the Company's loan portfolio, including the creditworthiness of the Company's borrowers and the value of the real estate and other assets serving as collateral for the repayment of the Company's loans. Despite the Company's underwriting and monitoring practices, the Company's loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. The Company may experience significant loan losses, which could have a material adverse effect on its operating results. Because the Company must use assumptions regarding individual loans and the economy, the current allowance for loan losses may not be sufficient to cover actual loan losses, and increases in the allowance may be necessary. The Company may need to significantly increase the Company's provision for losses on loans if one or more of the Company's larger credit relationships becomes delinquent. Material additions to the Company's allowance would materially decrease the Company's net income. The Company cannot provide any assurance that its monitoring procedures and policies will reduce certain lending risks or that the Company's allowance for loan losses will be adequate to cover actual losses.

Other Real Estate Owned

"Other real estate owned" consists of real estate collateral that the Company has received in foreclosure, or accepted in lieu of foreclosure, of impaired loans. The carrying value of the Company's holdings of other real estate owned decreased to $9,538,000 as of December 31, 2011 from $10,539,000 as of December 31, 2010, primarily due to sales of other real estate owned. Management obtains independent appraisals or performs evaluations to determine that these properties are carried at the lower of the new cost basis or fair value less cost to sell. These independent appraisals or evaluations are performed periodically by management with respect to current and any future other real estate owned, and any subsequent write-downs will be recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell. Due to potential changes in economic conditions, it is reasonably possible that changes in fair values will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

Rising Interest Rates

An increase in interest rates that may occur in connection with the recovery of the economy could negatively impact the Company's net interest margin if interest expense increases more quickly than interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily its deposits and other borrowings). Therefore, in a rising interest rate environment, interest expense will increase more quickly than interest income, as the interest bearing liabilities reprice more quickly than earning assets. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

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Liquidity Risk

Maintaining adequate liquidity is essential to the banking business. An inability to raise funds through deposits, borrowing, sale of securities or other sources could have a substantial negative impact on the Company’s liquidity. Access to funding sources in amounts necessary to finance the Company’s activities or with terms that are acceptable to the Company could be impaired by factors that affect the Company specifically or the financial services industry or economy in general. Factors that could detrimentally impact the Company’s access to liquidity sources include a decrease in the level of the Company’s business activity as a result of a downturn in the markets or adverse regulatory action against the Company. The Company’s ability to borrow could be impaired by factors such as a disruption in the financial markets or negative views and expectations of the prospects for the financial services industry in light of the recent turmoil facing the industry.

Customer Concern over Deposit Insurance

With recent increased concerns about bank failures, customers may be concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits in an effort to ensure that the amount they have on deposit with their bank is fully insured. Decreases in deposits, if they were to occur, could adversely affect the Company’s funding costs and net income.

Concentration of Operations

The Company’s operations are concentrated in central Iowa. As a result of this geographic concentration, the Company’s results may correlate to the economic conditions in this area, which were adversely impacted by the general decline in economic and market activity experienced during 2011, 2010 and 2009. Continuing deterioration in economic conditions, particularly in the industries on which this area depends (including agriculture which, in turn, is dependent upon weather conditions and government support programs), may adversely affect the quality of the Company’s loan portfolio and the demand for the Company’s products and services, and accordingly, its financial condition and results of operations.

Competition with Larger Financial Institutions

The banking and financial services business in the Company’s market area continues to be a competitive field and is becoming more competitive as a result of:

- changes in regulations;
- changes in technology and product delivery systems; and
- the accelerating pace of consolidation among financial services providers.

It may be difficult to compete effectively in the Company’s market, and results of operations could be adversely affected by the nature or pace of change in competition. The Company competes for loans, deposits and customers with various bank and non-bank financial services providers, many of which are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services.

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Trading Volume

The trading volume in the Company's common stock on the Nasdaq Capital Market is relatively limited compared to those of larger companies listed on the Nasdaq Capital Market, the Nasdaq Global Markets, the New York Stock Exchange or other consolidated reporting systems or stock exchanges. A change in the supply or demand for the Company's common stock may have a more significant impact on the price of the Company's stock than for more actively traded companies.

Technological Advances

The financial services industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. The Company's future success will depend, in part, on its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in the Company's operations. Many of our competitors have substantially greater resources than the Company to invest in technological improvements.

Information Security

The Company depends on data processing, communication and information exchange on a variety of computing platforms and networks and over the internet. The Company cannot be certain all of its systems are entirely free from vulnerability to attack, despite safe guards it has installed. Additionally, the Company relies on and does business with a variety of third-party service providers and vendors with respect to the Company's business, data and communications needs. If information security is breached, or one of the Company's service providers or vendors breaches compliance procedures, information could be lost or misappropriated, resulting in financial loss or costs to the Company or damages to others. If information security is breached, the Company's financial condition, results of operations and future prospects could be adversely affected.

Government Regulations

Current and future legislation and the policies established by federal and state regulatory authorities will affect the Company's operations. The Company and its Banks are subject to extensive supervision of, and examination by, federal and state regulatory authorities which may limit the Company's growth and the return to our shareholders by restricting certain activities, such as:

- the payment of dividends to the Company's shareholders;
- the payment of dividends to the Company from the Banks;
- possible mergers with or acquisitions of or by other institutions;

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- investment policies;
- loans and interest rates on loans;
- interest rates paid on deposits;
- expansion of branch offices; and/or
- the possibility to provide or expand securities or trust services.

On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States and, among many other things, establishes the new federal BCFP, requires the BCFP and other federal agencies are continuing to implement many new and significant rules and regulations. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will impact the Company's and the Banks' business. Compliance with the new law and regulations may result in additional costs, which could be significant, and could adversely impact the Company's results of operations, financial condition or liquidity.

The Company cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any changes may have on future business and earnings prospects. The cost of compliance with regulatory requirements may adversely affect the Company's net income.

ITEM 1B.UNRESOLVED STAFF COMMENTS

None.

ITEM 2.PROPERTIES

The Company's office is housed in the main office of First National located at 405 5th Street, Ames, Iowa and occupies approximately 3,400 square feet. A lease agreement between the Company and First National provides the Company will make available for use by First National an equal amount of interior space at the Company's building located at 2330 Lincoln Way, Ames, Iowa in lieu of rental payments. The main office owned by First National, consists of approximately 45,000 square feet and includes a drive-through banking facility. In addition to its main office, First National conducts its business through two full-service offices, the University office and the North Grand office. A full-service office in Ankeny, Iowa occupies approximately 14,000 square feet. Approximately 2,200 square feet of the Ankeny office is leased to two tenants for business purposes. The University office is located in a 16,000 square foot multi-tenant property owned by the Company. A 24-year lease agreement with the Company has been modified in 2002 to provide that an equal amount of interior space will be made available to the Company at First National's main office at 405 5th Street in lieu of rental payments. First National will continue to rent the drive-up facilities of approximately 1,850 square feet at this location for $1,200 per month. All of the properties owned by the Company and First National are free of any mortgages.

State Bank conducts its business from its main office located at 1025 Sixth Street, Nevada, Iowa and from a full-service office located in Colo, Iowa. All of these properties are owned by State Bank free of any mortgage.

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Boone Bank conducts its business from its main office located at 716 Eighth Street, Boone, Iowa and from one additional full-service office also located in Boone, Iowa. All properties are owned by Boone Bank free of any mortgage.

Randall-Story Bank conducts its business from its main office located at 606 Broad Street, Story City, Iowa which is owned by Randall-Story Bank free of any mortgage.

United Bank conducts its business from its main office located at 2101 South Center Street, Marshalltown, Iowa. The 5,200 square foot premise was constructed in 2002. In 2005, United Bank purchased an office location at 29 S. Center Street in Marshalltown that is 1,972 square feet. In 2007, United Bank purchased a commercial building located at 10 Westwood Drive, in Marshalltown that is 2,304 square feet for future expansion. All properties are owned by United Bank free of any mortgage.

The property the Company owns is located at 2330 Lincoln Way, Ames, Iowa consisting of a multi tenant building of approximately 16,000 square feet. First National leases 5,947 square feet of this building to serve as its University Office and remaining rentable space is leased to four tenants for business purposes. The Company owns a real estate property adjacent to 2330 Lincoln Way at 2318 Lincoln Way which consists of a single story commercial building with 2,400 square feet of leased space that is currently leased by one tenant for business purposes.

ITEM 3.LEGAL PROCEEDINGS

The Banks are from time to time parties to various legal actions arising in the normal course of business. The Company believes that there is no threatened or pending proceeding against the Company or the Banks, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company or the Banks.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

On February 29, 2012, the Company had approximately 477 shareholders of record and an estimated 983 additional beneficial owners whose shares were held in nominee titles through brokerage or other accounts. The Company’s common stock is traded on the NASDAQ Capital Market under the symbol “ATLO”. Trading in the Company’s common stock is, however, relatively limited. The closing price of the Company’s common stock was $21.65 on February 29, 2012.

Based on information provided to and gathered by the Company on an informal basis, the Company believes that the high and low sales price for the common stock on a per share basis during the last two years is as follows:

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	2011 Market Price			2010 Market Price	
Quarter	High	Low	Quarter	High	Low
1st	$ 21.92	$ 17.13	1st	$ 21.99	$ 17.00
2nd	$ 19.25	$ 16.55	2nd	$ 20.84	$ 17.26
3rd	$ 18.75	$ 14.15	3rd	$ 20.25	$ 16.61
4th	$ 19.88	$ 15.25	4th	$ 22.84	$ 18.90

The Company declared aggregate annual cash dividends in 2011 and 2010 of approximately $4,876,000 and $4,150,000, respectively, or $0.52 per share in 2011 and $0.44 per share in 2010. In February 2012, the Company declared a cash dividend of approximately $1,397,000 or $0.15 per share. Quarterly dividends declared during the last two years were as follows:

Quarter	2011 Cash dividends declared per share	2010 Cash dividends declared per share
1st	$ 0.13	$ 0.11
2nd	$ 0.13	$ 0.11
3rd	$ 0.13	$ 0.11
4th	$ 0.13	$ 0.11

The decision to declare cash dividends in the future and the amount thereof rests within the discretion of the Board of Directors of the Company and will be subject to, among other things, the future earnings, capital requirements and financial condition of the Company and certain regulatory restrictions imposed on the payment of dividends by the Banks. Such restrictions are discussed in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources and in Note 12 (Regulatory Matters) to the Company's financial statements included herein.

In May, 2011, the Company approved a Stock Repurchase Plan which provided for the repurchase of up to 100,000 shares of the Company's common stock. The Company purchased 78,222 shares in 2011 under this Stock Repurchase Plan. In November, 2011, the Company approved a second Stock Repurchase Plan which provided for the repurchase of up to 100,000 shares of the Company's common stock. The first Stock Repurchase Plan was terminated upon approval of the second Stock Repurchase Plan. The Company purchased 43,780 shares in 2011 under the second approved Stock Repurchase Plan. As of December 31, 2011, there were 56,220 shares remaining to be purchased under the second Stock Repurchase Plan.

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The following table provides information with respect to purchases made by or on behalf of the Company or any "affiliated purchaser" (as defined in rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Company's common stock during the three months ended December 31, 2011.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under The Plan
October 1, 2011 to October 31, 2011 (1)	11,991	$16.59	11,991	21,778
November 1, 2011 to November 30, 2011 (2)	35,666	$16.59	35,666	64,334
December 1, 2011 to December 31, 2011 (2)	8,114	$16.76	8,114	56,220
Total	55,771		55,771	

(1) Purchased 11,991 shares under the first Stock Repurchase Plan. This plan was terminated in November, 2011 upon adoption of the second Stock Repurchase Pland and no shares remain available for purchase as a result of the termination.
(2) Purchased 43,780 shares under the second Stock Repurchase Plan. 56,220 shares remain to be repurchased under this Plan.

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ITEM 6. SELECTED FINANCIAL DATA

The following financial data of the Company for the five years ended December 31, 2007 through 2011 is derived from the Company's historical audited financial statements and related footnotes. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and the consolidated financial statements and related notes contained elsewhere in this Annual Report.

Selected Financial Data

	Years Ended December 31,				
(dollars in thousands, except per share amounts)	2011	2010	2009	2008	2007
STATEMENT OF INCOME DATA					
Interest income	$37,616	$37,294	$38,891	$45,514	$47,562
Interest expense	6,730	7,775	10,226	16,402	23,537
Net interest income	30,886	29,519	28,665	29,112	24,025
Provision (credit) for loan losses	533	664	1,558	1,313	(94)
Net interest income after provision (credit) for loan losses	30,353	28,855	27,107	27,799	24,119
Noninterest income (loss)	6,970	6,836	6,774	(3,111)	7,128
Noninterest expense	18,852	18,221	22,582	17,491	16,696
Income before provision for income tax	18,471	17,470	11,299	7,197	14,551
Provision for income tax	4,550	4,504	2,293	845	3,542
Net income	$13,921	$12,966	$9,006	$6,352	$11,009
DIVIDENDS AND EARNINGS PER SHARE DATA					
Cash dividends declared	$4,876	$4,150	$3,773	$10,564	$10,183
Cash dividends declared per share	$0.52	$0.44	$0.40	$1.12	$1.08
Basic and diluted earnings per share	$1.48	$1.37	$0.95	$0.67	$1.17
Weighted average shares outstanding	9,399,076	9,432,915	9,432,915	9,431,393	9,427,503
BALANCE SHEET DATA					
Total assets	$1,035,564	$962,975	$915,570	$858,141	$861,591
Net loans	438,651	418,094	415,434	452,880	463,651
Deposits	818,705	743,862	722,164	664,795	690,119
Stockholders' equity	134,557	121,363	112,340	103,837	110,021
Equity to assets ratio	12.99%	12.60%	12.27%	12.10%	12.77%

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	Years Ended December 31,				
	2011	2010	2009	2008	2007
FIVE YEAR FINANCIAL PERFORMANCE					
Net income	$13,921	$12,966	$9,006	$6,352	$11,009
Average assets	1,009,231	928,610	880,057	857,705	843,788
Average stockholders' equity	128,679	118,889	108,412	107,794	111,371
Return on assets (net income divided by average assets)	1.38 %	1.40 %	1.02 %	0.74 %	1.30 %
Return on equity (net income divided by average equity)	10.82 %	10.91 %	8.31 %	5.89 %	9.89 %
Net interest margin (net interest income divided by average earning assets)	3.60 %	3.74 %	3.78 %	3.94 %	3.39 %
Efficiency ratio (noninterest expense divided by noninterest income plus net interest income)	49.80 %	50.12 %	63.72 %	67.27 %	53.59 %
Dividend payout ratio (dividends per share divided by net income per share)	35.14 %	32.12 %	42.11 %	167.16 %	92.31 %
Dividend yield (dividends per share divided by closing year-end market price)	2.67 %	2.03 %	1.89 %	4.22 %	5.54 %
Equity to assets ratio (average equity divided by average assets)	12.75 %	12.80 %	12.32 %	12.57 %	13.20 %

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The following discussion is provided for the consolidated operations of the Company and its Banks. The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks and the managing of its own bond, equity and loan portfolios. Products and services offered by the Banks are for commercial and consumer purposes, including loans, deposits and trust services. The Banks also offer investment services through a third-party broker-dealer. The Company employs eleven individuals to assist with financial reporting, human resources, marketing, audit, compliance, technology systems and the coordination of management activities, in addition to 182 full-time equivalent individuals employed by the Banks.

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

The principal sources of Company revenues and cash flows are: (i) interest and fees earned on loans made by the Company and Banks; (ii) interest on fixed income investments held by the Company and the Banks; (iii) fees on trust services provided by those Banks exercising trust powers; (iv) service charges on deposit accounts maintained at the

Banks; (v) gain on the sale of loans held for sale and (vi) securities gains. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs associated with maintaining the Banks' loan and deposit functions; (iv) occupancy expenses for maintaining the Banks' facilities; and (v) FDIC insurance assessments. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposit accounts and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

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The Company reported net income of $13,921,000 for the year ended December 31, 2011 compared to $12,966,000 and $9,006,000 reported for the years ended December 31, 2010 and 2009, respectively. This represents an increase in net income of 7.4% when comparing 2011 with 2010. The increase in net income in 2011 from 2010 was primarily the result of improved net interest income and lower FDIC insurance assessment, offset in part by higher salaries and benefits and other real estate owned costs. The increase in net income in 2010 from 2009 was primarily the result of improved net interest income, lower provision for loan losses and lower non-interest expense due to other real estate owned costs and FDIC insurance assessments. Earnings per share for 2011 were $1.48 compared to $1.37 in 2010 and $0.95 in 2009. All five Banks demonstrated profitable operations during 2011.

The Company's return on average equity for 2011 was 10.82% compared to 10.91% and 8.31% in 2010 and 2009, respectively, and the return on average assets for 2011 was 1.38% compared to 1.40% in 2010 and 1.02% in 2009. The decrease in return on average equity and assets when comparing 2011 to 2010 was primarily a result of increased average assets and equity. The increase in return on average equity and assets when comparing 2010 to 2009 was primarily a result of the increased net income.

The following discussion will provide a summary review of important items relating to:

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

Challenges

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

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

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

- Loans amounted to $438.7 million and $418.1 million as of December 31, 2011 and 2010, respectively. The loan portfolio increased 4.9% during the year ended December 31, 2011. The increase in the loan portfolio is primarily due to increases in the commercial and one-to-four family real estate loan portfolios. A decline in the loan portfolio would have a negative impact on the Company's earnings for the year.

- The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated over the past several years and contributed to the Company's level of non-performing loans, other real estate owned and related costs in 2011 and 2010. In 2011 and 2010, there were no significant additional impaired real estate development loans in the Des Moines market. Presently, the Company has $2.2 million in impaired loans with two Des Moines development companies with specific reserves totaling $165,000. The Company has additional customer relationships with real estate developers in the Des Moines area that may become impaired in the future if economic conditions do not improve or become worse. The Company has a limited number of such credits and is actively engaged with the customers to minimize credit risk.

- Other real estate owned amounted to $9.5 million and $10.5 million as of December 31, 2011 and 2010, respectively. Other real estate owned costs amounted to $434,000, $95,000 and $4,048,000 for the years ended December 31, 2011, 2010 and 2009, respectively. Management obtains independent appraisals or performs evaluations to determine that these properties are carried at the lower of the new cost basis or fair value less cost to sell. It is at least reasonably possible that change in fair values will occur in the near term and that such changes could have a negative impact on the Company's earnings.

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- The FDIC imposes an assessment against all depository institutions for deposit insurance. The FDIC has the authority to increase insurance assessments. FDIC insurance assessments amounted to $739,000, $1,120,000 and $1,675,000 for the years ended December 31, 2011, 2010 and 2009, respectively. In 2011, 92 banks failed compared to 161 bank failures in 2010 and 140 in 2009. An increase in FDIC deposit assessments will have a negative impact on the Company's earnings.

- The Company operates in a highly regulated environment and is subject to extensive regulation, supervision and examination. The compliance burden and impact on the Company's operations and profitability with respect to the Dodd-Frank Act are currently unknown, as the Dodd-Frank Act delegates to various federal agencies the task of implementing its many provisions through regulation. Hundreds of new federal regulations, studies and reports addressing all of the major areas of the new law, including the regulation of financial institutions and their holding companies, will be required, ensuring that federal rules and policies in this area will be further developing for months and years to come. Based on the provisions of the Dodd-Frank Act and anticipated implementing regulations, it is highly likely that financial institutions as well as their holding companies will be subject to significantly increased regulation and compliance obligations that expose them to noncompliance risk and consequences. The Bureau of Financial Consumer Protection ("BCFP") has broad rulemaking authority to administer and carry out the purposes and objectives of the new federal consumer protection laws, and to prevent "evasions thereof," with respect to all financial institutions that offer financial products and services to consumers. The BCFP is also authorized to prescribe rules, applicable to any covered person or service provider, identifying and prohibiting acts or practices that are "unfair, deceptive, or abusive" in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service ("UDAP authority"). The full reach and impact of the BCFP's broad new rulemaking powers and UDAP authority on the operations of financial institutions offering consumer financial products or services is currently unknown. Notwithstanding, insured depository institutions with assets of $10 billion or less will continue to be supervised and examined by their primary federal regulators, rather than the BCFP, with respect to compliance with the federal consumer protection laws. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, or legislation, including but not limited to changes in the regulations governing banks, could have a material impact on the Company's operations. It is unknown at this time to what extent legislation will be passed into law or regulatory proposals will be adopted, or the effect that such passage or adoption will have on the banking industry or the Company. Applicable laws and regulations may change, and there is no assurance that such changes will not adversely affect the Company's business.

Key Performance Indicators

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 7,357 commercial banks and savings institutions insured by the FDIC.

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Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

Selected Indicators for the Company and the Industry

	Year Ended December 31,					
	2011		2010		2009	
	Company	Industry	Company	Industry	Company	Industry
Return on assets	1.38 %	0.88 %	1.40 %	0.66 %	1.02 %	0.09 %
Return on equity	10.82 %	7.86 %	10.91 %	5.99 %	8.31 %	0.90 %
Net interest margin	3.60 %	3.60 %	3.74 %	3.76 %	3.78 %	3.47 %
Efficiency ratio	49.80 %	61.37 %	50.12 %	57.22 %	63.72 %	55.53 %
Capital ratio	12.75 %	9.09 %	12.80 %	8.90 %	12.32 %	8.65 %

Key performance indicators include:

- Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's return on assets ratio is higher than that of the industry, primarily as a result of the Company's lower provision for loan losses and non-interest expense relative to the industry.

- Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on equity ratio is higher than the industry primarily as a result of the Company's lower provision for loan losses and non-interest expense relative to the industry.

- Net Interest Margin

This ratio is calculated by dividing net interest income by average earning assets. Earning assets consist primarily of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposit accounts and other borrowings. The Company's net interest margin is comparable to that of the industry.

- Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio is lower than the industry average. The Company's efficiency ratio is lower than the industry primarily as a result of the Company's lower non-interest expense.

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- Capital Ratio

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

Industry Results

The FDIC Quarterly Banking Profile reported the following results for the fourth quarter of 2011:

Quarterly Net Income Posts Tenth Consecutive Year-Over-Year Gain

Lower provisions for loan losses, reflecting an improving trend in asset quality, lifted fourth-quarter net income of FDIC-insured commercial banks and savings institutions. Fourth-quarter earnings totaled $26.3 billion, an increase of $4.9 billion (23.1%) compared with the same period of 2010. The year-over-year improvement in profits comprised a majority of insured institutions. Almost two out of every three banks (63.2%) reported higher quarterly net income than a year ago, and only 18.9% were unprofitable, compared with 27.1% in fourth quarter 2010. The average return on assets (ROA) rose to 0.76%, from 0.64% a year earlier.

Earnings Benefit Further from Lower Provisions for Loan Losses

Insured institutions set aside $19.5 billion in provisions for loan losses in the fourth quarter, a decline of $13.1 billion (40.1%) from fourth quarter 2010. Provisions represented 12.1% of the industry's net operating revenue (the sum of net interest income and total noninterest income), down from 19.7% a year ago, and well below the 51.7% peak level in this cycle registered in fourth quarter 2008. Loss provisions have fallen, year over year, for nine consecutive quarters. The trend of reduced provisioning was relatively broad: more than half of all institutions (54.6%) reported lower quarterly provisions than a year ago.

Overall Revenues Continue to Exhibit Weakness

For the third time in the last four quarters, net operating revenue posted a year-over-year decline. The $3.8 billion (2.3%) drop was caused by a $4.4 billion (7.4%) reduction in noninterest income. Gains on loan sales were $1.9 billion (53%) below the level of a year ago, servicing income was $1.4 billion (29.9%) lower, and trading income fell by $812 million (23.5%). Increases in the market values of some large bank liabilities produced accounting losses in the fourth quarter that reversed some of the related gains in noninterest income that occurred in third quarter 2011.1 Net interest income increased year over year for the first time in four quarters, rising by $609 million (0.6%).

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Full-Year Net Income Rises to Five-Year High

For all of 2011, net income totaled $119.5 billion, an increase of $34 billion (39.8%) from full-year 2010 earnings. This is the highest annual net income total since the industry earned $145.2 billion in 2006. More than two out of every three banks (66.9%) reported improved earnings in 2011, and only 15.5% reported a net loss for the year. In 2010, 22.1% of all banks reported full-year net losses. The average ROA was 0.88%, up from 0.65% in 2010. The improvement in full-year net income was made possible by an $81.1 billion reduction in loan loss provisions.

Full-Year Operating Revenues Are Lower than in 2010

Both net interest income and noninterest income were lower than in 2010, as full-year net operating revenue declined for only the second time since 1938 (the only other decline occurred in 2008). Net interest income posted its first full-year decline since 1971, falling by $7.5 billion (1.7%). The average net interest margin in 2011 was 3.6%, down from 3.76% in 2010. Interest-bearing assets increased by 4.4% in 2011, but more than a third of this growth (35.7%) consisted of low-yielding balances with Federal Reserve Banks. Total noninterest income fell for a second consecutive year and the fourth time in the last five years, declining by $5.3 billion (2.3%). Income from trust operations and trading income were higher than in 2010 (by $1.6 billion and $2.2 billion, respectively), but these improvements were outweighed by lower servicing income (down $8 billion), reduced gains on loan sales (down $4.8 billion), and lower income from service charges on deposit accounts, which fell by $2.1 billion (5.9%). Realized gains on securities and other assets were $3.6 billion (39.5%) lower than in 2010. Insured institutions paid $77.9 billion in dividends during 2011, an increase of $24 billion (44.5%) from 2010, but below the record level of $110.3 billion paid out in 2007.

Loan Losses Fall to Lowest Level in 15 Quarters

Net charge-offs totaled $25.4 billion in the fourth quarter, a decline of $17.1 billion (40.2%) from a year ago. The fourth-quarter total represents the lowest level for quarterly charge-offs since first quarter 2008. This is the sixth consecutive quarter in which charge-offs have posted a year-over-year decline. Improvements occurred across all major loan types. The largest declines were in credit cards (down $5.4 billion, or 42.2%), real estate construction and land development loans (down $3.3 billion, or 62.4%), residential mortgage loans (down $2.4 billion, or 31.8%) and loans to commercial and industrial (C&I) borrowers (down $2 billion, or 43.5%).

Noncurrent Loan Balances Decline in Most Major Loan Categories

The amount of loan balances that were noncurrent (90 days or more past due or in nonaccrual status) declined for the seventh quarter in a row, falling by $4.3 billion (1.4%). The decline was led by real estate construction and land development loans, where noncurrent balances fell by $4.9 billion (13.2%), C&I loans, where noncurrents declined by $1.8 billion (9.5%), and nonfarm nonresidential real estate loans, where noncurrent balances fell by $1.6 billion (4%). The only significant increase in noncurrent loans occurred in residential mortgage portfolios, where noncurrent balances rose by $5.2 billion (3.1%). This increase reflected the addition of $6.3 billion in rebooked “GNMA loans” that were 90 days or more past due.

Reductions in Reserves Continue to Track Declines in Noncurrent Loans

Loan-loss reserves fell for a seventh consecutive quarter, declining by $6.3 billion (3.2%), as net charge-offs of $25.4 billion exceeded loss provisions of $19.5 billion. As has been the case throughout the recent period of reserve reductions, most of the declines have been concentrated among large institutions. Half of all banks increased their reserves during the fourth quarter, whereas 70% of the 50 largest banks reduced their reserves. The industry’s “coverage ratio” of reserves to noncurrent loans and leases declined slightly, from 63.7% to 62.5% during the quarter.

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Equity Capital Registers a Small Decline

Lower unrealized gains on available-for-sale securities and other financial instruments contributed to a $7.7 billion (0.5%) decline in the industry's total equity capital during the fourth quarter. Unrealized gains are not included in regulatory capital, and tier 1 leverage capital increased by $2.4 billion (0.2%). This is the smallest quarterly increase in leverage capital in the past 13 quarters. Retained earnings contributed $3.7 billion to capital growth in the quarter, as banks paid $22.6 billion of their $26.3 billion in quarterly earnings in dividends.

Loan Balances Post Largest Real Growth in Four Years

Total assets of insured institutions increased by $76.1 billion (0.6%) in the fourth quarter, as loan balances rose by $130.1 billion (1.8%). This is the third consecutive quarter in which total loan balances have increased and, apart from first quarter 2010 when accounting rule changes caused a $221 billion increase in reported balances, it represents the largest quarterly increase since fourth quarter 2007.3 As in the prior two quarters, overall loan growth was led by C&I loans, which rose by $62.8 billion (4.9%), accounting for almost half of the total increase in loans and leases during the quarter. C&I loans have increased in each of the last six quarters. Additionally, C&I loans to small businesses (C&I loans in original amounts of $1 million or less) increased by $2.8 billion (1%). This is the first time in the seven quarters for which data on quarterly changes in these loans are available that small C&I loan balances have increased. Residential mortgage loans increased by $26 billion (1.4%), following a $23.6 billion increase in the third quarter. Credit card balances posted a seasonal increase of $21.3 billion (3.2%). Real estate construction and development loans declined for a 15th consecutive quarter, falling by $14.7 billion (5.8%). Investment securities portfolios increased by $61.6 billion (2.2%), with mortgage-backed securities rising by $45.0 billion (2.8%), and state, county, and municipal securities increasing by $13.3 billion (6.5%). Assets in trading accounts declined by $36 billion (4.8%), while interest-bearing balances due from depository institutions fell by $34.9 billion (3.3%).

Money Continues to Flow into Fully Insured Deposit Accounts

Deposit balances registered strong growth for a sixth consecutive quarter, as large-denomination transaction accounts that offer unlimited insurance coverage through the end of 2012 continue to attract new depositors. Total deposits at insured institutions increased by $183.2 billion (1.8%). Over the last six quarters, deposits at FDIC-insured institutions have risen by more than $1 trillion. Most of the growth has consisted of large-denomination noninterest-bearing transaction deposits that are fully insured until the end of 2012. Balances in these accounts increased by $191.2 billion (13.7%) during the fourth quarter, and totaled $1.58 trillion at the end of the year. In contrast, nondeposit liabilities declined by $99.5 billion (4.5%), while deposits in foreign offices fell by $66.6 billion (4.5%).

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“Problem List” Shrinks for Third Consecutive Quarter

The number of institutions reporting financial results fell from 7,437 to 7,357 in the fourth quarter. During the quarter, 54 institutions were merged into other institutions, and 18 insured institutions failed. There were two institutions whose December financial reports had not been received at the time this publication was prepared. The number of institutions on the FDIC’s “Problem List” declined from 844 to 813 during the quarter, and total assets of “problem” institutions fell from $339 billion to $319.4 billion. For the full year, the number of reporting institutions declined by 314, as 3 new reporters were added, 92 institutions failed, and 198 were absorbed by mergers. During 2011, the number of full-time-equivalent employees at insured institutions increased from 2,088,579 to 2,107,976.

Critical Accounting Policies

The discussion contained in this Item 7 and other disclosures included within this Annual Report are based on the Company’s audited consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company’s significant accounting policies are described in the “Notes to Consolidated Financial Statements” accompanying the Company’s audited financial statements. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified the allowance for loan losses, valuation of other real estate owned and the assessment of other-than-temporary impairment for certain financial instruments to be the Company’s most critical accounting policies.

Allowance for Loan Losses

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

For further discussion concerning the allowance for loan losses and the process of establishing specific reserves, see the section of this Annual Report entitled “Asset Quality Review and Credit Risk Management” and “Analysis of the Allowance for Loan Losses”.

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Other Real Estate Owned

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

Other-Than-Temporary Impairment of Investment Securities

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

Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the last three years.

Average Balances and Interest Rates

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

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ASSETS

	2011			2010			2009		
(dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-earning assets									
Loans 1									
Commercial	$ 75,954	$ 3,951	5.20 %	$ 68,905	$ 3,869	5.61 %	$ 68,677	$ 3,535	5.15 %
Agricultural	44,866	2,491	5.55 %	41,941	2,443	5.82 %	36,351	2,196	6.04 %
Real estate	289,586	16,041	5.54 %	284,515	16,542	5.81 %	304,362	18,074	5.94 %
Consumer and other	20,962	1,117	5.33 %	22,327	1,207	5.41 %	25,078	1,407	5.61 %
Total loans (including fees)	431,368	23,600	5.47 %	417,688	24,061	5.76 %	434,468	25,212	5.80 %
Investment securities									
Taxable	262,894	6,993	2.66 %	239,853	6,965	2.90 %	203,735	7,967	3.91 %
Tax-exempt 2	221,679	10,077	4.55 %	183,541	8,875	4.84 %	151,340	7,991	5.28 %
Total investment securities	484,573	17,070	3.52 %	423,394	15,840	3.74 %	355,075	15,958	4.49 %
Interest bearing deposits and federal funds sold	39,257	466	1.19 %	32,130	489	1.52 %	41,645	499	1.20 %
Total interest-earning assets	955,198	$ 41,136	4.31 %	873,212	$ 40,390	4.63 %	831,189	$ 41,669	5.01 %
Noninterest-earning assets									
Cash and due from banks	18,065			19,544			20,720		
Premises and equipment, net	11,421			11,718			12,216		
Other, less allowance for loan losses	24,547			24,136			15,932		
Total noninterest-earning assets	54,033			55,398			48,868		

TOTAL ASSETS	$ 1,009,231	$ 928,610	$ 880,057

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.
2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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Average Balances and Interest Rates (continued)

LIABILITIES AND STOCKHOLDERS' EQUITY

	2011			2010			2009		
(dollars in thousands)	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-bearing liabilities									
Deposits									
Savings, NOW accounts and money markets	$ 436,419	$ 1,278	0.29 %	$ 386,010	$ 1,369	0.35 %	$ 355,504	$ 1,650	0.46 %
Time deposits > $100,000	103,175	1,620	1.57 %	89,290	1,651	1.85 %	84,786	2,290	2.70 %
Time deposits < $100,000	140,894	2,415	1.71 %	147,453	3,076	2.09 %	157,749	4,488	2.84 %
Total deposits	680,488	5,313	0.78 %	622,753	6,096	0.98 %	598,040	8,428	1.41 %
Other borrowed funds	83,085	1,417	1.70 %	87,758	1,679	1.91 %	83,841	1,798	2.14 %
Total interest-bearing liabilities	763,573	6,730	0.88 %	710,511	7,775	1.09 %	681,881	10,226	1.50 %
Noninterest-bearing liabilities									
Demand deposits	111,530			94,286			84,245		
Other liabilities	5,449			4,924			5,519		
Stockholders' equity	128,679			118,889			108,412		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,009,231			$ 928,610			$ 880,057		
Net interest income		$ 34,406	3.60 %		$ 32,615	3.74 %		$ 31,443	3.78 %
Spread Analysis									
Interest income/average		$ 41,136	4.08 %		$ 40,390	4.35 %		$ 41,669	4.73 %

assets						
Interest expense/average assets	6,730	0.67 %	7,775	0.84 %	10,226	1.16 %
Net interest income/average assets	34,406	3.41 %	32,615	3.51 %	31,443	3.57 %

Rate and Volume Analysis

The rate and volume analysis is used to determine how much of the change in interest income or expense is the result of a change in volume or a change in interest rate. For example, real estate loan interest income decreased $501,000 in 2011 compared to 2010. Increased volume of real estate loans increased income in 2011 by $287,000 and lower interest rates decreased interest income in 2011 by $788,000.

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The following table sets forth, on a tax-equivalent basis, a summary of the changes in net interest income resulting from changes in volume and rates.

(dollars in thousands)	2011 Compared to 2010			2010 Compared to 2009		
	Volume	Rate	Total 1	Volume	Rate	Total 1
Interest income						
Loans						
Commercial	$ 378	$ (296)	$ 82	$ 12	$ 322	$ 334
Agricultural	165	(117)	48	329	(82)	247
Real estate	287	(788)	(501)	(1,147)	(385)	(1,532)
Consumer and other	(73)	(17)	(90)	(151)	(49)	(200)
Total loans (including fees)	757	(1,218)	(461)	(957)	(194)	(1,151)
Investment securities						
Taxable	634	(606)	28	1,267	(2,269)	(1,002)
Tax-exempt	1,759	(557)	1,202	1,592	(708)	884
Total investment securities	2,393	(1,163)	1,230	2,859	(2,977)	(118)
Interest bearing deposits and federal funds sold	96	(119)	(23)	(127)	117	(10)
Total interest-earning assets	3,246	(2,500)	746	1,775	(3,054)	(1,279)
Interest-bearing liabilities						
Deposits						
Savings, NOW accounts and money markets	161	(252)	(91)	132	(413)	(281)
Time deposits > $100,000	238	(269)	(31)	116	(755)	(639)
Time deposits < $100,000	(130)	(531)	(661)	(279)	(1,133)	(1,412)
Total deposits	269	(1,052)	(783)	(31)	(2,301)	(2,332)
Other borrowed funds	(85)	(177)	(262)	81	(200)	(119)
Total interest-bearing liabilities	184	(1,229)	(1,045)	50	(2,501)	(2,451)

Net interest income-earning assets	$ 3,062	$ (1,271)	$ 1,791	$ 1,725	$ (553)	$ 1,172

1 The change in interest due to both volume and yield/rate has been allocated to change due to volume and change due to yield/rate in proportion to the absolute value of the change in each.

Net Interest Income

The Company's largest contributing component to net income is net interest income, which is the difference between interest earned on earning assets and interest paid on interest bearing liabilities. The volume of and yields earned on earning assets and the volume of and the rates paid on interest bearing liabilities determine net interest income. Refer to the tables preceding this paragraph for additional detail. Interest earned and interest paid is also affected by general economic conditions, particularly changes in market interest rates, by government policies and the action of regulatory authorities. Net interest income divided by average earning assets is referred to as net interest margin. For the years December 31, 2011, 2010 and 2009, the Company's net interest margin was 3.60%, 3.74% and 3.78%, respectively.

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Net interest income during 2011, 2010 and 2009 totaled $30,886,000, $29,519,000 and $28,665,000, respectively, representing a 5% increase in 2011 compared to 2010 and a 3% increase in 2010 from 2009. Net interest income increased in 2011 as compared to 2010 due primarily to increases in average interest-earning assets and lower rates on deposits, offset in part by declines in yields on loans and investments. Net interest income increased in 2010 as compared to 2009 due primarily to increases in average interest-earning assets, offset in part by yields on investments declining more than yields on deposits.

The high level of competition in the local markets will continue to put downward pressure on the net interest margin of the Company. Currently, the Company's largest market, Ames, Iowa, has ten banks, one thrift, six credit unions and several other financial investment companies. Multiple banks are also located in the Company's other communities creating similarly competitive environments.

Provision for Loan Losses

The provision for loan losses reflects management's judgment of the expense to be recognized in order to maintain an adequate allowance for loan losses. The Company's provision for loan losses for the year ended December 31, 2011 was $533,000 compared to $664,000 for the previous year. The lower provision for loan losses in 2011 as compared to 2010 was due primarily to lower net charge offs, offset in part by a higher provision for loan losses on impaired loans for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The Company's provision for loan losses for the year ended December 31, 2010 was $664,000 compared to $1,558,000 for the previous year. The lower provision for loan losses in 2010 as compared to 2009 was due primarily to a lower provision for loan losses on impaired loans for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Refer to the "Asset Quality and Credit Risk Management" discussion for additional details with regard to loan loss provision expense.

Management believes the allowance for loan losses is adequate to absorb probable losses in the current portfolio. This statement is based upon management's continuing evaluation of inherent risks in the current loan portfolio, current levels of classified assets and general economic factors. The Company will continue to monitor the allowance and make future adjustments to the allowance as conditions dictate. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

Noninterest Income and Expense

Total noninterest income is comprised primarily of fee-based revenues from trust and agency services, bank-related service charges on deposit activities, net securities gains, merchant and ATM fees related to electronic processing of merchant and cash transactions and gain on the sale of loans held for sale.

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Noninterest income during the years ended 2011, 2010 and 2009 totaled $6,970,000, $6,836,000 and $6,774,000, respectively. The higher non-interest income in 2011 as compared to 2010 related primarily to gain on the sale of loans held for sale and trust services income, offset in part by decreases in service fees. The increase in gain on sale of loans held for sale is due primarily to increased loan origination volume. The increase in trust department income was due primarily to increases in the number of customer relationships and income related to improving fair values for fee based managed assets. The decrease in service charges was primarily due to lower overdraft fees due in part to regulatory changes associated with the Dodd-Frank Act. The slightly higher non-interest income in 2010 as compared to 2009 related primarily to higher trust services income and merchant and ATM fees, offset in part by decreases in service fees and security gains. Trust income increases are due primarily to increases in the customer base. Increase in merchant and ATM fees are due primarily to increase in usage. Decreases in service fees are due in part to regulatory changes associated with overdraft fees. Excluding securities gains in 2011 and 2010, noninterest income increased 1.4% in 2011 as compared to 2010. Excluding securities gains in 2010 and 2009, noninterest income increased 4.4% in 2010 as compared to 2009.

Noninterest expense for the Company consists of all operating expenses other than interest expense on deposits and other borrowed funds. Historically, the Company has not had any material expenses relating to discontinued operations, extraordinary losses or adjustments from a change in accounting principles. Salaries and employee benefits are the largest component of the Company's operating expenses and comprise 62% of noninterest expenses in 2011.

Noninterest expense during the years ended 2011, 2010 and 2009 totaled $18,852,000, $18,221,000 and $22,582,000, respectively, representing a 3.5% increase in 2011 compared to a 19.3% decrease in 2010. The primary reason for the increase in 2011 was higher salaries and employee benefit costs and other real estate owned costs, offset in part by a decrease in FDIC insurance assessments. The higher salaries and employee benefit costs are primarily due to normal salary increases, higher incentive pay and one time personnel costs. The higher 2011 other real estate owned costs are primarily due to impairment write downs. The lower FDIC insurance assessments are due primarily to lower assessment rates. The primary reason for the decrease in 2010 was the decreases in other real estate owned costs, due primarily to impairment write downs in 2009, and the decrease in FDIC insurance assessment, due to a one-time special assessment in 2009 and lower assessment rates in 2010. The percentage of noninterest expense to average assets was 1.87% in 2011, compared to 1.96% and 2.57% during 2010 and 2009, respectively.

Provision for Income Taxes

The provision for income taxes for 2011, 2010 and 2009 was $4,550,000, $4,504,000 and $2,293,000, respectively. This amount represents an effective tax rate of 25% during 2011, compared to 26% and 20% for 2010 and 2009, respectively. The Company's marginal federal income tax rate is currently 35%. The difference between the Company's effective and marginal tax rate is primarily related to investments made in tax exempt securities.

Balance Sheet Review

The Company's assets are comprised primarily of loans and investment securities. Average earning asset maturity or repricing dates are less than five years for the combined portfolios as the assets are funded for the most part by short term deposits with either immediate availability or less than one year average maturities. This exposes the Company to risk with regard to changes in interest rates that are more fully explained in Item 7A of this Annual Report "Quantitative and Qualitative Disclosures about Market Risk".

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Total assets increased to $1,035,564,000 in 2011 compared to $962,975,000 in 2010, a 7.5% increase. The increase in assets was due primarily to an increase in securities available-for-sale and loans, funded primarily by a growth in deposits.

Loan Portfolio

Net loans as of December 31, 2011 totaled $438,651,000, an increase of 4.9% from the $418,094,000 as of December 31, 2010. The increase in loan volume occurred despite of a continuing weakness in loan demand in some sectors of the economy. Loans are the primary contributor to the Company's revenues and cash flows. The average yield on loans was 195 and 202 basis points higher in 2011 and 2010, respectively, in comparison to the average tax-equivalent investment portfolio yields.

Types of Loans

The following table sets forth the composition of the Company's loan portfolio for the past five years ending at December 31, 2011.

	2011	2010	2009	2008	2007
(dollars in thousands)					
Real Estate					
Construction	$ 23,631	$ 19,597	$ 22,864	$ 35,326	$ 46,568
1-4 family residential	94,262	88,933	91,673	95,988	104,762
Commercial	147,500	139,370	141,741	153,366	147,023
Agricultural	32,503	31,931	30,788	33,547	33,684
Commercial	75,958	78,173	69,031	76,653	78,616
Agricultural	52,179	45,630	42,356	40,324	36,133
Consumer and other	20,754	22,052	24,693	24,528	22,782
Total loans	446,787	425,686	423,146	459,732	469,568
Deferred loan fees, net	231	71	60	72	137
Total loans net of deferred fees	$ 446,556	$ 425,615	$ 423,086	$ 459,660	$ 469,431

The Company's loan portfolio consists of real estate loans, commercial loans, agricultural loans and consumer loans. As of December 31, 2011, gross loans totaled approximately $447 million, which equals approximately 54.6% of total deposits and 43.1% of total assets. The Company's peer group (consisting of 303 bank holding companies with total assets of $1 to $3 billion) loan to deposit ratio as of September 30, 2011 was a much higher 77%. The primary factor relating to the lower loan to deposit ratio for the Company compared to peer group averages is a more conservative underwriting philosophy. As of December 31, 2011, the majority of the loans were originated directly by the Banks to borrowers within the Banks' principal market areas. There are no foreign loans outstanding during the years presented.

Real estate loans include various types of loans for which the Banks hold real property as collateral and consist of loans primarily on commercial properties and single family residences. Real estate loans typically have fixed rates for up to five years, with the Company's loan policy permitting a maximum fixed rate maturity of up to 15 years. The majority of construction loan volume is given to contractors to construct commercial buildings and these loans generally have maturities of up to 12 months. The Banks originate residential real estate loans for sale to the secondary market for a fee.

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Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, floor-plans, inventory and accounts receivable; capital expenditure loans to finance equipment and other fixed assets; and letters of credit. These loans generally have short maturities, have either adjustable or fixed rates and are unsecured or secured by inventory, accounts receivable, equipment and/or real estate.

Agricultural loans play an important part in the Banks' loan portfolios. Iowa is a major agricultural state and is a national leader in both grain and livestock production. The Banks play a significant role in their communities in financing operating, livestock and real estate activities for area producers.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Banks' consumer lending is for vehicles, consolidation of personal debts, household appliances and improvements.

The interest rates charged on loans vary with the degree of risk and the amount and maturity of the loan. Competitive pressures, market interest rates, the availability of funds and government regulation further influence the rate charged on a loan. The Banks follow a loan policy, which has been approved by both the board of directors of the Company and the Banks, and is overseen by both Company and Bank management. These policies establish lending limits, review and grading criteria and other guidelines such as loan administration and allowance for loan losses. Loans are approved by the Banks' board of directors and/or designated officers in accordance with respective guidelines and underwriting policies of the Company. Credit limits generally vary according to the type of loan and the individual loan officer's experience. Loans to any one borrower are limited by applicable state and federal banking laws.

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Maturities and Sensitivities of Loans to Changes in Interest Rates as of December 31, 2011

The contractual maturities of the Company's loan portfolio are as shown below. Actual maturities may differ from contractual maturities because individual borrowers may have the right to prepay loans with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years	Total
Real Estate				
Construction	$ 14,963	$ 7,663	$ 1,005	$ 23,631
1-4 family residential	24,704	33,784	35,774	94,262
Commercial	35,440	84,577	27,483	147,500
Agricultural	5,524	10,983	15,996	32,503
Commercial	34,550	38,151	3,257	75,958
Agricultural	36,118	14,849	1,212	52,179
Consumer and other	5,686	10,113	4,955	20,754
Total loans	$ 156,985	$ 200,120	$ 89,682	$ 446,787

	After one year but within five years	After five years
Loan maturities after one year with:		
Fixed rates	$ 153,677	$ 81,763
Variable rates	46,443	7,919
	$ 200,120	$ 89,682

Loans Held For Sale

Mortgage origination funding awaiting delivery to the secondary market totaled $1,213,000 and $1,993,000 as of December 31, 2011 and 2010, respectively. Residential mortgage loans are originated by the Banks and sold to several secondary mortgage market outlets based upon customer product preferences and pricing considerations. The mortgages are sold in the secondary market to eliminate interest rate risk and to generate secondary market fee income. It is not anticipated at the present time that loans held for sale will become a significant portion of total assets.

Investment Portfolio

Total investments as of December 31, 2011 were $508,625,000, an increase of $38.7 million or 8.2% from the prior year end. As of December 31, 2011 and 2010, the investment portfolio comprised 49% of total assets.

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The following table presents the fair values, which represent the carrying values due to the available-for-sale classification, of the Company's investment portfolio as of December 31, 2011, 2010 and 2009, respectively. This portfolio provides the Company with a significant amount of liquidity.

(dollars in thousands)	2011	2010	2009
U.S. treasury securities	$ -	$ 503	$ 525
U.S. government agencies	63,200	87,412	106,640
U.S. government mortgage-backed securities	159,855	127,349	101,590
State and political subdivisions	259,393	228,373	178,052
Corporate bonds	20,387	20,372	24,300
Equity securities	5,790	5,898	7,548
Total	$ 508,625	$ 469,907	$ 418,655

Investments in states and political subdivisions represent purchases of municipal bonds located primarily in the state of Iowa and contiguous states.

The equity securities portfolio consisted primarily of financial and utility stocks and other required stocks as of December 31, 2011, 2010, and 2009.

During the year ended December 31, 2011, the Company did not recognize any other-than-temporary impairment charges in the securities available-for-sale portfolio. Management believes that there are no additional other-than-temporary impairments in the securities available-for-sale portfolio at December 31, 2011; however, it is possible that the Company may incur impairment losses in 2012.

As of December 31, 2011, the Company did not have securities from a single issuer, except for the United States Government or its agencies, which exceeded 10% of consolidated stockholders' equity.

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

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The valuation techniques used are consistent with the market approach, the income approach, and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques are consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, a fair value hierarchy was established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

The Company reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies, for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In general, the Company does not purchase investment portfolio securities that are esoteric or that have a complicated structure. The Company's entire portfolio consists of traditional investments, nearly all of which are federal agency or mortgage pass-through securities, general obligation or revenue based municipal bonds or corporate bonds. Equity securities consist of FHLB and FRB stock. Pricing for such instruments is fairly generic and is easily obtained. From time to time, the Company will validate, on a sample basis, prices supplied by the independent pricing service by comparison to prices obtained from third-party sources.

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Investment Maturities as of December 31, 2011

The investments in the following table are reported by contractual maturity. Expected maturities may differ from contractual maturities because issuers of the securities may have the right to call or prepay obligations with or without prepayment penalties.

(dollars in thousands)	Within one year	After one year but within five years	After five years but within ten years	After ten years	Total
U.S. government agencies	$3,319	$50,792	$9,089	$-	$63,200
U.S. government mortgage-backed securities	3,642	143,763	9,830	2,620	159,855
States and political subdivisions*	24,295	107,322	102,150	25,626	259,393
Corporate bonds	4,208	11,016	5,163	-	20,387
Total	$35,464	$312,893	$126,232	$28,246	$502,835
Weighted average yield					
U.S. government agencies	3.92 %	2.58 %	2.25 %	0.00 %	2.60 %
U.S government mortgage-backed securities	4.10 %	3.79 %	3.41 %	4.66 %	3.78 %
States and political subdivisions*	3.82 %	4.27 %	4.57 %	5.36 %	4.49 %
Corporate bonds	4.93 %	4.57 %	5.20 %	0.00 %	4.81 %
Total	4.25 %	3.79 %	4.34 %	5.29 %	4.04 %

*Yields on tax-exempt obligations of states and political subdivisions have been computed on a tax-equivalent basis.

Deposits

Total deposits were $818,705,000 and $743,862,000 as of December 31, 2011 and 2010, respectively. The increase of $74,844,000 can be attributed to increases in commercial, retail and public funds. Also the mix of deposits has changed, as depositors have moved deposits to demand, NOW and money market from time deposit accounts.

The Company's primary source of funds is customer deposits. The Company attempts to attract noninterest-bearing deposits, which are a low-cost funding source. In addition, the Banks offer a variety of interest-bearing accounts designed to attract both short-term and longer-term deposits from customers. Interest-bearing accounts earn interest at rates established by Bank management based on competitive market factors and the Company's need for funds. While nearly 63% of the Banks' certificates of deposit mature in the next year, it is anticipated that a majority of these certificates will be renewed. Rate sensitive certificates of deposits in excess of $100,000 are subject to somewhat higher volatility with regard to renewal volume as the Banks adjust rates based upon funding needs. In the event a substantial volume of certificates is not renewed, the Company has sufficient liquid assets and borrowing lines to fund significant runoff. A sustained reduction in deposit volume would have a significant negative impact on the Company's operation and liquidity. The Company had $3,249,000 and $1,249,000 of brokered deposits as of December 31, 2011 and 2010, respectively.

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Average Deposits by Type

The following table sets forth the average balances for each major category of deposit and the weighted average interest rate paid for deposits during the years ended December 31, 2011, 2010 and 2009.

(dollars in thousands)	2011 Average Amount	2011 Rate	2010 Average Amount	2010 Rate	2009 Average Amount	2009 Rate
Noninterest bearing demand deposits	$ 111,530	0.00 %	$ 94,286	0.00 %	$ 84,245	0.00 %
Interest bearing demand deposits	221,054	0.30 %	194,281	0.35 %	174,716	0.42 %
Money market deposits	173,440	0.29 %	154,264	0.37 %	147,782	0.54 %
Savings deposits	41,925	0.27 %	37,465	0.32 %	33,007	0.34 %
Time certificates > $100,000	103,175	1.57 %	89,290	1.85 %	84,786	2.70 %
Time certificates < $100,000	140,894	1.71 %	147,453	2.09 %	157,749	2.84 %
	$ 792,018		$ 717,039		$ 662,795	

Deposit Maturity

The following table shows the amounts and remaining maturities of time certificates of deposit that had balances of $100,000 and over as of December 31, 2011, 2010 and 2009.

(dollars in thousands)	2011	2010	2009
3 months or less	$ 21,319	$ 17,160	$ 17,814
Over 3 through 12 months	54,342	41,180	45,007
Over 12 through 36 months	23,425	29,210	20,752
Over 36 months	8,859	7,308	3,481
Total	$ 107,945	$ 94,858	$ 87,054

Borrowed Funds

Borrowed funds that may be utilized by the Company are comprised of Federal Home Loan Bank (FHLB) advances, federal funds purchased, Treasury, Tax, and Loan option notes, and repurchase agreements. Borrowed funds are an alternative funding source to deposits and can be used to fund the Company's assets and unforeseen liquidity needs. FHLB advances are loans from the FHLB that can mature daily or have longer maturities for fixed or floating rates of interest. Federal funds purchased are borrowings from other banks that mature daily. Securities sold under agreement to repurchase (repurchase agreements) are similar to deposits as they are funds lent by various Bank customers; however, investment securities are pledged to secure such borrowings. The Company has repurchase agreements that generally reprice daily. Term repurchase agreements are funds lent by a third party with securities pledged to secure such borrowings. These term repurchase agreements have longer terms. Treasury, Tax, and Loan

option notes consist of short term borrowing of tax deposits from the federal government and are not a significant source of borrowing for the Company.

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The following table summarizes the outstanding amount of, and the average rate on, borrowed funds as of December 31, 2011, 2010 and 2009.

	2011		2010		2009	
(dollars in thousands)	Balance	Average Rate	Balance	Average Rate	Balance	Average Rate
Federal funds purchased and repurchase agreements	$41,697	0.50 %	$54,859	0.63 %	$40,490	0.64 %
Other short-term borrowings	-	0.00 %	2,047	0.00 %	139	0.00 %
FHLB advances	15,179	2.81 %	16,745	2.91 %	16,500	3.12 %
Other long-term borrowings	20,000	3.36 %	20,000	3.36 %	20,000	3.77 %
Total	$76,876	1.70 %	$93,651	1.61 %	$77,129	1.98 %

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Average Annual Borrowed Funds

The following table sets forth the average amount of, the average rate paid and maximum outstanding balance on, borrowed funds for the years ended December 31, 2011, 2010 and 2009.

	2011		2010		2009	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Federal funds purchased and repurchase agreements	$46,081	0.57 %	$49,300	0.66 %	$42,795	0.92 %
Other short-term borrowings	748	0.00 %	610	0.00 %	616	0.00 %
FHLB advances	16,256	2.88 %	17,848	3.28 %	20,430	3.11 %
Other long-term borrowings	20,000	3.43 %	20,000	3.83 %	20,000	3.85 %
Total	$83,085	1.70 %	$87,758	1.91 %	$83,841	2.14 %
Maximum Amount Outstanding during the Year						
Federal funds purchased and repurchase agreements	$76,766		$76,559		$50,493	
Other short-term borrowings	$2,087		$3,131		$3,053	
FHLB advances	$19,195		$18,500		$23,500	
Other long-term borrowings	$20,000		$20,000		$20,000	

Off-Balance-Sheet Arrangements

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit that assist customers with their credit needs to conduct business. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. As of December 31, 2011, the most likely impact of these financial instruments on revenues, expenses, or cash flows of the Company would come from unidentified credit risk causing higher provision expense for loan losses in future periods. These financial instruments are not expected to have a significant impact on the liquidity or capital resources of the Company. For additional information, see Note 11 of the "Notes to Consolidated Statements" and the "Liquidity and Capital Resources" section of this discussion.

Contractual Obligations

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Contractual Obligations

The following table sets forth the balance of contractual obligations by maturity period as of December 31, 2011 (in thousands).

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Deposits	$818,705	$726,997	$70,349	$21,359	$-
Federal funds purchased and securities sold under agreements to repurchase	41,697	41,697	-	-	-
FHLB advances and other long-term borrowings (1)	35,179	568	2,151	7,152	25,308
Operating lease obligations	19	8	11	-	-
Purchase obligations (2)	1,744	672	1,072	-	-
Total	$897,344	$769,942	$73,583	$28,511	$25,308

(1) FHLB advances consist of various FHLB borrowings with fixed rates with final maturities through 2025. $11.5 million of the FHLB advances are callable and $1.2 million of the FHLB advances are amortizing. Other long-term borrowings consist of term repurchase agreements having maturities greater than one year and $13.0 million can be called by the issuing financial institution. The other long term borrowings have final maturities through 2018.

(2) Purchase obligations include data processing and Internet banking services contracts that include termination provisions that would accelerate all future payments in the event the Company changed service providers prior to the contracts' expirations.

Asset Quality Review and Credit Risk Management

The Company's credit risk is centered in the loan portfolio, which on December 31, 2011, totaled $438,651,000 as compared to $418,094,000 as of December 31, 2010, an increase of 4.9%. Net loans comprise 42% of total assets as of the end of 2011. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of a transaction and to quantify and manage credit risk on a portfolio basis. As the following chart indicates, the Company's non-performing assets have increased by 2.3% from 2010 and total $17,605,000 as of December 31, 2011. The Company's level of problem assets as a percentage of assets of 1.70% as of December 31, 2011, is lower than the average for FDIC insured institutions as of December 31, 2011, of 2.55%. Management believes that the allowance for loan losses remains adequate based on its analysis of the non-performing assets and the portfolio as a whole.

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Non-performing Assets

The following table sets forth information concerning the Company's non-performing assets for the past five years ended December 31, 2011.

(dollars in thousands)	2011	2010	2009	2008	2007
Non-performing assets:					
Nonaccrual loans	$ 7,915	$ 6,277	$ 10,187	$ 6,339	$ 3,249
Loans 90 days or more past due	152	21	121	469	1,300
Total non-performing loans	8,067	6,298	10,308	6,808	4,549
Securities available-for-sale	-	377	660	358	-
Other real estate owned	9,538	10,539	10,480	13,334	2,846
Total non-performing assets	$ 17,605	$ 17,214	$ 21,448	$ 20,500	$ 7,395

The accrual of interest on nonaccrual and other impaired loans is discontinued at 90 days or when, in the opinion of management, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received and principal obligations are expected to be recoverable. Interest income on restructured loans is recognized pursuant to the terms of the new loan agreement. Interest income on other impaired loans is monitored and based upon the terms of the underlying loan agreement. However, the recorded net investment in impaired loans, including accrued interest, is limited to the present value of the expected cash flows of the impaired loan or the observable fair value of the loan’s collateral.

At December 31, 2011 and 2010, the Company had non-performing loans of approximately $8,067,000 and $6,298,000, respectively. The economic conditions for commercial real estate developers in the Des Moines metropolitan area deteriorated over the past several years and contributed to the Company’s level of non-performing loans, other real estate owned and related costs in 2011 and 2010. In 2011 and 2010, there were no significant additional impaired real estate development loans in the Des Moines market. Presently, the Company has $2.2 million in impaired loans with two Des Moines development companies with specific reserves totaling $165,000. The Company has additional customer relationships with real estate developers in the Des Moines area that may become impaired in the future if economic conditions do not improve or become worse. The Company has a limited number of such credits and is actively engaged with the customers to minimize credit risk.

Impaired loans totaled $7,803,000 as of December 31, 2011 and were $1,371,000 higher than the impaired loans as of December 31, 2010. The Company considers impaired loans to generally include the non-performing loans (consisting of nonaccrual loans and loans past due 90 days or more and still accruing) and other loans that may or may not meet the former nonperforming criteria but are considered to meet the definition of impaired.

The allowance for loan losses related to these impaired loans was approximately $876,000 and $445,000 at December 31, 2011 and 2010, respectively. The average balances of impaired loans for the years ended December 31, 2011 and 2010 were $6,581,000 and $7,835,000, respectively. For the years ended December 31, 2011, 2010 and 2009, interest income, which would have been recorded under the original terms of such loans, was approximately $362,000, $425,000 and $564,000, respectively, with $215,000, $233,000 and $32,000, respectively, recorded. Loans greater than 90 days past due and still accruing interest were approximately $152,000 and $21,000 at December 31, 2011 and

2010, respectively.

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Summary of the Allowance for Loan Losses

The provision for loan losses represents an expense charged against earnings to maintain an adequate allowance for loan losses. The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial condition of the borrower; a realistic determination of value and adequacy of underlying collateral; historical charge-offs; the condition of the local economy; the condition of the specific industry of the borrower; an analysis of the levels and trends of loan categories; and a review of delinquent and classified loans.

The adequacy of the allowance for loan losses is evaluated quarterly by management and the respective Bank boards. This evaluation focuses on specific loan reviews, changes in the type and volume of the loan portfolio given the current economic conditions and historical loss experience. Any one of the following conditions may result in the review of a specific loan: concern about whether the customer's cash flow or collateral are sufficient to repay the loan; delinquent status; criticism of the loan in a regulatory examination; the accrual of interest has been suspended; or other reasons, including when the loan has other special or unusual characteristics which warrant special monitoring.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgment about information available to them at the time of their examination. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

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Analysis of the Allowance for Loan Losses

The Company's policy is to charge-off loans when, in management's opinion, the loan is deemed uncollectible, although concerted efforts are made to maximize future recoveries. The following table sets forth information regarding changes in the Company's allowance for loan losses for the most recent five years.

(dollars in thousands)	2011	2010	2009	2008	2007
Balance at beginning of period	$ 7,521	$ 7,652	$ 6,779	$ 5,781	$ 6,533
Charge-offs:					
Real estate					
Construction	-	22	105	76	402
1-4 Family residential	75	163	155	89	1
Commercial	51	20	415	70	25
Agricultural	-	50	15	-	-
Commercial	2	391	54	77	-
Agricultural	23	42	-	-	-
Consumer and other	52	179	122	115	299
Total charge-offs	203	867	866	427	727
Recoveries:					
Real estate					
Construction	-	-	6	-	-
1-4 Family residential	-	1	27	3	1
Commercial	2	-	98	1	-
Agricultural	-	-	-	-	-
Commercial	21	5	3	35	21
Agricultural	17	32	-	-	-
Consumer and other	14	34	47	73	47
Total recoveries	54	72	181	112	69
Net charge-offs	149	795	685	315	658
Provisions charged (credited) to operations	533	664	1,558	1,313	(94)
Balance at end of period	$ 7,905	$ 7,521	$ 7,652	$ 6,779	$ 5,781
Average loans outstanding	$ 431,368	$ 417,688	$ 434,468	$ 463,782	$ 454,088
Ratio of net charge-offs during the period to average loans outstanding	0.03 %	0.19 %	0.16 %	0.07 %	0.14 %

Ratio of allowance for loan losses to total loans net of deferred fees	1.77	%	1.77	%	1.81	%	1.47	%	1.23	%

The allowance for loan losses increased to $7,905,000 at the end of 2011 in comparison to the allowance of $7,521,000 at year end 2010 as a result of provisions in 2011 in the amount of $533,000, offset in part by net charge offs of $149,000. The lower provision for loan losses in 2011 as compared to 2010 was due primarily to lower net charge offs, offset in part by a higher provision for loan losses on impaired loans for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The allowance for loan losses decreased to $7,521,000 at the end of 2010 in comparison to the allowance of $7,652,000 at year end 2009 as a result of net charge offs of $795,000, offset in part by provisions in 2010 in the amount of $664,000. The lower provision for loan losses in 2010 as compared to 2009 was due primarily to a lower provision for loan losses on impaired loans for the year ended December 31, 2010 as compared to the year ended December 31, 2009. The allowance for loan losses increased to $7,652,000 at the end of 2009 in comparison to the allowance of $6,779,000 at year end 2008 as a result of provisions in 2009 in the amount of $1,558,000 offset by net charge offs of $685,000. The increase in the provision for loan losses was due primarily to an increase in factors related to weakening economic conditions and an increase in the specific reserve on impaired loans, offset in part by a decrease in the loan portfolio. The allowance for loan losses increased to $6,779,000 at the end of 2008 in comparison to the allowance of $5,781,000 at year end 2007 as a result of provisions in 2008 in the amount of $1,313,000 offset by net charge offs of $315,000. The increase in the provision for loan losses was due primarily to an increase in factors related to weakening economic conditions and an increase in the level of risks associated with the construction and commercial real estate loan portfolios.

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General reserves for loan categories normally range from 1.10% to 2.10% of the outstanding loan balances. In general as loan volume increases, the general reserve levels increase with that growth and as loan volume decreases, the general reserve levels decrease with that decline. The loan provisions recognized in 2011 were due primarily to an increase in the loan portfolio and specific reserves on impaired loans. The loan provisions recognized in 2010 were due primarily to a continuing weakness in the economic conditions and an increase in the loan portfolio. The loan provisions recognized in 2009 were due primarily to weakening economic conditions and an increase in the specific reserve on impaired loans, offset in part by a decrease in the loan portfolio. The allowance relating to commercial real estate, 1-4 family residential and commercial loans are the largest reserve components. Construction and commercial real estate loans have higher general reserve levels than 1-4 family and agricultural real estate loans as management perceives more risk in this type of lending. Elements contributing to the higher risk level include a higher percentage of watch and problem loans, higher past due percentages, declining collateral values and less favorable economic conditions for those portfolios. As of December 31, 2011, commercial real estate loans have general reserves ranging from 1.37% to 1.72%. The level of non-performing loans as of December 31, 2011 has increased since 2010 but remains at a manageable level.

Loans that the Banks have identified as having higher risk levels are reviewed individually in an effort to establish adequate loss reserves. These reserves are considered specific reserves and are directly impacted by the credit quality of the underlying loans. Normally, as the actual or expected level of non-performing loans increase, the specific reserves also increase. As of December 31, 2011, the specific reserve increased to $876,000 from $445,000, as the volume of problem credits increased.

As of December 31, 2010, the specific reserve decreased to $445,000 from $999,000, as the volume of problem credits decreased and economic conditions related to these borrowers stabilized. As of December 31, 2009, the specific reserve increased to $999,000 from $257,000 at the prior year end, as the volume of problem credits increased and economic conditions worsened. As of December 31, 2008, the specific reserve increased to $257,000 from $247,000 at the prior year end, as the volume of problem credits increased in 2008. As of December 31, 2007, specific reserves decreased to $247,000 from $1,477,000 reserved at year end 2006, in part, due to the charge-off of credits with specific reserves, an improved condition of certain credits and a change in the Company's method of determining specific reserves. The revised methodology resulted from implementing guidance provided by federal regulatory agencies. The specific reserves are dependent upon assumptions regarding the liquidation value of collateral and the cost of recovering collateral including legal fees. Changing the amount of specific reserves on individual loans has historically had the largest impact on the reallocation of the reserve among different parts of the portfolio.

Other factors considered when determining the adequacy of the general reserve include historical losses; watch, substandard and impaired loan volume; collecting past due loans; loan growth; loan to value ratios; loan administration; collateral values; and economic factors. The Company's concentration risks include geographic concentration in central Iowa; the local economy's dependence upon several large governmental entity employers, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that, in turn, is dependent on weather conditions and government programs. However, no assurances can be made that losses will remain at the relatively favorable levels experienced over the past five years.

Allocation of the Allowance for Loan Losses

The following table sets forth information concerning the Company's allocation of the allowance for loan losses.

(dollars in thousands)	2011			2010			2009			2008			2007		
	Amount	%	*	Amount	%	*	Amount	%	*	Amount	%	*	Amount	%	*
Balance at end of period applicable to:															
Real Estate															
Construction	$793	5	%	$731	5	%	$1,040	5	%	$472	8	%	$733	10	%
1-4 family residential	1,402	21	%	1,404	21	%	1,133	22	%	1,001	21	%	1,061	22	%
Commercial	2,859	33	%	2,720	33	%	2,683	34	%	3,566	33	%	1,964	31	%
Agricultural	501	7	%	486	7	%	523	7	%	395	7	%	407	7	%
Commercial	1,352	17	%	1,152	18	%	1,199	16	%	683	17	%	943	17	%
Agricultural	764	12	%	735	11	%	642	10	%	469	9	%	466	8	%
Consumer and other	234	5	%	293	5	%	432	6	%	193	5	%	207	5	%
	$7,905	100	%	$7,521	100	%	$7,652	100	%	$6,779	100	%	$5,781	100	%

* Percent of loans in each category to total loans.

Liquidity and Capital Resources

Liquidity management is the process by which the Company, through its Banks' Asset and Liability Committees (ALCO), ensures adequate liquid funds are available to meet its financial commitments on a timely basis, at a reasonable cost and within acceptable risk tolerances. These commitments include funding credit obligations to borrowers, funding of mortgage originations pending delivery to the secondary market, withdrawals by depositors, maintaining adequate collateral for pledging for public funds, trust deposits and borrowings, paying dividends to shareholders, payment of operating expenses, funding capital expenditures and maintaining deposit reserve requirements.

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Liquidity is derived primarily from core deposit growth and retention; principal and interest payments on loans; principal and interest payments, sale, maturity and prepayment of investment securities; net cash provided from operations; and access to other funding sources. Other funding sources include federal funds purchased lines, Federal Home Loan Bank (FHLB) advances and other capital market sources.

As of December 31, 2011, the level of liquidity and capital resources of the Company remain at a satisfactory level and compare favorably to that of other FDIC insured institutions. Management believes that the Company's liquidity sources will be sufficient to support its existing operations for the foreseeable future.

The liquidity and capital resources discussion will cover the following topics:

- Review of the Company's Current Liquidity Sources
- Review of the Consolidated Statements of Cash Flows
- Review of Company Only Cash Flows
- Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flow Needs
- Capital Resources

Review of the Company's Current Liquidity Sources

Liquid assets of cash on hand, balances due from other banks, federal funds sold and interest-bearing deposits in financial institutions for December 31, 2011, 2010 and 2009 totaled $56,571,000, $37,708,000 and $43,573,000, respectively. The higher balance of liquid assets as of December 31, 2011 primarily relates to an increase in interest bearing deposits in financial institutions and cash and due from banks. The lower balance of liquid assets as of December 31, 2010 primarily relates to a decrease in interest bearing deposits in financial institutions, offset in part by an increased level of federal funds sold.

Other sources of liquidity available to the Banks include total borrowing capacity with the FHLB of $76,587,000 and federal funds borrowing capacity at correspondent banks of $110,349,000. As of December 31, 2011, the Company had outstanding FHLB advances of $15,179,000 and securities sold under agreement to repurchase daily and term of $41,697,000 and $20,000,000, respectively. While the borrowing option is available, the Company has no Treasury Tax and Loan option notes or federal funds purchased outstanding.

Total investments as of December 31, 2011, were $508,625,000 compared to $469,908,000 as of year-end 2010. As of December 31, 2011 and 2010, the investment portfolio as a percentage of total assets was 49%. This provides the Company with a significant amount of liquidity since all investments are classified as available-for-sale as of December 31, 2011 and 2010 and have pretax net unrealized gains of $15,068,000 and $5,280,000, respectively.

The investment portfolio serves an important role in the overall context of balance sheet management in terms of balancing capital utilization and liquidity. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity and credit considerations. The portfolio's scheduled maturities represent a significant source of liquidity.

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Review of the Consolidated Statements of Cash Flows

Net cash provided by operating activities for the years ended December 31, 2011, 2010 and 2009 totaled $21,273,000, $16,822,000 and $11,400,000, respectively. The increase in net cash provided by operating activities in 2011 as compared to 2010 was primarily due to the change in amortization, net, loans held for sale and net income. The increase in net cash provided by operating activities in 2010 as compared to 2009 was primarily due to the changes in net income, other assets and amortization and accretion, net, offset in part by changes in impairment of other real estate owned, accrued interest receivables and loans held for sale.

Net cash used in investing activities for the years ended December 31, 2011, 2010 and 2009 was $65,270,000, $54,305,000 and $63,254,000, respectively. The increase in net cash used in investing activities in 2011 was primarily due to changes in interest bearing deposits in financial institutions and loans, offset in part by changes in securities available-for-sale and federal funds sold. The decrease in net cash used in investing activities in 2010 was primarily due to changes in investments and interest bearing deposits in financial institutions, offset in part by changes in loans and federal funds sold.

Net cash provided by financing activities for the years ended December 31, 2011, 2010 and 2009 totaled $51,348,000, $34,165,000 and $45,953,000, respectively. The increase in net cash provided by financing activities in 2011 was due primarily to an increase in deposits, offset in part by changes in borrowed funds and federal funds purchased and securities sold under agreements to repurchase. The decrease in net cash provided by financing activities in 2010 was due primarily to changes in deposits, offset in part by changes in borrowed funds and federal funds purchased and securities sold under agreements to repurchase. As of December 31, 2011, the Company did not have any external debt financing, off balance sheet financing arrangements or derivative instruments linked to its stock.

Review of Company Only Cash Flows

The Company's liquidity on an unconsolidated basis is heavily dependent upon dividends paid to the Company by the Banks. The Company requires adequate liquidity to pay its expenses and pay stockholder dividends. In 2011, dividends from the Banks amounted to $5,384,000 compared to $3,900,000 in 2010. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National and United Bank, as national banks, generally may pay dividends, without obtaining the express approval of the Office of the Comptroller of the Currency ("OCC"), in an amount up to their retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits, as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Randall-Story Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

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The Company has unconsolidated cash, interest bearing deposits and marketable investment securities totaling $13,945,000 that were available at December 31, 2011 to provide additional liquidity to the Banks.

Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flow Needs

Effective February 16, 2012, Randall-Story State Bank entered into a purchase and assumption agreement with Liberty Bank, F.S.B. ("Liberty") to purchase certain assets, including loans, and assume certain liabilities, including deposit accounts, of branch banking offices of Liberty in Garner, Iowa and Klemme, Iowa and to continue operation of those branch offices as offices of Randall-Story State Bank following the closing of the transaction. At closing, Randall-Story State Bank will pay to Liberty a premium in an amount equal to the lesser of (i) $5,400,00: or (ii) 5.87% of the total deposit liabilities assumed in the transaction. This transaction is expected to close in the second quarter of 2012, subject to regulatory approval and other standard closing conditions. No other material capital expenditures or other material changes in the capital resource mix are anticipated at this time.

Commitments to extend credit totaled $94,457,000 as of December 31, 2011 compared to a total of $79,757,000 at the end of 2010. The timing of these credit commitments varies with the underlying borrowers; however, the Company has satisfactory liquidity to fund these obligations as of December 31, 2011. The primary cash flow uncertainty would be a sudden decline in deposits causing the Banks to liquidate securities. Historically, the Banks have maintained an adequate level of short term marketable investments to fund the temporary declines in deposit balances. There are no other known trends in liquidity and cash flow needs as of December 31, 2011, that are of concern to management.

Capital Resources

The Company's total stockholders' equity increased to $134,557,000 at December 31, 2011, from $121,363,000 at December 31, 2010. At December 31, 2011 and 2010, stockholders' equity as a percentage of total assets was 13.0% and 12.6%, respectively. Total equity increased primarily due to net income and appreciation in the Company's investment portfolio, offset in part by dividends declared and stock repurchased. The capital levels of the Company currently exceed applicable regulatory guidelines as of December 31, 2011.

From time to time, the Corporation's board of directors has authorized stock repurchase plans. Stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. During 2011, 122,002 shares of common stock were repurchased under stock repurchase plans. No shares were repurchased under stock repurchase plans during 2010 and 2009. Also see Part II, Item 5 - Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, included elsewhere in this report.

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Interest Rate Risk

Interest rate risk refers to the impact that a change in interest rates may have on the Company's earnings and capital. Management's objectives are to control interest rate risk and to ensure predictable and consistent growth of earnings and capital. Interest rate risk management focuses on fluctuations in net interest income identified through computer simulations to evaluate volatility, varying interest rate, spread and volume assumptions. The risk is quantified and compared against tolerance levels.

The Company uses a third-party computer software simulation modeling program to measure its exposure to potential interest rate changes. For various assumed hypothetical changes in market interest rates, numerous other assumptions are made such as prepayment speeds on loans, the slope of the Treasury yield curve, the rates and volumes of the Company's deposits and the rates and volumes of the Company's loans. This analysis measures the estimated change in net interest income in the event of hypothetical changes in interest rates.

Another measure of interest rate sensitivity is the gap ratio. This ratio indicates the amount of interest-earning assets repricing within a given period in comparison to the amount of interest-bearing liabilities repricing within the same period of time. A gap ratio of 1.0 indicates a matched position, in which case the effect on net interest income due to interest rate movements will be minimal. A gap ratio of less than 1.0 indicates that more liabilities than assets reprice within the time period, while a ratio greater than 1.0 indicates that more assets reprice than liabilities.

The simulation model process provides a dynamic assessment of interest rate sensitivity, whereas a static interest rate gap table is compiled as of a point in time. The model simulations differ from a traditional gap analysis, as a traditional gap analysis does not reflect the multiple effects of interest rate movement on the entire range of assets and liabilities and ignores the future impact of new business strategies.

Inflation

The primary impact of inflation on the Company's operations is to increase asset yields, deposit costs and operating overhead. Unlike most industries, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than they would on non-financial companies. Although interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services, increases in inflation generally have resulted in increased interest rates. The effects of inflation can magnify the growth of assets and, if significant, require that equity capital increase at a faster rate than would be otherwise necessary.

Forward-Looking Statements and Business Risks

Certain statements contained in the foregoing Management's Discussion and Analysis and elsewhere in this Annual Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases and in oral and written statements made by or with the Company's approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of the Company or its management, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "projected", "continue", "remain", "will", "should", "
similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying

such statements.

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Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statement. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- Local, regional and national economic conditions and the impact they may have on the Company and its customers, and management's assessment of that impact on its estimates including, but not limited to, the allowance for loan losses and fair value of other real estate owned. Of particular relevance are the economic conditions in the concentrated geographic area in central Iowa in which the Banks conduct their operations.
- Changes in the level of nonperforming assets and charge-offs.
- Changes in the fair value of securities available-for-sale and management's assessments of other-than-temporary impairment of such securities.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the changes in assessment rates established by the Federal Deposit Insurance Corporation for its Deposit Insurance Fund and interest rate policies of the Federal Open Market Committee of the Federal Reserve Board.
- Changes in sources and uses of funds, including loans, deposits and borrowings, including the ability of the Banks to maintain unsecured federal funds lines with correspondent banks.
- Changes imposed by regulatory agencies to increase capital to a level greater than the level required for well-capitalized financial institutions.
- Inflation and interest rate, securities market and monetary fluctuations.
- Political instability, acts of war or terrorism and natural disasters.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by customers.
- Revenues being lower than expected.
- Changes in consumer spending, borrowings and savings habits.
- Changes in the financial performance and/or condition of the Company's borrowers.

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- Credit quality deterioration, which could cause an increase in the provision for loan losses.
- Technological changes.
- The ability to increase market share and control expenses.
- Changes in the competitive environment among financial or bank holding companies and other financial service providers.
- The effect of changes in laws and regulations with which the Company and the Banks must comply, including developments and changes related to the implementation of the recently-enacted Dodd-Frank Act.
- Changes in the securities markets.
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters, including the International Financial Reporting Standards.
- The costs and effects of legal and regulatory developments, including the resolution of regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
- The Company's success at managing the risks involved in the foregoing items.

Certain of the foregoing risks and uncertainties are discussed in greater detail under the heading "Risk Factors" in Item 1A herein.

These factors may not constitute all factors that could cause actual results to differ materially from those discussed in any forward-looking statement. The Company operates in a continually changing business environment and new facts emerge from time to time. It cannot predict such factors nor can it assess the impact, if any, of such factors on its financial position or its results of operations. Accordingly, forward-looking statements should not be relied upon as a predictor of actual results. The Company disclaims any responsibility to update any forward-looking statement provided in this document.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk is comprised primarily of interest rate risk arising from its core banking activities of making loans and taking deposits. Interest rate risk is the risk that changes in market interest rates may adversely affect the Company's net interest income. Management continually develops and applies strategies to mitigate this risk. Management does not believe that the Company's primary market risk exposure and how that exposure was managed in 2011 changed when compared to 2010.

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Based on a simulation modeling analysis performed as of December 31, 2011, the following table presents the estimated change in net interest income in the event of hypothetical changes in interest rates for the various rate shock levels:

Net Interest Income at Risk

Estimated Change in Net Interest Income for Year Ending December 31, 2012

(dollars in thousands)	$ Change	% Change
+300 Basis Points	$ (4,787)	-15.15 %
+200 Basis Points	(3,718)	-11.77 %
+100 Basis Points	(2,161)	-6.84 %
-100 Basis Points	(865)	-2.74 %
-200 Basis Points	(2,037)	-6.45 %
-300 Basis Points	(3,488)	-11.04 %

As shown above, at December 31, 2011, the estimated effect of an immediate 300 basis point increase in interest rates would decrease the Company’s net interest income by 15.15% or approximately $4,787,000 in 2012. In an increasing interest rate environment, the assets are repricing slower than the liabilities, thus a decrease in net interest income. The estimated effect of an immediate 200 basis point decrease in rates would decrease the Company’s net interest income by 6.45% or approximately $2,037,000 in 2012. In a decreasing interest rate environment, a portion of the liabilities are not repricing downward due to their already historically low rates, thus a decrease in net interest income. The Company’s Asset Liability Management Policy establishes parameters for a 200 basis point change in interest rates. Under this policy, the Company and the Banks’ objective is to properly structure the balance sheet to prevent a 200 basis point change in interest rates from causing a decline in net interest income by more than 15% in one year compared to the base year that hypothetically assumes no change in interest rates.

Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions. Actual values may differ from those projections set forth above. Further, the computations do not contemplate any actions the Company may undertake in response to changes in interest rates. Current interest rates on certain liabilities are at a level that does not allow for significant repricing should market interest rates decline considerably.

Contractual Maturity or Repricing

The following table sets forth the estimated maturity or re-pricing, and the resulting interest sensitivity gap, of the Company's interest-earning assets and interest-bearing liabilities and the cumulative interest sensitivity gap at December 31, 2011. The expected maturities are presented on a contractual basis. Actual maturities may differ from contractual maturities because of prepayment assumptions, early withdrawal of deposits and competition.

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(dollars in thousands)	Less than three months	Three months to one year	One to five years	Over five years	Cumulative Total
Interest - earning assets					
Interest-bearing deposits and federal funds sold	$12,719	$4,883	$15,659	$480	$33,741
Investments (1)	11,408	24,056	312,604	160,557	508,625
Loans	65,358	91,627	200,120	89,682	446,787
Loans held for sale	1,213	-	-	-	1,213
Total interest - earning assets	$90,698	$120,566	$528,383	$250,719	$990,366
Interest - bearing liabilities					
Interest bearing demand deposits	$229,810	$-	$-	$-	$229,810
Money market and savings deposits	216,768	-	-	-	216,768
Time certificates > $100,000	21,319	54,342	32,284	-	107,945
Time certificates < $100,000	20,906	57,793	59,424	-	138,123
Other borrowed funds (2)	517	51	9,303	25,308	35,179
Total interest - bearing liabilities	$489,320	$112,186	$101,011	$25,308	$727,825
Interest sensitivity gap	$(398,622)	$8,380	$427,372	$225,411	$262,541
Cumulative interest sensitivity gap	$(398,622)	$(390,242)	$37,130	$262,541	$262,541
Cumulative interest sensitivity gap as a percent of total assets	-38.49 %	-37.68 %	3.59 %	25.35 %	

(1) Investments with maturities over 5 years include the market value of equity securities of $5,790.
(2) Includes $15.2 million of advances from the FHLB. Of these advances, $2.5 million are term advances, $11.5 million are callable and $1.2 million are 15 year amortizing. The term advances have been categorized based upon their maturity date. The $11.5 million of callable advances were also categorized based upon maturity, because the interest rates on such advances are near or above current market rates. The $1.2 million of amortizing advances are based upon original amortization schedule. Includes $20.0 million of term repurchase agreements, of which $13.0 million are callable. The callable repurchase agreements were categorized based upon maturity, because the interest rates on such advances are near or above current market rates.

As of December 31, 2011, the Company's cumulative gap ratios for assets and liabilities repricing within three months and within one year were a negative 38% and 38%, respectively, meaning more liabilities than assets are scheduled to reprice within these periods. This situation suggests that a decrease in market interest rates may benefit net interest income and that an increase in interest rates may negatively impact the Company. The liability sensitive gap position is largely the result of classifying the interest bearing NOW accounts, money market accounts and savings accounts as immediately repriceable. Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities and periods to repricing, they may react differently to changes in market interest rates. Also, interest rates on assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other assets and liabilities may follow changes in market interest rates. Additionally, certain assets have features that restrict changes in the interest rates of such assets, both on a short-term basis and over the lives of such assets.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Ames National Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Ames National Corporation's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Ames National Corporation's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment we determined that, as of December 31, 2011, the Company's internal control over financial reporting is effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2011 has been audited by CliftonLarsonAllen LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Thomas H. Pohlman, President
(Principal Executive Officer)

/s/ John P. Nelson
John P. Nelson, Vice President
(Principal Financial Officer)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Ames National Corporation
Ames, Iowa

We have audited the accompanying consolidated balance sheets of Ames National Corporation and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, comprehensive income, 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 Company's management. Our responsibility is to express an opinion of 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Ames National Corporation and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 12, 2012 expressed an unqualified opinion.

West Des Moines, Iowa
March 12, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Ames National Corporation
Ames, Iowa

We have audited Ames National Corporation and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Ames National Corporation's management is responsible for maintaining effective internal control over the financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, Ames National Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based upon criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Ames National Corporation and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 12, 2012 expressed an unqualified opinion.

West Des Moines, Iowa
March 12, 2012

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2011 and 2010

ASSETS	2011	2010
Cash and due from banks	$22,829,291	$15,478,133
Federal funds sold	-	3,000,000
Interest bearing deposits in financial institutions	33,741,406	19,229,814
Securities available-for-sale	508,624,622	469,907,901
Loans receivable, net	438,650,837	418,093,571
Loans held for sale	1,212,620	1,993,108
Bank premises and equipment, net	11,362,626	11,538,588
Accrued income receivable	6,467,509	6,098,535
Deferred income taxes	-	3,305,983
Other real estate owned	9,538,440	10,538,883
Other assets	3,136,482	3,790,329
Total assets	$1,035,563,833	$962,974,845
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$126,059,239	$105,513,143
NOW accounts	229,810,463	201,230,880
Savings and money market	216,768,048	199,017,213
Time, $100,000 and over	107,944,525	94,858,053
Other time	138,123,116	143,242,355
Total deposits	818,705,391	743,861,644
Federal funds purchased and securities sold under agreements to repurchase	41,696,585	54,858,701
Other short-term borrowings	-	2,047,175
Federal Home Loan Bank (FHLB) advances	15,179,335	16,745,497
Other long-term borrowings	20,000,000	20,000,000
Dividend payable	1,210,419	1,037,621
Deferred income taxes	885,433	-
Accrued expenses and other liabilities	3,329,285	3,061,183
Total liabilities	901,006,448	841,611,821
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; issued 9,432,915 shares; outstanding 9,310,913 shares as of December 31, 2011 and 9,432,915 shares as of December 31, 2010	18,865,830	18,865,830
Additional paid-in capital	22,651,222	22,651,222
Retained earnings	85,564,078	76,519,493
Accumulated other comprehensive income-net unrealized gain on securities available-for-sale	9,492,753	3,326,479

Treasury stock, at cost: 122,002 shares and no shares at December 31, 2011 and 2010, respectively	(2,016,498)	-
Total stockholders' equity	134,557,385	121,363,024
Total liabilities and stockholders' equity	$1,035,563,833	$962,974,845

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
Interest income:			
Loans, including fees	$23,600,471	$24,061,277	$25,212,884
Securities:			
Taxable	6,993,213	6,964,979	7,966,594
Tax-exempt	6,555,546	5,778,722	5,213,031
Interest bearing deposits and federal funds sold	466,475	488,980	498,798
Total interest income	37,615,705	37,293,958	38,891,307
Interest expense:			
Deposits	5,313,476	6,096,504	8,428,163
Other borrowed funds	1,416,589	1,678,587	1,798,149
Total interest expense	6,730,065	7,775,091	10,226,312
Net interest income	30,885,640	29,518,867	28,664,995
Provision for loan losses	532,961	663,798	1,558,307
Net interest income after provision for loan losses	30,352,679	28,855,069	27,106,688
Noninterest income:			
Trust services income	2,046,914	1,948,519	1,541,831
Service fees	1,465,055	1,626,352	1,814,925
Securities gains, net	1,025,714	973,012	1,157,347
Gain on sale of loans held for sale	1,048,583	942,826	1,008,566
Merchant and ATM fees	739,951	724,725	621,316
Other noninterest income	644,163	620,845	630,143
Total noninterest income	6,970,380	6,836,279	6,774,128
Noninterest expense:			
Salaries and employee benefits	11,631,032	10,826,307	10,757,475
Data processing	1,985,329	1,857,259	1,892,123
Occupancy expenses	1,377,333	1,488,100	1,436,485
FDIC insurance assessments	738,893	1,120,058	1,675,401
Other real estate owned, net	434,041	95,086	4,048,183
Other operating expenses, net	2,685,344	2,834,212	2,772,556
Total noninterest expense	18,851,972	18,221,022	22,582,223
Income before income taxes	18,471,087	17,470,326	11,298,593
Provision for income taxes	4,550,280	4,504,052	2,292,807
Net income	$13,920,807	$12,966,274	$9,005,786

Basic and diluted earnings per share	$1.48	$1.37	$0.95

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
Net income	$13,920,807	$12,966,274	$9,005,786
Other comprehensive income, before tax:			
Unrealized gains on securities without other than temporary impairment before tax:			
Unrealized holding gains arising during the period	10,813,453	1,302,129	6,347,532
Less: reclassification adjustment for gains realized in net income	1,025,714	977,512	1,186,912
Plus: reclassification adjustment for impairment losses realized in net income	-	4,500	29,565
Other comprehensive income before tax	9,787,739	329,117	5,190,185
Tax expense related to other comprehensive income	(3,621,465)	(121,773)	(1,920,367)
Other comprehensive income, net of tax:	6,166,274	207,344	3,269,818
Comprehensive income	$20,087,081	$13,173,618	$12,275,604

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2011, 2010 and 2009

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Taxes	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2008	$ 18,865,830	$ 22,651,222	$ 62,471,081	$ (150,683)	$ -	$ 103,837,450
Net income	-	-	9,005,786	-	-	9,005,786
Other comprehensive income	-	-	-	3,269,818	-	3,269,818
Cash dividends declared, $0.40 per share	-	-	(3,773,166)	-	-	(3,773,166)
Balance, December 31, 2009	18,865,830	22,651,222	67,703,701	3,119,135	-	112,339,888
Net income	-	-	12,966,274	-	-	12,966,274
Other comprehensive income	-	-	-	207,344	-	207,344
Cash dividends declared, $0.44 per share	-	-	(4,150,482)	-	-	(4,150,482)
Balance, December 31, 2010	18,865,830	22,651,222	76,519,493	3,326,479	-	121,363,024
Net income	-	-	13,920,807	-	-	13,920,807
Other comprehensive income	-	-	-	6,166,274	-	6,166,274
Purchase of 122,002 shares of treasury stock	-	-	-	-	(2,016,498)	(2,016,498)
Cash dividends declared, $0.52 per share	-	-	(4,876,222)	-	-	(4,876,222)
Balance, December 31, 2011	$ 18,865,830	$ 22,651,222	$ 85,564,078	$ 9,492,753	$ (2,016,498)	$ 134,557,385

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$13,920,807	$12,966,274	$9,005,786
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	532,961	663,798	1,558,307
Provision (credit) for off-balance sheet commitments	10,000	13,000	(21,000)
Amortization, net	5,024,526	3,205,568	868,971
Depreciation	741,665	748,008	876,792
Provision for deferred income taxes	569,954	439,766	50,154
Securities gains, net	(1,025,714)	(973,012)	(1,157,347)
Impairment of other real estate owned	335,048	14,900	3,879,901
Gain on sale of other real estate owned	(148,542)	(63,959)	(92,513)
Loss on disposal of equipment	-	-	1,096
Change in assets and liabilities:			
Decrease (increase) in loans held for sale	780,488	(969,908)	128,820
Decrease (increase) in accrued income receivable	(368,974)	(388,309)	940,061
Decrease (increase) in other assets	642,246	1,111,984	(3,860,396)
Increase (decrease) in accrued expenses and other liabilities	258,102	53,892	(778,849)
Net cash provided by operating activities	21,272,567	16,822,002	11,399,783
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of securities available-for-sale	(197,289,227)	(208,372,243)	(252,088,448)
Proceeds from sale of securities available-for-sale	25,400,121	22,326,136	68,698,126
Proceeds from maturities and calls of securities available-for-sale	138,958,819	132,889,786	83,228,240
Net decrease (increase) in interest bearing deposits in financial institutions	(14,509,102)	5,546,274	(14,375,327)
Net decrease (increase) in federal funds sold	3,000,000	(3,000,000)	16,533,000
Net decrease (increase) in loans	(21,390,113)	(4,450,923)	33,580,577
Net proceeds from the sale of other real estate owned	1,163,609	1,132,969	1,367,578
Purchase of bank premises and equipment, net	(554,102)	(362,514)	(202,997)
Other changes in other real estate owned	(49,786)	(14,554)	5,378
Net cash used in investing activities	(65,269,781)	(54,305,069)	(63,253,873)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in deposits	74,843,747	21,697,695	57,369,239
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	(13,162,116)	14,369,196	1,979,946
Proceeds (payments) from other short-term borrowings, net	(2,047,175)	1,908,301	(924,932)
Proceeds from FHLB and other long-term borrowings	4,000,000	3,750,000	2,500,000
Payments on FHLB and other long-term borrwings	(5,566,162)	(3,504,503)	(9,500,000)
Purchase of treasury stock	(2,016,498)	-	-
Dividends paid	(4,703,424)	(4,056,153)	(5,471,090)
Net cash provided by financing activities	51,348,372	34,164,536	45,953,163

Net increase (decrease) in cash and cash equivalents	7,351,158	(3,318,531)	(5,900,927)
CASH AND DUE FROM BANKS			
Beginning	15,478,133	18,796,664	24,697,591
Ending	$22,829,291	$15,478,133	$18,796,664

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash payments for:			
Interest	$6,797,673	$7,996,827	$10,712,422
Income taxes	3,988,241	3,875,900	1,588,103
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES			
Transfer of loans to other real estate owned	$299,886	$1,127,790	$2,307,228

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Description of business: Ames National Corporation and subsidiaries (the Company) operates in the commercial banking industry through its subsidiaries in Ames, Boone, Story City, Nevada and Marshalltown, Iowa. Loan and deposit customers are located primarily in Story, Boone, Polk and Marshall Counties and adjacent counties in Iowa.

Segment information: The Company uses the "management approach" for reporting information about segments in annual and interim financial statements. The "management approach" is based on the way the chief operating decision-maker organizes segments within a company for making operating decisions and assessing performance. Based on the "management approach" model, the Company has determined that its business is comprised of one operating segment: banking. The banking segment generates revenues through personal, business, agricultural and commercial lending, management of the investment securities portfolio, deposit account services and trust services.

Consolidation: The consolidated financial statements include the accounts of Ames National Corporation (the Parent Company) and its wholly-owned subsidiaries, First National Bank, Ames, Iowa; State Bank & Trust Co., Nevada, Iowa; Boone Bank & Trust Co., Boone, Iowa; Randall-Story State Bank, Story City, Iowa; and United Bank & Trust NA, Marshalltown, Iowa (collectively, the Banks). All significant intercompany transactions and balances have been eliminated in consolidation.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, assessment of the fair value of other real estate owned and the assessment of other-than-temporary impairment for certain financial instruments.

Cash and cash equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks. The Company reports net cash flows for customer loan transactions, deposit transactions and short-term borrowings with maturities of 90 days or less.

Securities available-for-sale: The Company classifies all securities as available-for-sale. Securities available-for-sale are those securities the Company may decide to sell if needed for liquidity, asset-liability management or other reasons. Securities available-for-sale are reported at fair value, with the change in the net unrealized gains reported as other comprehensive income and as accumulated other comprehensive income (loss), net of taxes, a separate component of stockholders' equity.

Gains and losses on the sale of securities are determined using the specific identification method based on amortized cost and are reflected in results of operation at the time of sale. Interest and dividend income, adjusted by amortization of purchase premium or discount over the estimated life of the security using the level yield method, is included in income as earned.

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

Loans held for sale: Loans held for sale are the loans the Banks have the intent to sell in the foreseeable future. They are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Gains and losses on sales of loans are determined by the difference between the sale proceeds and the carrying value of the loans, recognized at settlement date and recorded as noninterest income.

Loans: Loans are stated at the principal amount outstanding, net of deferred loan fees and the allowance for loan losses. Interest on loans is credited to income as earned based on the principal amount outstanding. The Banks' policy is to discontinue the accrual of interest income on any loan 90 days or more past due unless the loans are well collateralized and in the process of collection. Income on nonaccrual loans is subsequently recognized only to the extent that cash payments are received and principal obligations are expected to be recoverable. Nonaccrual loans are returned to an accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to timely payment of principal or interest.

Allowance for loan losses: The allowance for loan losses is established through a provision for loan losses and maintained at a level deemed appropriate by management to provide for known and inherent risks in the loan portfolio. The allowance is based upon an ongoing review of past loan loss experience, current economic conditions, the underlying collateral value securing the loans and other adverse situations that may affect the borrower's ability to repay. Loans which are deemed to be uncollectible are charged off and deducted from the allowance. Recoveries on loans charged-off are added to the allowance. This evaluation is inherently subjective and requires estimates that are susceptible to significant revisions as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

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The Company's allowance for possible loan losses consists of two components (i) specific valuation allowances based on probable losses on specific loans and (ii) general valuation allowances based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk rating process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include residential first mortgage loans secured by one-to-four family residences, residential construction loans, and automobile loans. Commercial and agricultural loans and mortgage loans secured by other properties are evaluated individually for impairment when analysis of borrower operating results and financial condition indicates that underlying cash flows of the borrower's business are not adequate to meet its debt service requirements. Often this is associated with a delay or shortfall in payments of 90 days or more. Nonaccrual loans are often also considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

General valuation allowances are based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) actual charge offs; (ii) the experience, ability and effectiveness of the Company's lending management and staff; (iii) the effectiveness of the Company's loan policies, procedures and internal controls; (iv) changes in asset quality; (v) changes in loan portfolio volume; (vi) the composition and concentrations of credit; (vii) the impact of competition on loan structuring and pricing; (viii) the effectiveness of the internal audit loan review function; (ix) the impact of environmental risks on portfolio risks; and (x) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance. Included in the general valuation allowances are allocations for groups of loans with similar risk characteristics.

Premises and equipment: Premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using straight-line and accelerated methods over the estimated useful lives of the respective assets. Depreciable lives range from 3 to 7 years for equipment and 15 to 39 years for premises.

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

Trust department assets: Property held for customers in fiduciary or agency capacities are not included in the accompanying consolidated balance sheets, as such items are not assets of the Banks.

Advertising Costs: Advertising costs are expensed as incurred.

Income taxes: Deferred income taxes are provided on temporary differences between financial statement and income tax reporting. Temporary differences are differences between the amounts of assets and liabilities reported for financial statement purposes and their tax basis. Deferred tax assets are recognized for temporary differences that will be deductible in future years' tax returns and for operating loss and tax credit carry forwards. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns. Accounting for uncertainty in income taxes sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. Benefits from tax positions taken or expected to be taken in a tax return are not recognized if the likelihood that the tax position would be sustained upon examination by a taxing authority is considered to be 50 percent or less. Interest and penalties are accounted for as a component of income tax expense.

The Company files a consolidated federal income tax return, with each entity computing its taxes on a separate company basis. For state tax purposes, the Banks file franchise tax returns, while the Parent Company files a corporate income tax return.

Comprehensive income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available-for-sale, are reported as accumulated other comprehensive income (loss), a separate component of the stockholders' equity section of the consolidated balance sheet, and such items, along with net income, are components of the statement of comprehensive income. Gains and losses on securities available-for-sale are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges are reclassified to net income at the time of the charge.

Financial instruments with off-balance-sheet risk: The Company, in the normal course of business, makes commitments to make loans which are not reflected in the consolidated financial statements. A summary of these commitments is disclosed in Note 11.

Transfers of financial assets: Transfers of an entire financial asset or a participating interest in an entire financial asset 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 Company, (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 Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

The transfer of a participating interest in an entire financial asset must also meet the definition of a participating interest. A participating interest in a financial asset has all of the following characteristics: (a) from the date of the transfer, it must represent a proportionate (pro rata) ownership in the financial asset, (2) from the date of transfer, all cash flows received, except any cash flows allocated as any compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share ownership, (3) the rights of each participating interest holder must have the same priority, (4) no party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so.

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

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

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

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

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

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

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

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

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

Commitments to extend credit and standby letters of credit: The fair values of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and credit worthiness of the counterparties. The carry value and fair value of the commitments to extend credit and standby letters of credit are not considered significant.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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Earnings per share: Basic earnings per share computations for the years ended December 31, 2011, 2010 and 2009, were determined by dividing net income by the weighted-average number of common shares outstanding during the years then ended. The Company had no potentially dilutive securities outstanding during the periods presented.

The following information was used in the computation of basic earnings per share for the years ended December 31, 2011, 2010, and 2009.

	2011	2010	2009
Basic earning per share computation:			
Net income	$13,920,807	$12,966,274	$9,005,786
Weighted average common shares outstanding	9,399,076	9,432,915	9,432,915
Basic EPS	$1.48	$1.37	$0.95

Reclassifications: Certain reclassifications have been made to the prior consolidated financial statements to conform to the current period presentation. These reclassifications had no effect on stockholders' equity and net income of the prior periods.

Recent accounting pronouncements: In January 2010, the Financial Accounting Standards Board ("FASB") issued guidance which modifies certain aspects contained in the Fair Value Measurements and Disclosure topic of FASB Accounting Standard Codification ("ASC") 820. This standard enhances information reported to users of the financial statements by providing additional and enhanced disclosures about the fair value measurements The adoption of this standard did not have any impact on the Company's financial position or results of operations and required disclosures have been made.

In July 2010, the FASB issued Accounting Standards Update 2010-20, Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The new guidance increases disclosures made about the credit quality of loans and the allowance for credit losses. The disclosures provide additional information about the nature of credit risk inherent in the Company's loans, how credit risk is analyzed and assessed, and the reasons for the change in the allowance for loan losses. The requirements were generally effective for the Company as of December 31, 2010 and the appropriate required disclosures were made in the consolidated financial statements.

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

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

In June, 2011, the FASB issued guidance on comprehensive income to require that all nonowner changes in stockholders’ equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. The guidance is effective for interim and annual periods beginning after December 15, 2011, with early adoption allowed. The adoption by the Company on December 31, 2011 did not have a material impact on the Company's consolidated financial statements.

Note 2. Concentrations and Restrictions on Cash and Due from Banks and Interest Bearing Deposits in Financial Institutions

The Federal Reserve Bank requires member banks to maintain certain cash and due from bank reserves. The subsidiary banks’ reserve requirements totaled approximately $3,896,000 and $3,530,000 at December 31, 2011 and 2010, respectively.

At December 31, 2011, the Company had approximately $49,803,000 on deposit at various financial institutions. Management does not believe these balances carry a significant risk of loss but cannot provide absolute assurance that no losses would occur if these institutions were to become insolvent.

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Note 3. Debt and Equity Securities

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

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2010:				
U.S. treasury	$ 499,885	$ 3,265	$ -	$ 503,150
U.S. government agencies	86,336,578	1,190,768	(114,727)	87,412,619
U.S. government mortgage-backed securities	125,740,846	2,237,443	(629,668)	127,348,621
State and political subdivisions	226,352,715	3,254,157	(1,234,045)	228,372,827
Corporate bonds	19,220,366	1,183,213	(31,575)	20,372,004
Equity securities, financial industry common stock	3,402,389	-	(588,208)	2,814,181
Equity securities, other	3,074,999	9,500	-	3,084,499
	$ 464,627,778	$ 7,878,346	$ (2,598,223)	$ 469,907,901

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The amortized cost and estimated fair value of debt securities available-for-sale as of December 31, 2011, are shown below by contractual maturity. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 35,093,427	$ 35,464,233
Due after one year through five years	303,497,878	312,603,558
Due after five years through ten years	121,478,277	126,520,270
Due after ten years	27,104,590	28,246,862
	487,174,172	502,834,923
Equity securities	6,382,588	5,789,699
	$ 493,556,760	$ 508,624,622

At December 31, 2011 and 2010, securities with a carrying value of approximately $192,632,000 and $186,472,000, respectively, were pledged as collateral on public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law. Securities sold under agreements to repurchase are held by the Company's safekeeping agent.

The proceeds, gains and losses from securities available-for-sale are summarized below:

	2011	2010	2009
Proceeds from sales of securities available-for-sale	$ 25,400,121	$ 22,326,136	$ 68,698,126
Gross realized gains on securities available-for-sale	1,030,530	999,492	2,152,256
Gross realized losses on securities available-for-sale	4,816	26,480	994,909
Tax provision applicable to net realized gains on securities available-for-sale	383,000	364,000	439,000

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Gross unrealized losses and estimated fair value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2011 and 2010, are summarized as follows:

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

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
2010:						
Securities available for sale:						
U.S. government agencies	$15,321,189	$(107,139)	$372,404	$(7,588)	$15,693,593	$(114,727)
U.S. government mortgage-backed securities	43,327,689	(629,668)	-	-	43,327,689	(629,668)
State and political subdivisions	53,299,308	(1,218,282)	497,051	(15,763)	53,796,359	(1,234,045)
Corporate bonds	2,022,914	(31,575)	-	-	2,022,914	(31,575)
Equity securities, financial industry common stock	-	-	2,814,181	(588,208)	2,814,181	(588,208)
	$113,971,100	$(1,986,664)	$3,683,636	$(611,559)	$117,654,736	$(2,598,223)

At December 31, 2011, debt securities have unrealized losses of $577,940. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. Management concluded that the unrealized losses on debt securities were temporary. Unrealized losses on equity securities totaled $592,889 as of December 31, 2011. Management analyzed the financial condition of the equity issuers and considered the general market conditions and other factors in concluding that the unrealized losses on equity securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

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Note 4. Loans Receivable and Credit Disclosures

The composition of loans receivable is as follows:

	2011	2010
Real estate - construction	$ 23,631,288	$ 19,597,188
Real estate - 1 to 4 family residential	94,262,349	88,933,070
Real estate - commercial	147,499,687	139,369,508
Real estate - agricultural	32,503,097	31,931,533
Commercial	75,958,450	78,172,694
Agricultural	52,178,566	45,629,689
Consumer and other	20,754,010	22,051,870
	446,787,447	425,685,552
Less:		
Allowance for loan losses	(7,905,316)	(7,520,665)
Deferred loan fees	(231,294)	(71,316)
	$ 438,650,837	$ 418,093,571

Construction loans are underwritten utilizing independent appraisals, sensitivity analysis of absorption, vacancy and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and the availability of long-term financing. The Company may require guarantees on these loans. The Company's construction loans are secured primarily by properties located in its primary market area.

The Company originates 1-4 family real estate and consumer loans utilizing credit reports to supplement the underwriting process. The Company's manual underwriting standards for 1-4 family loans are generally in accordance with FHLMC and FNMA manual underwriting guidelines. Properties securing 1-4 four-family real estate loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function and have been approved by the Board of Directors. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. The Company will lend up to 100% of the lesser of the appraised value or purchase price for conventional 1-4 family real estate loans, provided private mortgage insurance is obtained. The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. To monitor and manage loan risk, policies and procedures are developed and modified, as needed by management. This activity, coupled with smaller loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, market conditions are reviewed by management on a regular basis. The Company's 1-4 family real estate loans are secured primarily by properties located in its primary market area.

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Commercial and agricultural real estate loans are subject to underwriting standards and processes similar to commercial and agricultural operating loans, in addition to those unique to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial and agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Loan to value is generally 75% of the cost or value of the assets. Appraisals on properties securing these loans are performed by fee appraisers approved by the Board of Directors. Because payments on commercial and agricultural real estate loans are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. Management monitors and evaluates commercial and agricultural real estate loans based on collateral and risk rating criteria. The Company may require guarantees on these loans. The Company's commercial and agricultural real estate loans are secured primarily by properties located in its primary market area.

Commercial and agricultural operating loans are underwritten based on the Company's examination of current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. This underwriting includes the evaluation of cash flows of the borrower, underlying collateral, if applicable, and the borrower's ability to manage its business activities. The cash flows of borrowers and the collateral securing these loans may fluctuate in value after the initial evaluation. A first priority lien on the general assets of the business normally secures these types of loans. Loan to value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s). The Company's commercial and agricultural operating lending is primarily in its primary market area.

The Company maintains an internal audit department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Summary changes in the allowance for loan losses are as follows:

	2011	2010	2009
Balance, beginning	$ 7,520,665	$ 7,651,510	$ 6,779,215
Provision for loan losses	532,961	663,798	1,558,307
Recoveries of loans charged-off	54,616	72,007	180,961
Loans charged-off	(202,926)	(866,650)	(866,973)
Balance, ending	$ 7,905,316	$ 7,520,665	$ 7,651,510

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Activity in the allowance for loan losses, on a disaggregated basis, for the years ended December 31, 2011 and 2010 is as follows:

2011

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, beginning	$ 731,000	$ 1,404,000	$ 2,720,000	$ 486,000	$ 1,152,000	$ 735,000	$ 293,000	$ 7,521,000
Provision (credit) for loan losses	62,000	73,000	188,000	15,000	181,000	35,000	(21,000)	533,000
Recoveries of loans charged-off	-	-	2,000	-	21,000	17,000	14,000	54,000
Loans charged-off	-	(75,000)	(51,000)	-	(2,000)	(23,000)	(52,000)	(203,000)
Balance, ending	$ 793,000	$ 1,402,000	$ 2,859,000	$ 501,000	$ 1,352,000	$ 764,000	$ 234,000	$ 7,905,000

2010

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, beginning	$ 1,040,000	$ 1,133,000	$ 2,683,000	$ 523,000	$ 1,199,000	$ 642,000	$ 432,000	$ 7,652,000
Provision (credit) for loan losses	(287,000)	433,000	57,000	13,000	339,000	103,000	6,000	664,000
Recoveries of loans charged-off	-	1,000	-	-	5,000	32,000	34,000	72,000
Loans charged-off	(22,000)	(163,000)	(20,000)	(50,000)	(391,000)	(42,000)	(179,000)	(867,000)
Balance, ending	$ 731,000	$ 1,404,000	$ 2,720,000	$ 486,000	$ 1,152,000	$ 735,000	$ 293,000	$ 7,521,000

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Allowance for loan losses disaggregated on the basis of the impairment analysis method as of December 31, 2011 and 2010 is as follows:

2011

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

2010

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Tot
Ending balance: Individually evaluated for impairment	$223,000	$158,000	$42,000	$-	$-	$-	$22,000	$445,(
Ending balance: Collectively evaluated for impairment	508,000	1,246,000	2,678,000	486,000	1,152,000	735,000	271,000	7,076
Ending balance	$731,000	$1,404,000	$2,720,000	$486,000	$1,152,000	$735,000	$293,000	$7,521

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Loans receivable disaggregated on the basis of the impairment analysis method as of December 31, 2011 and 2010 is as follows:

2011

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Co an
Ending balance: Individually evaluated for impairment	$2,163,000	$2,346,000	$2,703,000	$-	$590,000	$-	$1,
Ending balance: Collectively evaluated for impairment	21,468,000	91,916,000	144,797,000	32,503,000	75,368,000	52,179,000	20
Ending balance	$23,631,000	$94,262,000	$147,500,000	$32,503,000	$75,958,000	$52,179,000	$20

2010

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Co an
Ending balance: Individually evaluated for impairment	$4,156,000	$1,395,000	$802,000	$-	$45,000	$-	$34
Ending balance: Collectively evaluated for impairment	15,441,000	87,538,000	138,568,000	31,931,000	78,128,000	45,630,000	22
Ending balance	$19,597,000	$88,933,000	$139,370,000	$31,931,000	$78,173,000	$45,630,000	$22

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk ratings of construction, commercial and agricultural real estate loans and commercial and agricultural operating loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans and (v) the general economic conditions in our market area.

The Company utilizes a risk rating matrix to assign risk ratings to each of its construction, commercial and agricultural loans. Loans are rated on a scale of 1 to 7. A description of the general characteristics of the 7 risk ratings is as follows:

Ratings 1, 2 and 3 - These ratings include loans to average to excellent credit quality borrowers. These borrowers generally have significant capital strength, moderate leverage and stable earnings and growth commensurate to their relative risk rating. These ratings also include performing loans less than $100,000.

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Rating 4 - This rating includes loans on management's "watch list" and is intended to be utilized for pass rated borrowers where credit quality has began to show signs of financial weakness that now requires management's heightened attention.

Rating 5 - This rating is for "Special Mention" in accordance with regulatory guidelines. This rating is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.

Rating 6 - This rating includes "Substandard" loans, in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. By definition under regulatory guidelines, a "Substandard" loan has defined weaknesses which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.

Rating 7 - This rating includes "Substandard-Impaired" loans, in accordance with regulatory guidelines, for which the accrual of interest has generally been stopped. This rating includes loans; (i) where interest is more than 90 days past due; (ii) not fully secured; (iii) loans where a specific valuation allowance may be necessary.

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The credit risk profile by internally assigned grade, on a disaggregated basis, at December 31, 2011 and 2010 is as follows:

2011

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	$9,942,000	$94,820,000	$29,534,000	$65,502,000	$49,489,000	$249,287,000
Special Mention	4,087,000	43,201,000	2,441,000	7,667,000	2,190,000	59,586,000
Substandard	7,439,000	6,776,000	528,000	2,199,000	500,000	17,442,000
Substandard-Impaired	2,163,000	2,703,000	-	590,000	-	5,456,000
	$23,631,000	$147,500,000	$32,503,000	$75,958,000	$52,179,000	$331,771,000

2010

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	$6,739,000	$83,235,000	$29,580,000	$64,791,000	$42,941,000	$227,286,000
Special Mention	3,694,000	42,137,000	2,351,000	8,922,000	1,318,000	58,422,000
Substandard	5,008,000	13,196,000	-	4,415,000	1,371,000	23,990,000
Substandard-Impaired	4,156,000	802,000	-	45,000	-	5,003,000
	$19,597,000	$139,370,000	$31,931,000	$78,173,000	$45,630,000	$314,701,000

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The credit risk profile based on payment activity, on a disaggregated basis, at December 31, 2011 and 2010 is as follows:

2011

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

2010

	1-4 Family Residential Real Estate	Consumer and Other	Total
Performing	$ 87,517,000	$ 22,018,000	$ 109,535,000
Non-performing	1,416,000	34,000	1,450,000
	$ 88,933,000	$ 22,052,000	$ 110,985,000

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment. The following is a recap of impaired loans, on a disaggregated basis, at December 31, 2011 and 2010 and the average recorded investment and interest income recognized on these loans for the years ended December 31, 2011 and 2010:

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2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded:					
Real estate - construction	$1,493,000	$1,493,000	$-	$882,000	$183,000
Real estate - 1 to 4 family residential	2,030,000	2,030,000	-	1,452,000	1,000
Real estate - commercial	951,000	951,000	-	504,000	8,000
Real estate - agricultural	-	-	-	-	-
Commercial	-	-	-	18,000	-
Agricultural	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total loans with no specific reserve:	4,474,000	4,474,000	-		