

IN TOWN. IN TOUCH.

February 2011

Volume VIII, Issue I



Board of Directors

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Letter from the President

To Our Shareholders,

2010 was a profitable year bolstered by increasing net interest income and mortgage banking income from the high volume of refinancing. We were, however, unable to escape the ramifications of the serious economic recession of the last three years. Our loan loss provision and problem loan expenses were higher. With the exception of an elevated level of Other Real Estate Owned (ORE) (i.e., Germania), our loan quality numbers have improved substantially since early 2010. This bodes well for 2011. Due to the difference in tax expense recognition between 2009 and 2010, the most useful comparison to gauge the Bank's operational performance to prior years is net income before taxes, less preferred dividends paid. This amount is \$607,227, which is \$157,273, or a 35% increase over 2009.

We are excited about the prospects for 2011 and beyond. We have projected continued improvement in operations and profitability, along with good, solid growth. The main office project on Fashion Square Boulevard is in the hands of the architects. We expect construction to commence in the spring and hope to move in the fall.

Our technology continues to improve with the soon-to-be-launched new website and upgrades to our branch operations. We are working diligently to become the bank of choice for businesses and professionals.

Thank you for your support. Please feel free to contact me with any questions or comments.

Sincerely,

Financial Report

CONSOLIDATED BALANCE SHEETS (unaudited)

	<u>12/31/2010</u>	<u>12/31/2009</u>
Assets		
Cash and cash equivalents	\$25,091,369	\$16,883,004
Investments	5,452,453	8,764,607
Loans, net of reserve for loan losses	121,509,336	122,345,542
Other assets	<u>7,779,409</u>	<u>5,587,636</u>
Total Assets	<u>\$159,832,567</u>	<u>\$153,580,789</u>
Liabilities and Shareholders' Equity		
Deposits	\$121,985,305	\$118,011,138
FHLB and other borrowings	22,052,825	20,302,825
Other Liabilities	594,486	714,480
Total Liabilities	<u>144,632,616</u>	<u>139,028,443</u>
Total Shareholders' Equity	<u>14,899,951</u>	<u>14,552,346</u>
Total Liabilities and Shareholders' Equity	<u>\$159,532,567</u>	<u>\$153,580,789</u>

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	THREE MONTHS ENDING		TWELVE MONTHS ENDING	
	<u>12/31/2010</u>	<u>12/31/2009</u>	<u>12/31/2010</u>	<u>12/31/2009</u>
Interest Income				
Investments	\$107,117	\$129,937	\$453,080	\$531,590
Loans	<u>1,882,289</u>	<u>1,811,449</u>	<u>7,378,728</u>	<u>7,206,527</u>
Total interest income	<u>1,989,406</u>	<u>1,941,386</u>	<u>7,831,808</u>	<u>7,738,117</u>
Interest Expense				
Deposits	466,330	589,269	2,116,101	2,697,355
Other borrowings	<u>164,688</u>	<u>167,729</u>	<u>641,657</u>	<u>711,026</u>
Total interest expense	<u>631,018</u>	<u>756,998</u>	<u>2,757,758</u>	<u>3,408,381</u>
Net Interest Income	<u>1,358,388</u>	<u>1,184,388</u>	<u>5,074,050</u>	<u>4,329,736</u>
Provision for loan losses	<u>210,000</u>	<u>165,000</u>	<u>1,030,000</u>	<u>697,000</u>
Net Interest Income After Provision for Loan Losses	<u>1,148,388</u>	<u>1,019,388</u>	<u>4,044,050</u>	<u>3,632,736</u>
Other Income	<u>333,131</u>	<u>190,254</u>	<u>840,373</u>	<u>710,118</u>
Other Expense	<u>1,269,867</u>	<u>1,036,201</u>	<u>4,190,936</u>	<u>3,892,850</u>
Net Income Before Federal Income Tax	<u>211,652</u>	<u>173,441</u>	<u>693,487</u>	<u>450,004</u>
Federal income tax expense	<u>74,700</u>	<u>(1,500,000)</u>	<u>243,200</u>	<u>(1,500,000)</u>
Net Income	<u>\$136,952</u>	<u>\$1,673,441</u>	<u>\$450,287</u>	<u>\$1,950,004</u>
Preferred Stock Dividends and Accretion of Discount	<u>20,962</u>	<u>0</u>	<u>86,209</u>	<u>0</u>
Net Income Available to Common Shareholders	<u>\$115,990</u>	<u>\$1,673,441</u>	<u>\$364,078</u>	<u>\$1,950,004</u>





Coming in February...watch for our new website
www.1stStateBk.com

Community Bank Awareness

1st State Bank has partnered with Community Bankers of Michigan and other community banks in a state-wide campaign to educate consumers about what makes community banks different from the “Wall Street and super-regional banks”, why community banks are at the very heart of building and supporting local economies and, above all, why a community bank is where they want to do business!

We invite you to visit www.MiLocalBank.org and refer local business owners, friends, family members, and neighbors to 1st State Bank so they can understand the benefits of our community bank.

What makes a community bank different than credit unions or larger banks?

- We focus on the needs of businesses and local families. Most deposits come from local people, not out-of-town investors.
- Community banks are local businesses; we understand the needs of business owners.
- We offer a unique opportunity to build long-term relationships, rather than high volume “transactional banking.”
- Community banks offer timely responses, work with individuals to reach solutions, offer common-sense lending, and are dedicated to engaging in civic loyalty.

Office Locations

TOWNE CENTRE
 Anne Smith
 Office Manager
 4805 Towne Centre
 Suite 100
 Saginaw, MI 48604

Phone: 989.799.7500
 Mon. — Fri.
 8:30 a.m. — 5:00 p.m.

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STATE STREET
 Deb Mazur
 Office Manager
 5424 State Street
 Saginaw, MI 48603

Phone: 989.596.7500
 Mon. — Fri.
 8:30 a.m. — 5:30 p.m.
 Saturday
 9:00 a.m. — 12:00 p.m.

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DOWNTOWN
 BAY CITY
 Dennis Dinauer
 Office Manager
 601 N. Madison Ave.
 Bay City, MI 48708

Phone: 989.322.7500
 Mon. — Fri.
 8:30 a.m. — 5:30 p.m.
 Saturday
 9:00 a.m. — 12:00 p.m.

Annual Meeting Date

Please mark your calendar to join us on Tuesday, May 3, 2011, for Valley Financial Group’s 6th Annual Meeting at Apple Mountain Conference Center. We will begin the meeting at 9:00 a.m. If you would like to attend, please call the Towne Centre Office at 989.799.7500 no later than March 19, 2011.

Introducing our Rate Swap CD 1.75% APY 30 Month Certificate of Deposit

Once during the life of the certificate
 you can “swap” your rate
 with the current 30 Month rate for the remaining term.

The 1.75% annual percentage yield (APY) is available to our customers who maintain a monthly minimum balance of \$1,000 in a checking, savings, or money market account, or who have direct deposit. APY of 1.50% is available without a relationship. Rates and terms are subject to change. Call us for all the details.

Come Celebrate with Us at The 6th Annual Event



Tuesday, February 22, 2011
 Apple Mountain Conference Center

Cash Bar at 5:00 pm • Dinner at 5:30 pm • Award Celebration at 7:00 pm

Call 989.596.0846 for ticket information