



## **Phoenix Bancorp, Inc.**

Consolidated Financial Statements  
December 31, 2011

## Phoenix Bancorp, Inc. and Subsidiary

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## Independent Auditor's Report

To the Board of Directors and Shareholders  
Phoenix Bancorp, Inc. and Subsidiary  
Minersville, Pennsylvania

We have audited the accompanying consolidated balance sheets of Phoenix Bancorp, Inc. and Subsidiary (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 Phoenix Bancorp, Inc. and Subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*McGladrey & Pullen, LLP*

Blue Bell, Pennsylvania  
February 29, 2012

**Phoenix Bancorp, Inc. and Subsidiary**

**Consolidated Balance Sheets**

**December 31, 2011 and 2010**

	2011	2010
<b>Assets</b>		
Cash and Due from Banks	\$ 2,102,000	\$ 2,444,000
Interest-Bearing Deposits with Other Banks	1,619,000	226,000
Federal Funds Sold	2,780,000	1,800,000
Cash and cash equivalents	<u>6,501,000</u>	4,470,000
Certificates of Deposit	743,000	979,000
Securities Held-to-Maturity, at amortized cost (fair value \$5,536,000 and \$4,966,000 as of December 31, 2011 and 2010, respectively)	5,056,000	5,066,000
Securities Available-for-Sale, at fair value	11,108,000	9,439,000
Restricted Stock, at cost	354,000	363,000
Loans Receivable (net of allowance for loan losses of \$1,145,000 and \$1,059,000 as of December 31, 2011 and 2010, respectively)	94,647,000	91,065,000
Accrued Interest Receivable	441,000	324,000
Premises and Equipment, net	2,518,000	2,320,000
Intangible Assets, net	101,000	181,000
Goodwill	689,000	689,000
Bank Owned Life Insurance	2,670,000	2,072,000
Prepaid FDIC Assessment	320,000	433,000
Other Assets	576,000	281,000
	<u>\$ 125,724,000</u>	<u>\$ 117,682,000</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Demand deposits	\$ 22,514,000	\$ 19,713,000
Savings and NOW deposits	48,995,000	41,986,000
Time deposits	35,899,000	41,832,000
Total deposits	<u>107,408,000</u>	103,531,000
Borrowings	3,000,000	3,000,000
Accrued interest payable	85,000	107,000
Other liabilities	522,000	420,000
<b>Total liabilities</b>	<u>111,015,000</u>	<u>107,058,000</u>
Commitments and Contingencies (Notes 7 and 16)		
<b>Shareholders' Equity</b>		
Preferred stock, \$1,000 par value; 4,000 shares authorized; 3,500 shares issued and outstanding at December 31, 2011	3,500,000	-
Common stock, \$10 par value; 1,000,000 shares authorized; 30,942 shares issued at December 31, 2011 and December 31, 2010	309,000	309,000
Additional paid-in capital	4,825,000	4,791,000
Retained earnings	7,837,000	7,439,000
Treasury stock, 7,130 and 7,558 shares at December 31, 2011 and 2010, respectively, at cost	(1,858,000)	(1,953,000)
Accumulated other comprehensive income	96,000	38,000
	<u>14,709,000</u>	<u>10,624,000</u>
	<u>\$ 125,724,000</u>	<u>\$ 117,682,000</u>

See Notes to Consolidated Financial Statements.

**Phoenix Bancorp, Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
**Years Ended December 31, 2011 and 2010**

	2011	2010
Interest income		
Loans	\$ 5,327,000	\$ 5,017,000
Securities held-to-maturity	283,000	45,000
Securities available-for-sale	276,000	358,000
Federal funds sold and certificates of deposit	16,000	17,000
Total interest income	<u>5,902,000</u>	<u>5,437,000</u>
Interest expense		
Savings and NOW deposits	269,000	226,000
Time deposits	722,000	928,000
Borrowings	70,000	12,000
Total interest expense	<u>1,061,000</u>	<u>1,166,000</u>
Net interest income	4,841,000	4,271,000
Provision for loan losses	205,000	312,000
Net interest income after provision for loan losses	<u>4,636,000</u>	<u>3,959,000</u>
Noninterest income		
Service charges and fees on deposits	528,000	492,000
Other income	138,000	109,000
Gain (loss) on sale of premises and equipment	2,000	(1,000)
Gain on sale of mortgage loans	16,000	-
Gains on securities available-for-sale	107,000	150,000
Total noninterest income	<u>791,000</u>	<u>750,000</u>
Noninterest expenses		
Salaries and employee benefits	2,545,000	2,222,000
Occupancy expense	553,000	434,000
FDIC assessments	122,000	188,000
Other assessments and taxes	120,000	116,000
Amortization of intangible assets	80,000	80,000
Director fees	66,000	95,000
Professional fees	286,000	187,000
Data processing	393,000	321,000
Office supplies	114,000	70,000
Postage and courier	38,000	50,000
Telephone	48,000	39,000
Other expenses	288,000	201,000
Total noninterest expenses	<u>4,653,000</u>	<u>4,003,000</u>
Income before provision for income taxes	774,000	706,000
Provision for income taxes	193,000	183,000
<b>Net income</b>	<u>581,000</u>	<u>523,000</u>
<b>Preferred stock dividend</b>	<u>29,000</u>	<u>-</u>
<b>Net income available to common shareholders</b>	<u>\$ 552,000</u>	<u>\$ 523,000</u>
Earnings per share	<u>\$ 23.41</u>	<u>\$ 22.58</u>
Weighted average shares outstanding	<u>23,578</u>	<u>23,157</u>

See Notes to Consolidated Financial Statements.

Phoenix Bancorp, Inc. and Subsidiary

Consolidated Statements of Shareholders' Equity  
Years Ended December 31, 2011 and 2010

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, January 1, 2010	\$ -	275,000	\$ 3,727,000	\$ 7,093,000	\$ (1,953,000)	\$ 172,000	\$ 9,314,000
Cash dividends paid - common stock \$7.80 per share	-	-	-	(177,000)	-	-	(177,000)
Issuance of common stock, 3,442 shares at \$325 per share, net of offering costs of \$20,000	-	34,000	1,064,000	-	-	-	1,098,000
Comprehensive income:							
Net income - 2010	-	-	-	523,000	-	-	523,000
Other comprehensive income							
Change in net unrealized gains on securities available-for-sale, net of re-classification adjustment and tax effect	-	-	-	-	-	(134,000)	(134,000)
Total comprehensive income	-	-	-	-	-	-	389,000
Balance, December 31, 2010	-	309,000	4,791,000	7,439,000	(1,953,000)	38,000	10,624,000
Cash dividends declared on common stock - \$6.50 per share	-	-	-	(154,000)	-	-	(154,000)
Purchase and sale of treasury shares at cost, net	-	-	56,000	-	95,000	-	151,000
Issuance of preferred stock, 3,500 shares at \$1,000, net of offering costs of \$22,000	3,500,000	-	(22,000)	-	-	-	3,478,000
Cash dividends declared on preferred stock	-	-	-	(29,000)	-	-	(29,000)
Comprehensive income:							
Net income - 2011	-	-	-	581,000	-	-	581,000
Other comprehensive income							
Change in net unrealized gains on securities available-for-sale, net of re-classification adjustment and tax effect	-	-	-	-	-	58,000	58,000
Total comprehensive income	-	-	-	-	-	-	639,000
Balance, December 31, 2011	<u>\$ 3,500,000</u>	<u>\$ 309,000</u>	<u>\$ 4,825,000</u>	<u>\$ 7,837,000</u>	<u>\$ (1,858,000)</u>	<u>\$ 96,000</u>	<u>\$ 14,709,000</u>

See Notes to Consolidated Financial Statements.

Phoenix Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows  
Years Ended December 31, 2011 and 2010

	2011	2010
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 581,000	\$ 523,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	263,000	221,000
Net amortization (accretion) of premiums and discounts on investment securities	(47,000)	31,000
Provision for loan losses	205,000	312,000
Amortization of intangible assets	80,000	80,000
(Gain) loss on sale of premises and equipment	(2,000)	1,000
Gains on securities available-for-sale	(107,000)	(150,000)
Gain on sale of mortgage loans	(16,000)	-
Originations of mortgage loans sold	(884,000)	-
Proceeds from mortgage loans sold	900,000	-
Earnings on Bank owned life insurance	(98,000)	(72,000)
Deferred income taxes	16,000	52,000
Changes in:		
Accrued interest receivable	(117,000)	6,000
Other assets and prepaid FDIC assessment	(228,000)	250,000
Accrued interest payable	(22,000)	(26,000)
Other liabilities	46,000	147,000
<b>Net cash provided by operating activities</b>	<b>570,000</b>	<b>1,375,000</b>
<b>Cash Flows from Investing Activities</b>		
Redemptions (purchases) of certificates of deposit	236,000	(879,000)
Purchases of securities held-to-maturity	-	(5,066,000)
Proceeds from maturities, calls, and paydowns of securities held-to-maturity	5,000	1,500,000
Purchases of securities available-for-sale	(11,319,000)	(12,701,000)
Proceeds from sale of securities available-for-sale	1,896,000	3,771,000
Proceeds from maturities, calls, and paydowns of securities available-for-sale	8,001,000	11,893,000
Redemptions (purchases) of restricted stock	9,000	(351,000)
Purchases of bank-owned life insurance	(500,000)	(2,000,000)
Net increase in loans	(3,787,000)	(6,819,000)
Purchases of premises and equipment	(486,000)	(324,000)
Proceeds from sale of premises and equipment	27,000	-
<b>Net cash used in investing activities</b>	<b>(5,918,000)</b>	<b>(10,976,000)</b>
<b>Cash Flows from Financing Activities</b>		
(Decrease) increase in demand deposits	2,801,000	(2,381,000)
Increase in savings, NOW and time deposits	1,076,000	7,369,000
Proceeds from issuance of common stock	-	1,098,000
Proceeds from issuance of preferred stock	3,478,000	-
Proceeds from issuance of treasury stock, net	151,000	-
Proceeds from borrowings	-	3,000,000
Dividends paid	(127,000)	(177,000)
<b>Net cash provided by financing activities</b>	<b>7,379,000</b>	<b>8,909,000</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>2,031,000</b>	<b>(692,000)</b>
Cash and Cash Equivalents, January 1	4,470,000	5,162,000
Cash and Cash Equivalents, December 31	<b>\$ 6,501,000</b>	<b>\$ 4,470,000</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash Paid During the Year for:		
Interest	\$ 1,083,000	\$ 1,191,000
Income taxes paid	\$ 159,000	\$ 28,000
Noncash item: Dividends payable	\$ 56,000	-

See Notes to Consolidated Financial Statements.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies

Description of Business: Phoenix Bancorp, Inc. is a bank holding company headquartered in Minersville, Pennsylvania. Through its wholly owned subsidiary, Miners Bank (collectively “the Company”), the Company provides individuals, corporations and other businesses, commercial and retail banking services, principally loans and deposits. Phoenix Bancorp, Inc. was incorporated in 1987 under the laws of the Commonwealth of Pennsylvania for the sole purpose of becoming the holding company of Miners Bank (the “Bank”). Phoenix is subject to regulation by the Federal Reserve Bank of Philadelphia.

Miners Bank (the “Bank”) is a commercial bank incorporated in 1935 under the laws of the Commonwealth of Pennsylvania. The Company is chartered by the Pennsylvania Department of Banking and insured by the Federal Deposit Insurance Corporation. The Company maintains its principal office in Minersville, Pennsylvania but also has branch offices in Frackville, Gordon, and Tremont, Pennsylvania. The Company provides financial services primarily to Schuylkill County and the surrounding Pennsylvania counties.

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Phoenix Bancorp, Inc. (“Phoenix”) and its wholly-owned subsidiary, Miners Bank (“Miners”). All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and 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, the valuation of deferred tax assets, the determination of goodwill impairment, and the fair value of investment securities available for sale.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand, interest bearing deposits with banks and federal funds sold, all of which mature within ninety days.

Investment Securities: Management determines the appropriate classification of investments at the time of purchase. As of December 31, 2011 and 2010, the Company classifies its securities into two categories, available for sale and held to maturity.

Securities are classified as held to maturity based on management’s intent and ability to hold them to maturity. Such securities are stated at cost, adjusted for unamortized purchase premiums and discounts using the level yield method.

Securities that are classified as available for sale are stated at fair value. Unrealized gains and losses on securities available for sale are excluded from results of operations and are reported as other comprehensive income or loss, a separate component of shareholders’ equity, net of taxes. Securities classified as available for sale include securities that may be sold in response to changes in interest rates, changes in prepayment risks or for asset/liability management purposes.

The cost of investment securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization or accretion recorded as adjustments to interest and dividends are included in interest income from investments. Realized gains and losses are included in gains (losses) on investment securities in the statements of income. Gains and losses on the sale of securities are recorded on the trade date and are determined based on the specific-identification method.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Investment Securities (Continued): Management periodically evaluates securities for other-than-temporary impairment when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which fair value has been less than cost (2) the financial condition and near term prospects of the issuer, (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value and (4) whether it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, whether the Company intends to sell the security, or it is more likely than not that the Company will be required to sell the security before recovery of the cost basis, which may be maturity. In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security or it is more likely than not that it will not be required to sell the debt security prior to its anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income or loss.

Restricted Stock: The Company holds investments in the common stocks of Atlantic Central Bankers Bank ("ACBB") and Federal Home Loan Bank of Pittsburgh ("FHLB"). These investments in restricted stock are carried at cost. The stock has no quoted market value and is subject to redemption restrictions. Management reviews for impairment based on the ultimate recoverability of the cost basis in the stock. Management considers such criteria as the significance of the decline in net assets, if any, the length of time the situation has persisted, commitments by the institution to make payments required by law or regulation, the impact of legislative and regulatory changes on the customer base of the institution and the liquidity position of the institution. As of December 31, 2011 and 2010, the Company's holdings of restricted stock were not deemed impaired.

Certificates of Deposit: Certificates of deposit mature within two years and are carried at cost.

Loans: The Company makes commercial, real estate and consumer loans to customers. A substantial portion of the loan portfolio is represented by loans in Schuylkill County and neighboring counties in Pennsylvania. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area. Loans are stated at the outstanding principal amount, adjusted for the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on loans is recognized as earned based on contractual interest rates applied to daily principal amounts outstanding.

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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Loans – Nonaccrual: Loans are placed on nonaccrual status and the accrual of interest income ceases, when a default of principal or interest exists for a period of ninety days except when, in management's judgment, the collection of principal and interest is reasonably anticipated (i.e. the loan is well secured and in the process of collection). Interest receivable on nonaccrual loans previously credited to interest income is reversed. Nonaccrual loans are generally not returned to accruing status until principal and interest payments have been brought current for a reasonable period of time, generally six months, and full collectability is reasonably assured.

Loans Held for Sale: The Bank periodically originates loans for sale within the secondary market. Loans held for sale are residential mortgages that the Bank has the intent to sell in the near term, servicing released. These loans are carried at the lower of aggregate cost or fair market value. Gains and losses on sales of loans are recognized on the settlement date and are determined by the difference between sale proceeds and the carrying value of the loans. All sales are made without recourse. There were no loans held for sale at December 31, 2011 or 2010.

Concentration of Credit Risk: The Company's loans are generally to diversified customers in Schuylkill and surrounding counties. Loan participations purchased from community financial institutions in the region represent approximately 25% of the portfolio. Generally, loans are collateralized by real estate and other assets of the borrower and are expected to be repaid from the cash flow or proceeds from collateral liquidation.

Loan Fees: Loan fees and direct costs associated with loan originations are netted and deferred. The deferred amount is recognized as an adjustment to loan interest over the term of the related loans using the interest method.

Allowance for Loan Losses: The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses. Loans that are determined to be uncollectible are charged against the allowance account, and subsequent recoveries, if any, are credited to the allowance. Management's periodic evaluation of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Such periodic assessments may, in management's judgment, require the Company to recognize additions or reductions to the allowance.

Various regulatory agencies periodically review the adequacy of the Company's allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to recognize additions or reductions to the allowance based on their evaluation of information available to them at the time of their examination. It is reasonably possible that the above factors may change significantly and, therefore, affect management's determination of the allowance for loan losses in the near term.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. The general component covers non-classified loans and is based on historical charge-off experience and expected losses given the Company's internal risk rating process. Other qualitative adjustments are made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not reflected in the historical loss or risk rating data. These qualitative factors include trends in classified loans, charge-offs, delinquencies and non-accruals, changes in loan policy and underwriting standards, changes in credit personnel, industry conditions, national and local economic conditions, concentrations, etc.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued): Impaired loans also include troubled debt restructurings (TDRs), if any, where management has modified loan terms and made concessions to borrowers in financial difficulty. Consequently, the allowance for loan losses related to TDRs is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral-dependent loans. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when all of the components meet the definition of a participating interest and when control over the assets has been surrendered. A participating interest generally represents (1) a proportionate (pro rata) ownership interest in an entire financial asset, (2) a relationship where from the date of transfer all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership, (3) the priority of cash flows has certain characteristics, including no reduction in priority, subordination of interest, or recourse to the transferor other than standard representation or warranties, and (4) no party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset. 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.

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed and charged to expense using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized to expense over the shorter of the term of the respective lease or the estimated useful life of the improvements.

Foreclosed Assets: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosures, valuations are periodically performed and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations, changes in the valuation allowance and realized gains and losses are included in other income. The Company held no foreclosed assets at December 31, 2011 and 2010.

Bank Owned Life Insurance and Benefit Liability: The Company invests in bank owned life insurance ("BOLI") as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Company on a chosen group of employees as more fully described in Note 12.

Intangible Assets: Premiums paid for deposit liabilities assumed in branch acquisitions are being amortized over the remaining life of the deposit base acquired using a straight line method, which approximates the interest method. Core deposit intangible assets are being amortized on a straight line basis over the average expected life of the deposit base acquired (five to seven years), as more fully described in Note 8.

Goodwill: Goodwill represents the excess of the cost over fair value of net assets in a business acquisition accounted for as a purchase in 2003. Goodwill is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset may be impaired. As of December 31, 2011 and 2010, management has determined that goodwill was not impaired.

Treasury Stock: Treasury stock is recorded at cost. The subsequent disposition or sale of the treasury stock is recorded using the average cost inventory method.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Retirement Plans: The Company sponsors a 401(k) savings plan, which is a qualified defined contribution plan and a funded deferred compensation plan. Effective July 1, 2010, the Company adopted a split dollar life insurance plan covering certain eligible participating employees. Retirement plans are more fully described in Note 12.

Stock Based Compensation: The Company has a Stock Appreciation Rights Plan (SARs) covering eligible employees. The Company accounts for the SARs as a liability since the awards are payable in cash. The Company utilizes the intrinsic value method to account for this liability and records compensation expense ratably over the service period adjusting for changes in the intrinsic value of SARs at each reporting period.

Income Taxes: Income tax accounting results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities. Enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that all or some portion of the deferred tax asset will not be realized.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

Interest and penalties associated with unrecognized tax benefits would be recognized in income tax expense on the income statement.

Earnings Per Share: Earnings per share are computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period, adjusted for treasury stock. The Company's basic and diluted earnings per share are the same since there are no dilutive potential shares of common stock or common stock equivalents outstanding.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. However, certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as other comprehensive income (loss), a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Subsequent Events: The Company has evaluated subsequent events for recognition or disclosure through February 29, 2012, the date the consolidated financial statements were available to be issued, and has determined that no such events have occurred that would warrant inclusion or disclosure in these financial statements.

Reclassifications: Certain amounts relating to 2010 have been reclassified to conform to the 2011 reporting format.

#### Note 2. Recent Accounting Pronouncements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures: New authoritative accounting guidance (Accounting Standards Update No. 2010-6) provides amendments to ASC Topic 820 that require new disclosures as follows: 1) A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and 2) In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances and settlements (that is, on a gross basis rather than as one net number).

The new authoritative guidance also clarifies existing disclosures as follows:

- 1) A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities.
- 2) A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3.

These new disclosures and clarifications of existing disclosures were effective for the Company's financial statements in 2010 (except for the disclosures about the purchases, sales, issuances, and settlements in the roll forward activity of Level 3 fair value measurements, which are effective for 2011) and did not have a significant impact on the Company's financial statements.

Accounting Standards Update (ASU) 2010-20, Receivables (Topic 310) ("Update") was issued in July 2010 covering disclosures about the credit quality of financing receivables and the allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The disclosures as of the end of a reporting period are effective for non public entities for annual reporting periods ending on or after December 15, 2011. The new guidance requires significantly expanded disclosures with respect to the credit quality of the Company's loan portfolio, as detailed in Note 6.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 2. Recent Accounting Pronouncements (Continued)

Accounting Standard Update No. 2011-02 Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring (the ASU) was issued in April 2011. The ASU provides additional guidance to creditors for evaluating whether a modification or restructuring of a receivable constitutes a troubled debt restructuring. Specifically, the ASU:

- Adds factors for creditors to consider in determining whether the debtor is experiencing financial difficulties;
- Provides additional considerations in determining whether a creditor has granted a concession, including expectations of collecting all amounts due, receipt of additional collateral or guarantees from the debtor, and restructuring the debt at a below-market rate. It also includes factors and examples to assist creditors in determining whether an *insignificant* delay in payment is considered a concession;
- Prohibits creditors from using the borrower's effective-rate test in ASC 470-60, *Debt, Troubled Debt Restructurings by Debtors*, to evaluate whether a concession has been granted to the borrower;
- Ends the FASB's deferral of the additional disclosures about TDR activities required by ASU 2010-20.

For non-public entities, the ASU is effective for annual periods ending after December 15, 2012, including interim periods within those annual periods. Non-public entities may also elect to early adopt the provisions of the ASU. The Company has determined adoption of the ASU will not have a material impact on the Company's reported financial condition, results of operations, or cash flows.

Accounting Standards Update (ASU) 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. In September 2011, the FASB issued guidance to amend and simplify how entities are required to test goodwill for impairment. The revised guidance, however, would not change the current guidance for testing indefinite-lived intangible assets for impairment. The amendments will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The guidance also includes examples of the types of factors to consider in conducting the qualitative assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted and the Company adopted the new guidance as of December 31, 2011. In accordance with new amended accounting guidance issued, Management assessed qualitative factors to determine that it was not necessary to perform the two-step quantitative goodwill impairment test. This qualitative assessment included positive trends in earnings, assets, dividend payout and capital and resulted in a conclusion that it is not more likely than not that the fair value of the Company is less than its carrying amount.

Notes to Consolidated Financial Statements

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**Note 2. Recent Accounting Pronouncements (Continued)**

Accounting Standards Update (ASU) 2011-05, Comprehensive Income (Topic 220) – Presentation of Comprehensive Income was issued to improve the consistency of presentation of Other Comprehensive Income. The amendments in this ASU require all non-owner changes in stockholders' equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Regardless of whether an entity chooses to present comprehensive income in a single continuous statement or in two separate but consecutive statements, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented.

The amendments in the ASU do not change:

- The items that must be reported in other comprehensive income
- When an item of other comprehensive income must be reclassified to net income
- The option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items. In both cases, the tax effect for each component must be disclosed in the notes to the financial statements or presented in the statement in which other comprehensive income is presented.
- How earnings per share is calculated or presented

The amendments in ASU 2011-05 should be applied retrospectively. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. Early adoption is permitted. Adoption of this amendment will have no impact on the Company's financial position or results of operations.

FASB ASU 2011-12, Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. This ASU issued in December 2011 amends ASU 2011-05 to reflect only those changes in 2011-05 that relate to the presentation of reclassification adjustments. The amendments are being made to allow FASB time to re-deliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. Nonpublic entities should begin applying these requirements for fiscal years ending after December 15, 2012. The Company has determined that ASU 2011-12 will have no material impact on its financial statements.

FASB ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU issued in May 2011 represents the converged guidance of the FASB and the International Accounting Standards Board (the "Boards") on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. The amendments to the Codification in ASU 2011-04 are to be applied prospectively. For non-public entities, the amendments are effective during annual periods beginning after December 15, 2011. The Company has determined that the impact of ASU 2011-04 on its financial statements and related disclosures is not material.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 3. Cash and Due from Banks

The Company maintains various deposit accounts with other banks to meet normal funds transaction requirements, to satisfy minimum deposit requirements, and to compensate other banks for certain correspondent services. The Company's subsidiary bank is required to maintain average balances on hand with the Federal Reserve Bank. These balances approximated \$355,000 and \$335,000 at December 31, 2011 and 2010, respectively. The Federal Deposit Insurance Corporation insures these accounts up to \$250,000 per account. Management is responsible for assessing the credit risk of its correspondent banks. The withdrawal or usage restrictions of these balances did not have a significant impact on the operations of the Company as of December 31, 2011 and 2010.

#### Note 4. Investment Securities

The amortized cost and fair value of securities at December 31 were as follows:

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities held-to-maturity:				
State and political subdivisions	\$ 5,056,000	\$ 480,000	\$ -	\$ 5,536,000
Securities available-for-sale:				
State and political subdivisions	\$ 4,151,000	\$ 135,000	\$ 3,000	\$ 4,283,000
U.S. government-sponsored enterprises ("GSE")	6,482,000	14,000	3,000	6,493,000
Mortgage-backed - GSE - residential	329,000	4,000	1,000	332,000
	<u>\$ 10,962,000</u>	<u>\$ 153,000</u>	<u>\$ 7,000</u>	<u>\$ 11,108,000</u>
	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities held-to-maturity:				
State and political subdivisions	\$ 5,066,000	\$ 16,000	\$ 116,000	\$ 4,966,000
Securities available-for-sale:				
State and political subdivisions	\$ 3,032,000	\$ 24,000	\$ 39,000	\$ 3,017,000
U.S. government-sponsored enterprises ("GSE")	5,014,000	14,000	21,000	5,007,000
Mortgage-backed - GSE - residential	1,335,000	80,000	-	1,415,000
	<u>\$ 9,381,000</u>	<u>\$ 118,000</u>	<u>\$ 60,000</u>	<u>\$ 9,439,000</u>

For the years ended December 31, 2011 and 2010, proceeds from sales of securities available for sale amounted to \$1,896,000 and \$3,771,000, respectively. Gross realized gains were \$107,000 and 150,000 respectively in 2011 and 2010 for security sales. There were no gross realized losses in 2011 or 2010.

Securities with an approximate fair value of \$4,715,000 and \$4,756,000 at December 31, 2011 and 2010, respectively, were pledged to secure public deposits, trust funds and for other purposes required or permitted by law.

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 4. Investment Securities (Continued)**

The amortized cost and fair value of securities at December 31, 2011, by contractual maturity, are shown below. Expected maturities for mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. Therefore, these securities are not included in the maturity categories of the following summary:

	Amortized Cost	Fair Value
Securities held-to-maturity		
Due within five through ten years	\$ 265,000	\$ 288,000
Due after ten years	4,791,000	5,248,000
	<u>\$ 5,056,000</u>	<u>\$ 5,536,000</u>
Securities available-for-sale:		
Due within one year or less	\$ 940,000	\$ 945,000
Due within one through five years	5,474,000	5,541,000
Due within five through ten years	3,218,000	3,276,000
Due after ten years	1,001,000	1,014,000
Mortgage-backed - GSE - residential	329,000	332,000
	<u>\$ 10,962,000</u>	<u>\$ 11,108,000</u>

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2011 and 2010:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2011						
Available-for-Sale:						
State and political subdivisions	\$ 223,000	\$ 3,000	\$ -	\$ -	\$ 223,000	\$ 3,000
U.S. government-sponsored enterprises	1,519,000	3,000	-	-	1,519,000	3,000
Mortgage-backed - GSE - residential	286,000	1,000	-	-	286,000	1,000
	<u>\$ 2,028,000</u>	<u>\$ 7,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,028,000</u>	<u>\$ 7,000</u>
December 31, 2010						
Available-for-Sale:						
State and political subdivisions	\$ 2,194,000	\$ 39,000	\$ -	\$ -	\$ 2,194,000	\$ 39,000
U.S. government-sponsored enterprises	1,976,000	21,000	-	-	1,976,000	21,000
	<u>\$ 4,170,000</u>	<u>\$ 60,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,170,000</u>	<u>\$ 60,000</u>
Held to Maturity - state and political subdivisions	<u>\$ 4,171,000</u>	<u>\$ 116,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,171,000</u>	<u>\$ 116,000</u>

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 4. Investment Securities (Continued)

Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the loss attributable to credit impairment recognized in net income in the period in which the other-than-temporary impairment is identified. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments nor does the Company expect to not recover the amortized cost basis. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the invests before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2011 or 2010.

#### Note 5. Loans

Loans are summarized as follows:

	December 31,	
	2011	2010
Commercial loans	\$ 60,380,000	\$ 57,260,000
Residential real estate loans	25,118,000	25,115,000
Consumer loans	10,294,000	9,749,000
Total loans	95,792,000	92,124,000
Less:		
Allowance for loan losses	1,145,000	1,059,000
Loans, net	\$ 94,647,000	\$ 91,065,000

Deferred loan fees, net of costs, were approximately \$185,000 and \$71,000 at December 31, 2011 and 2010, respectively, and are presented with the related loan segments. Unearned income for consumer loans of \$958,000 and \$1,502,000 at December 31, 2011 and 2010, respectively, has also been reflected in the above loan segments.

#### Note 6. Credit Quality

Loan Origination/Risk Management: The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentration of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

#### Note 6. Credit Quality (Continued)

##### Loan Origination/Risk Management (Continued):

**Commercial loans** are primarily made based on the available cash flows of the borrower and secondarily on the underlying collateral provided by the borrower which may include real estate. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory or the real estate where the business is located and may incorporate a personal guarantee to attempt to reduce the risk of loss. Some short-term loans may be made on an unsecured basis. The risk of loss on commercial business loans is substantially greater than the risk of loss from residential real estate lending. Commercial lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the business or the property securing the loan or the business conducted on the property securing the loan. The nature of these loans are varied and include Commercial Real Estate Loans (CRE), Commercial and Industrial loans (C&I) and, to a much lesser extent, construction loans and loans to state and political subdivisions. Commercial loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. The Company seeks to minimize these risks in a variety of ways, including limiting the size and loan-to-value ratios on its commercial real estate loans as well as participating in similar commercial credits originated by other financial institutions in the Company's geography. These loans are subject to the same underwriting criteria as loans originated by the Company prior to being purchased. Management monitors and evaluates all commercial loans based on collateral, geography and risk grade criteria.

**Residential real estate** lending involves lending to consumers through first and second lien mortgage loans and home lines of credit secured by residential properties generally located within the Company's market area. Because payments on these loans are highly dependent upon the borrower's financial condition and real estate values, the Company analyzes credit scores, financial stability and general local and national economic conditions. The Company carefully evaluates collateral values on the secured property to insure the Company is fully protected at the time of origination. However, fluctuations in real estate values and the borrower's financial condition may change over time, thus affecting the Company's collateral position and the borrower's ability to meet their contractual obligations. The Company minimizes its risk by primarily lending to its customers on first mortgages.

**Consumer** loans generally involve more risk than first mortgages. Consumer loans are generally originated at higher rates than residential mortgage loans but also tend to have a higher risk than residential loans due to the loan being unsecured or secured by rapidly depreciable assets.

Age Analysis of Past Due Loans: The following table represents an aging of loans by category as of December 31, 2011. The table presents the principal amount outstanding on the loans which may be past due for principal and/or interest payments contractually due.

	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Commercial:							
Originations	\$ 271,000	\$ 42,000	\$ -	\$ 227,000	\$ 540,000	\$ 35,369,000	\$ 35,909,000
Participations purchased	-	-	-	-	-	24,471,000	24,471,000
Total Commercial	271,000	42,000	-	227,000	540,000	59,840,000	60,380,000
Residential real estate	35,000	462,000	-	-	497,000	24,621,000	25,118,000
Consumer	90,000	25,000	-	135,000	250,000	10,044,000	10,294,000
Total	\$ 396,000	\$ 529,000	\$ -	\$ 362,000	\$ 1,287,000	\$ 94,505,000	\$ 95,792,000

**Note 6. Credit Quality (Continued)**

Credit Quality Classifications: The Company assigns internal credit classifications at the inception of each loan. These ratings are reviewed by an independent third party on a semi-annual basis as well as periodic internal reviews when loans are renewed or if the Company experiences delinquencies in contractual expectations that would cause a downgrade in the quality of the loan. For residential real estate loans and consumer loans, the Company uses performing versus nonperforming information as the best indicator of credit quality. If this type loan becomes in default for a period of 90 days or more or when the contractual collection of principal or interest are in doubt, the loan would be placed on nonaccrual status and the credit quality would be downgraded to watch or substandard from satisfactory for these loan segments. The following definitions summarize the basis for each classification.

**Excellent** credit classifications will generally reflect a credit, which is fully secured by cash and/or near cash investments.

**Good** credit classifications will generally exhibit little or no credit risk, positive financial trends, strong and stable management, minimal exposure to macro and/or micro economic fluctuations. The credits will also generally have a clean credit history and above average loan to value ratio relative to the collateral strength.

**Satisfactory** credit classifications will generally exhibit consistent performance in meeting cash flow needs, display strong competent management capabilities and offer satisfactory collateral with easily determinable values that meets or exceeds the Company's minimum loan to value ratio.

**Fair** credit classifications will generally exhibit satisfactory performance in meeting cash flow needs, display satisfactory management capabilities and offer readily marketable collateral that meets, at a minimum, the Company's minimum loan to value ratio.

**Special mention** credit classifications will generally contain some weaknesses, but the risk of loss is considered to be minimal. Generally, the collateral may be subject to deterioration, proper documentation may be lacking or economic conditions may have a severe adverse impact on the customer. Delinquencies may be increasing and financial trends may also show deterioration, but not to the point where repayment is considered to be in jeopardy.

**Watch** credit classifications will generally contain emerging problems such as incomplete documentation, questionable collateral values, unmarketable collateral or lack of timely financial information. These credits are subject to a higher level of monitoring by the Company.

**Substandard** credit classifications will generally be characterized by well defined weaknesses. The weaknesses will evidence a significant probability that the credit will not be repaid in full if the weaknesses are not corrected. Generally, substandard credits will lack a consistent net worth, liquidity and repayment capacity. Loans in this category need impairment consideration.

**Loss** credits are those where a borrower is deemed incapable of repayment of unsecured debt, including portions of those credits where collateral value is insufficient to fully cover the recorded amount of the loan and charged-off immediately. Loans or portions of loans to such borrowers are considered uncollectible and of such little value that continuance as active assets of the Bank is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may occur in the future.

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 6. Credit Quality (Continued)**

Credit Quality Classifications (Continued):

The following table summarizes the loan portfolio by category of loan and the internally assigned credit quality ratings for those categories at December 31, 2011, excluding deferred loan costs. The Company did not acquire any loans with impaired credit quality during the year ended December 31, 2011.

	Commercial		Residential Real Estate	Consumer	Total
	Originated	Participations Purchased			
Excellent	\$ 1,552,000	\$ -	\$ -	\$ -	\$ 1,552,000
Good	1,241,000	-	-	-	1,241,000
Satisfactory	17,642,000	21,801,000	24,656,000	10,116,000	74,215,000
Fair	13,857,000	-	-	-	13,857,000
Special Mention	579,000	978,000	-	-	1,557,000
Watch	42,000	996,000	462,000	25,000	1,525,000
Substandard	996,000	696,000	-	153,000	1,845,000
	<u>\$ 35,909,000</u>	<u>\$ 24,471,000</u>	<u>\$ 25,118,000</u>	<u>\$ 10,294,000</u>	<u>\$ 95,792,000</u>

Allowance for Loan Losses: The following table summarizes the allowance for loan losses as of and for the year ended December 31, 2011, by loan category and the amount by category of the loans evaluated individually or collectively for impairment. The Company did not acquire any loans with impaired credit quality during the year ended December 31, 2011.

	Commercial	Residential Real Estate	Consumer	Total
Allowance for loan losses:				
Beginning balance	\$ 939,000	\$ 83,000	\$ 37,000	\$ 1,059,000
Charge-offs	(97,000)	-	(27,000)	(124,000)
Recoveries	1,000	-	4,000	5,000
Provisions for loan losses	222,000	(45,000)	28,000	205,000
Ending Balance	<u>\$ 1,065,000</u>	<u>\$ 38,000</u>	<u>\$ 42,000</u>	<u>\$ 1,145,000</u>
Ending balance of allowance for loan losses:				
Individually evaluated for impairment	\$ 100,000	\$ -	\$ 6,000	\$ 106,000
Collectively evaluated for impairment	965,000	38,000	36,000	1,039,000
Totals	<u>\$ 1,065,000</u>	<u>\$ 38,000</u>	<u>\$ 42,000</u>	<u>\$ 1,145,000</u>
Loan ending balances				
Individually evaluated for impairment	\$ 227,000	\$ -	\$ 18,000	\$ 245,000
Collectively evaluated for impairment	60,153,000	25,118,000	10,276,000	95,547,000
Totals	<u>\$ 60,380,000</u>	<u>\$ 25,118,000</u>	<u>\$ 10,294,000</u>	<u>\$ 95,792,000</u>

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

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**Note 6. Credit Quality (Continued)**

Allowance for Loan Losses (Continued):

Changes in the allowance for loan losses for 2010 were as follows:

	<u>2010</u>
Beginning balance	\$ 857,000
Provision for loan losses	312,000
Charge-offs	(111,000)
Recoveries	<u>1,000</u>
Ending balance	<u>\$ 1,059,000</u>

Impaired Loans: Loans are considered impaired when current information and events indicate that the Bank may be unable to collect all amounts due according to the contractual terms of the related loan agreements. The Bank identifies impaired loans including troubled debt restructurings (TDRs) by applying its normal loan review procedures in accordance with its Allowance for Loan Loss methodology.

Nonaccrual loans amounted to \$362,000 and \$1,092,000 at December 31, 2011 and 2010, respectively. There were no loans past due 90 days and still accruing at December 31, 2011 or 2010.

Interest income that would have been recognized on such nonaccrual loans had they been current in accordance with their original terms is \$25,000 and \$17,000 during the years ended December 31, 2011 and 2010, respectively.

From time to time, management will modify or restructure the terms of certain loans to provide relief to borrowers. Restructured loans or TDRs are those loans whose terms have been modified because of deterioration in the financial condition of a borrower to provide for a reduction of either interest or principal, regardless of whether such loans are secured or unsecured and regardless of whether such credits are guaranteed by the government or by others. At December 31, 2011 and 2010 there were no TDRs.

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 6. Credit Quality (Continued)**

Impaired Loans (Continued):

The following table summarizes the impaired loans as of December 31, 2011. The table segregates the loans by category of loan and illustrates those with specific allowances for losses as well as impaired loans without specific allowances.

	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial - originated	\$ 66,000	\$ -	\$ 107,000	\$ 25,000
Commercial - participations purchased	-	-	-	-
Residential real estate	-	-	-	-
Consumer	-	-	-	-
Subtotal	<u>66,000</u>	<u>-</u>	<u>107,000</u>	<u>25,000</u>
With an allowance recorded:				
Commercial - originated	161,000	100,000	162,000	-
Commercial - participations purchased	-	-	-	-
Residential real estate	-	-	-	-
Consumer	18,000	6,000	18,000	1,000
Subtotal	<u>179,000</u>	<u>106,000</u>	<u>180,000</u>	<u>1,000</u>
Total				
Commercial - originated	227,000	100,000	269,000	25,000
Commercial - participations purchased	-	-	-	-
Residential real estate	-	-	-	-
Consumer	18,000	6,000	18,000	1,000
Total	<u>\$ 245,000</u>	<u>\$ 106,000</u>	<u>\$ 287,000</u>	<u>\$ 26,000</u>

Unpaid principal balances are substantially the same as the recorded investment.

Below is a summary of the Company's impaired loan information as of December 31, 2010:

Impaired loans with a valuation allowance	\$ 362,000
Impaired loans without a valuation allowance	248,000
Total impaired loans	<u>\$ 610,000</u>
Related allowance for loan losses for impaired loans	<u>\$ 9,000</u>
Average monthly balance of impaired loans (based on month end balances)	<u>\$ 465,000</u>
Interest income recognized on cash basis on impaired loans	<u>\$ 17,000</u>

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 7. Premises and Equipment

Premises and equipment are summarized as follows:

	December 31,		Estimated Useful Lives
	2011	2010	
Bank premises	\$ 2,364,000	\$ 2,354,000	25 years
Furniture and equipment	3,324,000	2,927,000	5 years
Land improvements	172,000	172,000	-
Total	5,860,000	5,453,000	
Less accumulated depreciation	3,342,000	3,133,000	
Property and equipment, net	<u>\$ 2,518,000</u>	<u>\$ 2,320,000</u>	

The Company had a 10-year non-cancellable lease for its Frackville branch location which expired in 2011. The lease has been extended as a month-to-month lease until the Company's Frackville premises, currently under construction, is completed.

In 2011, the Company entered into a 10-year non-cancellable lease for its Rockwood executive offices location which expires on March 31, 2021. The lease includes options to renew for two additional five year terms. Minimum lease payments are as follows:

Years Ending December 31,	
2012	\$ 60,000
2013	60,000
2014	65,000
2015	66,000
2016	70,000
Thereafter	340,000
	<u>\$ 661,000</u>

Rent expense totaled \$68,000 and \$17,000 for 2011 and 2010 respectively.

#### Note 8. Intangible Assets

Amortizable intangible assets consist of the following:

	December 31,	
	2011	2010
Deposit assumption premium, net of accumulated amortization of \$623,000 in 2011 and \$588,000 in 2010	\$ 12,000	\$ 48,000
Core deposit intangible asset, net of accumulated amortization of \$361,000 in 2011 and \$316,000 in 2010	89,000	133,000
Total	<u>\$ 101,000</u>	<u>\$ 181,000</u>

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

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**Note 8. Intangible Assets (Continued)**

The estimated future amortization expense is as follows:

<u>Years Ending December 31,</u>	
2012	\$ 57,000
2013	<u>44,000</u>
Total	<u>\$ 101,000</u>

**Note 9. Deposits**

Deposits consisted of the following:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Demand deposits, noninterest-bearing	\$ 22,514,000	\$ 19,713,000
Demand deposits, interest-bearing (NOW)	25,579,000	19,706,000
Savings deposits	23,416,000	22,280,000
Time deposits of less than \$100,000	27,279,000	33,425,000
Time deposits of \$100,000 or more	<u>8,620,000</u>	<u>8,407,000</u>
Total deposits	<u>\$ 107,408,000</u>	<u>\$ 103,531,000</u>

At December 31, 2011, the scheduled maturities of time deposits are as follows:

<u>Years Ending December 31,</u>	
2012	\$ 16,102,000
2013	10,867,000
2014	1,656,000
2015	2,139,000
2016	531,000
Thereafter	<u>4,604,000</u>
Total	<u>\$ 35,899,000</u>

**Note 10. Borrowings**

In February 2010, the Company entered into a Master Agreement with the Federal Home Loan Bank of Pittsburgh (FHLB) to receive advances with terms varying from 1 day through 3 years. Maximum borrowing capacity with the FHLB as of December 31, 2011 was \$46,467,000, of which \$3,000,000 was outstanding at December 31, 2011 and 2010 as follows:

**Phoenix Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements**

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**Note 10. Borrowings (Continued)**

Fixed Rate Advances:

<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount</u>	<u>Interest Rate</u>
11/09/2010	11/09/2017	\$ 1,000,000	3.03%
11/09/2010	11/09/2015	1,000,000	2.37%
10/08/2010	10/08/2013	<u>1,000,000</u>	1.51%
Total Advances		<u>\$ 3,000,000</u>	
Weighted Average Rate		<u>2.303%</u>	

Advances from FHLB are secured by qualifying assets of the Company.

**Note 11. Income Taxes**

The provision for income taxes consists of the following:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Current	\$ 177,000	\$ 131,000
Deferred	<u>16,000</u>	<u>52,000</u>
Total	<u>\$ 193,000</u>	<u>\$ 183,000</u>

Applicable income taxes for financial reporting differ from the amount computed by applying the statutory federal tax rate to income taxes before federal taxes. The reasons for these differences are as follows:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Federal tax expense (benefit) on income at statutory rates	\$ 263,000	\$ 240,000
Non-deductible expenses	5,000	15,000
Tax-exempt income	<u>(75,000)</u>	<u>(72,000)</u>
	<u>\$ 193,000</u>	<u>\$ 183,000</u>

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 11. Income Taxes (Continued)

The following temporary differences gave rise to the deferred tax assets and liabilities detailed below. Net deferred tax assets are included in other assets on the consolidated balance sheets as of December 31, 2011 and 2010.

	December 31,	
	2011	2010
Deferred tax assets:		
Intangible assets	\$ 107,000	\$ 102,000
Allowance for loan losses	349,000	323,000
Alternative minimum tax credit	16,000	16,000
Nonaccrual interest	8,000	15,000
Deferred employee benefits	32,000	13,000
Other	22,000	12,000
Total deferred tax assets	534,000	481,000
Deferred tax liabilities:		
Depreciation	(215,000)	(160,000)
Goodwill	(126,000)	(111,000)
Deferred loan costs	(19,000)	(20,000)
Net unrealized gain on securities available-for-sale	(50,000)	(22,000)
Total deferred tax liabilities	(410,000)	(313,000)
Net deferred tax assets	\$ 124,000	\$ 168,000

The Company's tax years that remain subject to examination by taxing authorities include 2008 through 2011. The Company had no unrecognized tax benefits at December 31, 2011 and 2010. There were no interest and penalties recognized in the consolidated balance sheets and statements of income in 2011 or 2010.

#### Note 12. Employee Benefit Plans

Retirement Plan: The Company sponsors a defined contribution retirement plan. Retirement plan expense was \$63,000 in 2011 and \$84,000 in 2010.

Bank Owned Life Insurance: Effective July 1, 2010, the Company adopted a split dollar life insurance plan covering certain eligible participating employees. The Company is the owner of the policies and benefits are split with beneficiaries chosen by the employee as defined in the BOLI agreement. The life insurance investment is carried at the cash surrender value of the underlying policies. Income generated from the increase in cash surrender value of the policies is included in other income in the statements of income. The value of estimated liabilities payable to the beneficiaries was approximately \$19,000 and \$29,000 respectively as of December 31, 2011 and 2010 and is recorded in other liabilities.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 13. Stock-based Compensation

Effective February 16, 2011, the Company adopted the Phoenix Bancorp, Inc./Miners Bank Stock Appreciation Rights Plan (the "Plan"). The Plan permits the award of stock appreciation rights as bonus compensation. The Plan is intended to comply with and will be administered in accordance with Internal Revenue Code Section 409A. Accordingly, the Board of Directors awarded 2,600 stock appreciation right units to eligible employees. Each stock appreciation right ("SAR") awarded represents the right to receive an amount of cash equal to the excess of the fair market value of a share of the Company's common stock on the vesting date over the Base Price, which for the 2011 award is \$350. Awards of SARs granted during 2011 are expected to vest as follows:

Number of Units	Period Vested
1,000	February 2014
400	February 2015
850	February 2018
350	June 2018
<u>2,600</u>	

The SARs are not transferable except as defined in the Plan. Vesting periods range from 3 years to 7 years from the grant date and assume the following: the grantee completes the specified years of service until vesting, does not become disabled or die before the vesting date, and there is not a change in control of the Company before the vesting date. At December 31, 2011, the 350 SAR units that would have vested in June 2018 had been forfeited and a total of 2,250 SAR units were outstanding.

The Company accounts for the SARs as a liability since the awards are payable and settled in cash. The Company utilizes the intrinsic value method to account for this liability. The Company records compensation expense ratably over the servicing period and adjusts for changes in the intrinsic value of SARs at each reporting period. At December 31, 2011, no expense or liability was recorded on the consolidated balance sheet since the stock trade price was below the Base Price of \$350.

#### Note 14. Comprehensive Income (Loss)

The components of other comprehensive income (loss) and related tax effects are as follows:

	2011	2010
Unrealized holding gains (losses) on available-for-sale securities	\$ 195,000	\$ (54,000)
Less reclassification adjustment for gains realized in income	107,000	150,000
Net unrealized gains (losses)	88,000	(204,000)
Tax effect	30,000	(70,000)
Net-of-tax amount	<u>\$ 58,000</u>	<u>\$ (134,000)</u>

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 14. Comprehensive Income (Loss) (Continued)

The components of accumulated other comprehensive income and related tax effects are as follows:

	December 31,	
	2011	2010
Unrealized gains on available-for-sale securities	\$ 146,000	\$ 60,000
Tax effect	50,000	22,000
Net-of-tax accumulated other comprehensive income	<u>\$ 96,000</u>	<u>\$ 38,000</u>

#### Note 15. Related Party Transactions

In the ordinary course of business, the Company grants loans to executive officers, directors, significant shareholders (greater than 10%) and related interests of such persons. These transactions were made on substantially the same terms and at those rates prevailing at the time for comparable transactions with others. A summary of loan activity with officers, directors, board members and significant shareholders and related interests of such persons is as follows:

	2011	2010
Balance, January 1	\$ 897,000	\$ 804,000
New loans	1,229,000	216,000
Repayments	(793,000)	(123,000)
Other changes	(104,000)	-
Balance, December 31,	<u>\$ 1,229,000</u>	<u>\$ 897,000</u>

Other changes arise from the separation from employment, reclassification of executive officers, or discontinuance of membership on the board of directors.

Related party deposits were \$1,468,000 at December 31, 2011 and \$1,452,000 at December 31, 2010. The Company pays legal fees to a law firm, in which a director is a partner, for legal services provided to the Company. The Company also pays rent to an entity in which two Board members are partners. The fees and rent were nominal for 2011 and 2010.

#### Note 16. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

Unless noted otherwise, the Company does not require collateral or other security to support financial instruments with off-balance-sheet credit risk.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 16. Financial Instruments with Off-Balance-Sheet Risk (Continued)

Commitments to Extend Credit: Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty.

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit may or may not be collateralized and usually contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby Letters of Credit: Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support bonding and commercial business transactions. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds cash and marketable securities as full collateral supporting those commitments.

Collateral Requirements: To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate.

The Company has not incurred any losses nor recorded any liability on its commitments in 2011 or 2010.

Financial instruments whose contract amount represents credit risk were as follows:

	2011	2010
Commitments to extend credit	\$ 5,453,000	\$ 5,479,000
Standby letters of credit	\$ 451,000	\$ 153,000

#### Note 17. Shareholders' Equity

Small Business Lending Fund (SBLF): The SBLF is a \$30 billion fund that encourages lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than \$10 billion. The intent is for community banks and small businesses to work together to create jobs and promote economic growth in local communities across the nation. On July 19, 2011, the Company entered into a Securities Purchase Agreement (the Agreement) with the Secretary of the Treasury (the Treasury) as a result of its election to participate in the Treasury's Small Business Lending Fund Program. The Agreement contains the terms and conditions on which the Company issued preferred stock to Treasury, which Treasury purchased using SBLF Funds.

**Note 17. Shareholders' Equity (Continued)**

Small Business Lending Fund (SBLF) (Continued): Accordingly, the Board of Directors authorized 4,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, \$1,000 par value, of which 3,500 shares were issued to Treasury. Dividends are payable quarterly in arrears on the first day of each calendar quarter of each year. The dividend rate will be no more than 5% for the first two years and the rate falls to one percent if small business lending increases by ten percent or more. Institutions that increase their lending by less than ten percent pay rates between two percent and four percent. If an institution's lending does not increase in the first two years, however, the rate increases to seven percent, and after 4.5 years total, the rate for all institutions increases to nine percent (if the institution has not already repaid the SBLF funding). The proceeds were immediately transferred by Phoenix Bancorp, Inc. to Miners Bank as equity capital contributions and qualify for inclusion in the Tier I capital of the Bank.

The Company is subject to certain periodic reporting requirements, covenants and restrictions which include certain related party transactions, maintenance of minimum capital requirements mandated by its primary regulators, mergers and consolidations of the Company and / or its subsidiaries, and restrictions on dividends and share repurchases as defined in the Agreement. During 2011, the Company recorded dividends aggregating \$29,000 to the Treasury representing an average rate of 1.84%.

Dividend Reinvestment and Stock Purchase Plan: During 2011, the Company implemented a Dividend Reinvestment and Stock Purchase Plan (DRIP) whereby the Company has offered up to 2,000 shares of common stock, par value \$10.00 per share, for sale under its DRIP only to shareholders who reside in Pennsylvania and whose shares are registered in their name. Participation in the plan by eligible shareholders is entirely voluntary.

Under the plan, participants have the opportunity to purchase additional shares of the Company's common stock using their cash dividends on their registered shares. Shares purchased by the plan directly from the Company using cash dividends will be purchased at 95% of the fair market value of the shares. The plan does not permit shareholders to make optional cash payments to purchase additional shares under the plan so that the plan may qualify for an exemption from registration for the sale of common stock under the Pennsylvania Securities Act of 1972 (the "1972 Act"). Participation in the plan is limited to registered shareholders who own at least 10 shares of the Corporation's common stock and who are bona fide Pennsylvania residents. There were no shares issued under this Plan in 2011.

Capital Ratios: The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt correction action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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

As of December 31, 2011, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. Prompt corrective action provisions are not applicable to bank holding companies. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage ratios as set forth in the table. There are no conditions or events since the notification that management believes have changed the Bank's category. Consolidated and Bank's actual capital amounts and ratios are presented in the following table (in thousands).

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

#### Note 17. Shareholders' Equity (Continued)

##### Capital Ratios (Continued):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011:						
Total Risk Based Capital (to Risk Weighted Assets)						
Bank	\$ 14,474	16.44%	≥ \$ 7,045	≥ 8.00%	≥ \$ 8,806	≥ 10.00%
Consolidated	14,923	16.95%	≥ 7,045	≥ 8.00%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)						
Bank	\$ 13,373	15.19%	≥ \$ 3,522	≥ 4.00%	≥ \$ 5,284	≥ 6.00%
Consolidated	13,822	15.70%	≥ 3,523	≥ 4.00%	N/A	N/A
Tier I Capital (to Average Assets)						
Bank	\$ 13,373	10.84%	≥ \$ 4,937	≥ 4.00%	≥ \$ 6,171	≥ 5.00%
Consolidated	13,822	11.20%	≥ 4,937	≥ 4.00%	N/A	N/A
As of December 31, 2010:						
Total Risk Based Capital (to Risk Weighted Assets)						
Bank	\$ 10,563	12.86%	≥ \$ 6,571	≥ 8.00%	≥ \$ 8,214	≥ 10.00%
Consolidated	10,743	13.08%	≥ 6,572	≥ 8.00%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)						
Bank	\$ 9,535	11.61%	≥ \$ 3,286	≥ 4.00%	≥ \$ 4,929	≥ 6.00%
Consolidated	9,716	11.83%	≥ 3,286	≥ 4.00%	N/A	N/A
Tier I Capital (to Average Assets)						
Bank	\$ 9,535	8.49%	≥ \$ 4,494	≥ 4.00%	≥ \$ 5,618	≥ 5.00%
Consolidated	9,716	8.65%	≥ 4,495	≥ 4.00%	N/A	N/A

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to Phoenix Bancorp, Inc. The amount of total dividends, which may be paid at any date, is generally limited to the retained earnings of the Bank. Furthermore, dividend payments would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

#### Note 18. Fair Value

**Fair Value Measurements:** The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Accounting guidance defines the fair value of a financial instrument as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 18. Fair Value (Continued)

Fair Value Measurements (Continued): If there has been a significant decrease in the volume and the level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. A three-level hierarchy exists for fair value measurements based upon the inputs to the valuation of an asset or liability. The classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities;

Level 2: Valuation is determined from observable inputs other than Level 1 prices such as 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; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3: Valuation is derived from model-based and other techniques in which one significant input is unobservable in the market and which may be based on the Company's own estimates about assumptions that a market participant would use to value the asset or liability.

The following table presents the Company's financial assets measured at fair value on a recurring basis by level within the fair value hierarchy:

<u>December 31, 2011</u>	Level 1	Level 2	Level 3	Total
Securities available-for-sale:				
State and political subdivisions	\$ -	\$ 4,283,000	\$ -	\$ 4,283,000
Mortgage-backed - GSE - residential	-	332,000	-	332,000
U.S. government-sponsored enterprises	-	6,493,000	-	6,493,000
Total	\$ -	\$ 11,108,000	\$ -	\$ 11,108,000

<u>December 31, 2010</u>	Level 1	Level 2	Level 3	Total
Securities available-for-sale:				
State and political subdivisions	\$ -	\$ 3,017,000	\$ -	\$ 3,017,000
Mortgage-backed - GSE - residential	-	1,415,000	-	1,415,000
U.S. government-sponsored enterprises	-	5,007,000	-	5,007,000
Total	\$ -	\$ 9,439,000	\$ -	\$ 9,439,000

Available-for-sale debt securities are measured at fair value using quoted prices from an independent third party that provides valuation services by using quotes for similar assets, with similar terms, in actively traded markets and are classified as Level 2 in the fair value hierarchy.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 18. Fair Value (Continued)

Fair Value Measurements (Continued): The following table presents the Company's financial assets subject to fair value adjustments on a nonrecurring basis by level within the fair value hierarchy (in thousands):

<u>December 31, 2011</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial Assets:				
Impaired loans, net	\$ -	\$ -	\$ 62,000	\$ 62,000

  

<u>December 31, 2010</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial Assets:				
Impaired loans, net	\$ -	\$ -	\$ 239,000	\$ 239,000

Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. These loans are measured at the fair value of collateral less estimated disposition costs. The collateral is primarily real estate whose value is based on appraisals performed by certified appraisers. These values are generally adjusted based on management's knowledge of changes in market conditions or other factors. Since the adjustments may be significant, are based on management's estimates and are generally unobservable, they have been classified as Level 3.

Fair Value of Financial Instruments: In addition to the disclosures of financial instruments recorded at fair value, generally accepted accounting principles require the disclosure of the estimated fair value for certain of the Company's financial instruments. The majority of the Company's assets and liabilities are considered financial instruments. However, many of these instruments lack an available market. In addition, the Company's general practice and intent is to hold its financial instruments to maturity. The Company has considered the fair value measurement criteria as described above for financial instruments measured on a recurring and non-recurring basis. Fair value estimates have been determined based on the methodologies management considers most appropriate for each financial instrument.

The carrying value of the following short-term financial instruments approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities and carry interest rates that approximate market.

- Cash and cash equivalents
- Certificates of deposit
- Restricted stock
- Accrued interest receivable
- Demand, savings and NOW deposits
- Accrued interest payable

The fair value methodology for securities available-for-sale is described above. Securities held-to-maturity are similarly measured using quoted prices from an independent third party that provides valuation services by using quotes for similar assets, with similar terms, in actively traded markets.

For short-term loans and variable rate loans which reprice within ninety days, the carrying value was considered to approximate fair value. For other types of loans, fair value was estimated by discounting cash flows using interest rates approximating current market rates for similar loans and adjusted to reflect credit risk. Where quoted market prices are available, such market prices were used as estimates for fair value.

The fair values of time deposits were estimated by discounting contractual cash flows using the current market rates for instruments with similar maturities.

## Phoenix Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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#### Note 18. Fair Value (Continued)

Fair Value of Financial Instruments (Continued): The estimated fair values of borrowings are based on the discounted value of estimated cash flows. The discount rate is estimated using current market rates for similar instruments.

The fair value of commitments to extend credit is estimated using the fees currently charged for similar agreements. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit is based on fees currently charged for similar agreements plus the estimated cost to terminate or otherwise settle the obligations. Fair values of unrecognized financial instruments are considered immaterial.

The following are the estimated fair values of the Company's financial instruments as of December 31 (in thousands):

	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 6,501	\$ 6,501	\$ 4,470	\$ 4,470
Certificates of deposit	743	743	979	979
Securities held-to-maturity	5,056	5,536	5,066	4,966
Securities available-for-sale	11,108	11,108	9,439	9,439
Restricted stock	354	354	363	363
Loans receivable	94,647	95,783	91,065	91,876
Accrued interest receivable	441	441	324	324
Financial liabilities:				
Demand, savings and NOW deposits	71,509	71,509	61,699	61,699
Time deposits	35,899	36,132	41,832	42,469
Borrowings	3,000	3,227	3,000	3,024
Accrued interest payable	85	85	107	107



**Independent Auditor's Report  
on the Supplementary Information**

To the Board of Directors and Shareholders  
Phoenix Bancorp, Inc. and Subsidiary  
Minersville, Pennsylvania

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*McGladrey & Pullen, LLP*

Blue Bell, Pennsylvania  
February 29, 2012

Phoenix Bancorp, Inc. and Subsidiary

Consolidating Balance Sheet  
December 31, 2011

	Phoenix Bancorp, Inc.	Miners Bank	Eliminations	Consolidated
<b>Assets</b>				
Cash and Due from Banks	\$ 100,000	\$ 2,102,000	\$ (100,000)	\$ 2,102,000
Interest Bearing Deposits with Other Banks	387,000	1,619,000	(387,000)	1,619,000
Federal Funds Sold	-	2,780,000	-	2,780,000
Certificates of Deposit	-	743,000	-	743,000
Securities Held-to-Maturity, at amortized cost	-	5,056,000	-	5,056,000
Securities Available-for-Sale, at fair value	-	11,108,000	-	11,108,000
Restricted Stock	-	354,000	-	354,000
Loans Receivable, net	-	94,647,000	-	94,647,000
Investment in Subsidiary	14,260,000	-	(14,260,000)	-
Accrued Interest Receivable	-	441,000	-	441,000
Premises and Equipment, net	-	2,518,000	-	2,518,000
Intangible Assets, net	-	101,000	-	101,000
Goodwill	-	689,000	-	689,000
Bank Owned Life Insurance	-	2,670,000	-	2,670,000
Prepaid FDIC Assessment	-	320,000	-	320,000
Other Assets	18,000	572,000	(14,000)	576,000
	<u>\$ 14,765,000</u>	<u>\$ 125,720,000</u>	<u>\$ (14,761,000)</u>	<u>\$ 125,724,000</u>
<b>Liabilities</b>				
Demand deposits	\$ -	\$ 22,614,000	\$ (100,000)	\$ 22,514,000
Savings and NOW deposits	-	49,382,000	(387,000)	48,995,000
Time deposits	-	35,899,000	-	35,899,000
Total deposits	-	107,895,000	(487,000)	107,408,000
Borrowings	-	3,000,000	-	3,000,000
Accrued interest payable	-	85,000	-	85,000
Other liabilities	56,000	480,000	(14,000)	522,000
<b>Total liabilities</b>	<u>56,000</u>	<u>111,460,000</u>	<u>(501,000)</u>	<u>111,015,000</u>
<b>Shareholders' Equity</b>				
Preferred stock	3,500,000	-	-	3,500,000
Common stock	309,000	275,000	(275,000)	309,000
Additional paid-in capital	4,825,000	7,725,000	(7,725,000)	4,825,000
Retained earnings	7,837,000	6,164,000	(6,164,000)	7,837,000
Treasury stock	(1,858,000)	-	-	(1,858,000)
Accumulated other comprehensive income	96,000	96,000	(96,000)	96,000
	<u>14,709,000</u>	<u>14,260,000</u>	<u>(14,260,000)</u>	<u>14,709,000</u>
	<u>\$ 14,765,000</u>	<u>\$ 125,720,000</u>	<u>\$ (14,761,000)</u>	<u>\$ 125,724,000</u>

**Phoenix Bancorp, Inc. and Subsidiaries**

**Consolidating Statement of Income**

**Year Ended December 31, 2011**

	Phoenix Bancorp, Inc.	Miners Bank	Eliminations	Consolidated
<b>Interest income</b>				
Loans	\$ -	\$ 5,327,000	\$ -	\$ 5,327,000
Securities held-to-maturity	-	283,000	-	283,000
Securities available-for-sale	-	276,000	-	276,000
Federal funds sold and certificates of deposit	2,000	16,000	(2,000)	16,000
<b>Total interest income</b>	<b>2,000</b>	<b>5,902,000</b>	<b>(2,000)</b>	<b>5,902,000</b>
<b>Interest expense</b>				
Savings and NOW deposits	-	271,000	(2,000)	269,000
Time deposits	-	722,000	-	722,000
Borrowings	-	70,000	-	70,000
<b>Total interest expense</b>	<b>-</b>	<b>1,063,000</b>	<b>(2,000)</b>	<b>1,061,000</b>
<b>Net interest income</b>	<b>2,000</b>	<b>4,839,000</b>	<b>-</b>	<b>4,841,000</b>
Provision for loan losses	-	205,000	-	205,000
<b>Net interest income after provision for loan losses</b>	<b>2,000</b>	<b>4,634,000</b>	<b>-</b>	<b>4,636,000</b>
<b>Noninterest income</b>				
Service charges and fees on deposits	-	528,000	-	528,000
Other income	-	138,000	-	138,000
Gain on sale of premises and equipment	-	2,000	-	2,000
Gain on mortgage loans	-	16,000	-	16,000
Gain on securities available-for-sale	-	107,000	-	107,000
<b>Total noninterest income</b>	<b>-</b>	<b>791,000</b>	<b>-</b>	<b>791,000</b>
<b>Noninterest expenses</b>				
Salaries and employee benefits	-	2,545,000	-	2,545,000
Occupancy expense	-	553,000	-	553,000
FDIC assessments	-	122,000	-	122,000
Other assessments and taxes	-	120,000	-	120,000
Amortization of intangible assets	-	80,000	-	80,000
Director fees	14,000	52,000	-	66,000
Professional fees	27,000	259,000	-	286,000
Data processing	-	393,000	-	393,000
Office supplies	3,000	111,000	-	114,000
Postage and courier	-	38,000	-	38,000
Telephone	-	48,000	-	48,000
Other expenses	-	288,000	-	288,000
<b>Total noninterest expenses</b>	<b>44,000</b>	<b>4,609,000</b>	<b>-</b>	<b>4,653,000</b>
<b>Income (loss) before provision (benefit) for income taxes</b>	<b>(42,000)</b>	<b>816,000</b>	<b>-</b>	<b>774,000</b>
Provision (benefit) for income taxes	(14,000)	207,000	-	193,000
<b>Income (loss) before equity in earnings of subsidiary</b>	<b>(28,000)</b>	<b>609,000</b>	<b>-</b>	<b>581,000</b>
Equity in earnings of subsidiary	609,000	-	(609,000)	-
<b>Net income</b>	<b>581,000</b>	<b>609,000</b>	<b>(609,000)</b>	<b>581,000</b>
<b>Preferred stock dividend</b>	<b>29,000</b>	<b>-</b>	<b>-</b>	<b>29,000</b>
<b>Net income available to common shareholders</b>	<b>\$ 552,000</b>	<b>\$ 609,000</b>	<b>\$ (609,000)</b>	<b>\$ 552,000</b>