ISABELLA BANK CORP
Form 10-Q
August 08, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2008

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period from __________ to __________

Commission File Number: 0-18415
Isabella Bank Corporation
(Exact name of registrant as specified in its charter)

Michigan	38-2830092
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No.)
200 East Broadway, Mt. Pleasant, MI	48858
(Address of principal executive offices)	(Zip code)

(989) 772-9471

(Registrant s telephone number, including area code)
IBT Bancorp, Inc.

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes o No

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock no par value, 7,472,805 as of July 14, 2008

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Item 1 Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands)

	June 30 2008	December 31 2007
ASSETS		
Cash and demand deposits due from banks	$ 26,930	$ 25,583
Trading securities	25,092	25,064
Securities available for sale (amortized cost of $230,304 in 2008 and $212,285 in 2007)	229,568	213,127
Mortgage loans available for sale	464	2,214
Loans		
Agricultural	58,954	47,407
Commercial	300,731	238,306
Installment	34,531	29,037
Residential real estate mortgage	326,804	297,937
Total loans	**721,020**	**612,687**
Less allowance for loan losses	8,289	7,301
Net loans	**712,731**	**605,386**
Accrued interest receivable	6,113	5,948
Premises and equipment	22,471	22,516
Corporate-owned life insurance policies	14,647	13,195
Acquisition intangibles and goodwill, net	48,008	27,010
Equity securities without readily determinable fair values	15,160	7,353
Other assets	12,703	9,886
TOTAL ASSETS	**$ 1,113,887**	**$ 957,282**
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 98,508	$ 84,846
NOW accounts	103,049	105,526
Certificates of deposit and other savings	460,352	410,782
Certificates of deposit over $100,000	147,415	132,319
Total deposits	**809,324**	**733,473**
Other borrowed funds ($17,401 carried at fair value in 2008, $7,523 in 2007)	157,570	92,887
Escrow funds payable		1,912
Accrued interest and other liabilities	6,881	5,930
Total liabilities	**973,775**	**834,202**
Shareholders Equity		
	136,409	116,319

Common stock no par value 15,000,000 shares authorized; outstanding 7,472,805 in 2008 (6,364,120 in 2007)		
Retained earnings	5,010	7,027
Accumulated other comprehensive loss	(1,307)	(266)
Total shareholders equity	**140,112**	**123,080**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,113,887**	**$ 957,282**

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands except per share data)

	Six Months Ended June 30 2008	2007
Number of Shares of Common Stock Outstanding		
Balance at beginning of period	6,364,120	6,335,861
Common stock dividends	687,599	
Shares issued in exchange for bank acquisition	514,809	
Other issuances of common stock	50,116	25,241
Common stock repurchased	(143,839)	(22,734)
Balance end of period	**7,472,805**	**6,338,368**
Common Stock		
Balance at beginning of period	$ 116,319	$ 114,785
Common stock dividends (10%)	30,254	
Transfer	(28,000)	
Issuance of common stock in exchange for bank acquisition	22,652	
Other issuances of common stock	1,156	990
Share-based payment awards under equity compensation plan	286	452
Common stock repurchased	(6,258)	(978)
Balance end of period	**136,409**	**115,249**
Retained Earnings		
Balance at beginning of period	7,027	4,451
Adjustment to initially apply FASB Statement No. 159, net of tax		(1,050)
Adjustment to initially apply EITF 06-4, net of tax	(1,571)	
Net income	3,618	3,566
Common stock dividends (10%)	(30,254)	
Transfer	28,000	
Cash dividends ($0.24 per share in 2008 and $0.22 per share in 2007)	(1,810)	(1,518)
Balance end of period	**5,010**	**5,449**
Accumulated Other Comprehensive Loss		
Balance at beginning of period	(266)	(3,487)
Adjustment to initially apply fair value provisions of FASB Statement No. 159, net of tax		897
Other comprehensive (loss) income	(1,041)	682

Balance end of period	**(1,307)**	**(1,908)**
Total shareholders equity end of period	**$ 140,112**	**$ 118,790**

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(Dollars in thousands except per share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Interest Income				
Loans, including fees	$ 12,420	$ 10,875	$ 24,945	$ 21,398
Investment securities				
Taxable	1,367	897	2,735	1,642
Nontaxable	1,157	919	2,305	1,705
Trading account securities	307	720	635	1,420
Federal funds sold and other	108	128	265	266
Total interest income	**15,359**	**13,539**	**30,885**	**26,431**
Interest Expense				
Deposits	5,043	5,661	10,947	11,247
Borrowings	1,336	893	2,514	1,556
Total interest expense	**6,379**	**6,554**	**13,461**	**12,803**
Net interest income	**8,980**	**6,985**	**17,424**	**13,628**
Provision for loan losses	1,593	224	2,800	350
Net interest income after provision for loan losses	**7,387**	**6,761**	**14,624**	**13,278**
Noninterest Income				
Service charges and fees	1,448	1,217	2,678	2,349
Title insurance revenue (Note 2)		653	234	1,127
Trust fees	227	228	445	446
Gain on sale of mortgage loans	73	46	157	99
Net loss on trading securities	(485)	(282)	(42)	(57)
Change in the fair value of other borrowings carried at fair market value	239	81	122	83
Other	276	284	701	591
Total noninterest income	**1,778**	**2,227**	**4,295**	**4,638**
Noninterest Expenses				
Compensation and benefits	4,203	3,920	8,537	7,817
Occupancy	493	431	1,021	889
Furniture and equipment	937	847	1,870	1,663
Other	1,708	1,635	3,469	3,268
Total noninterest expenses	**7,341**	**6,833**	**14,897**	**13,637**
Income before federal income taxes	**1,824**	**2,155**	**4,022**	**4,279**
Federal income taxes	133	399	404	713

NET INCOME	**$ 1,691**	**$ 1,756**	**$ 3,618**	**$ 3,566**
Earnings per share				
Basic	**$ 0.23**	**$ 0.25**	**$ 0.48**	**$ 0.51**
Diluted	**$ 0.22**	**$ 0.25**	**$ 0.47**	**$ 0.50**
Cash dividends per basic share	**$ 0.12**	**$ 0.11**	**$ 0.24**	**$ 0.22**

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)

	Three months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Net Income	**$ 1,691**	**$ 1,756**	**$ 3,618**	**$ 3,566**
Unrealized losses on available-for-sale securities:				
Unrealized holding losses arising during the period	(4,053)	(2,222)	(1,563)	(2,025)
Reclassification adjustment for net realized (gains) losses included in net income	(15)		(15)	30
Net unrealized losses	(4,068)	(2,222)	(1,578)	(1,995)
Tax effect	1,383	754	537	678
Unrealized losses, net of tax	(2,685)	(1,468)	(1,041)	(1,317)
Change in unrecognized actuarial loss of defined benefit pension plan, principally due to curtailment		3,029		3,029
Tax effect		(1,030)		(1,030)
Change in unrecognized actuarial loss of defined benefit pension plan, principally due to curtailment, net of tax		1,999		1,999
Other comprehensive (loss) income, net of tax	**(2,685)**	**531**	**(1,041)**	**682**
Comprehensive (loss) income	**$ (994)**	**$ 2,287**	**$ 2,577**	**$ 4,248**

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Six months ended June 30 2008	2007
OPERATING ACTIVITIES		
Net income	$ 3,618	$ 3,566
Reconciliation of net income to cash provided by operations:		
Provision for loan losses	2,800	350
Depreciation	1,063	977
Amortization and impairment of mortgage servicing rights	134	105
Amortization of acquisition intangibles	211	142
Net amortization of investment securities	131	77
Realized (gain) loss on sale of available-for-sale investment securities	(15)	30
Unrealized losses on trading securities	42	57
Unrealized gains on borrowings measured at their fair values	(122)	(83)
Earnings on corporate owned life insurance policies	(221)	(208)
Share-based payment awards	286	452
Deferred income tax (expense) benefit	(212)	23
Net changes in operating assets and liabilities which provided (used) cash, net in 2008 of bank acquisition and joint venture formation:		
Trading securities	5,609	36,005
Loans held for sale	1,750	1,884
Accrued interest receivable	435	322
Other assets	(747)	(3,236)
Escrow funds payable	(46)	1,129
Accrued interest and other liabilities	(1,376)	(228)
Net Cash Provided By Operating Activities	**13,340**	**41,364**
INVESTING ACTIVITIES		
Activity in available-for-sale securities		
Maturities, calls, and sales	39,578	34,666
Purchases	(51,406)	(65,358)
Loan principal originations, net	(23,380)	(16,388)
Proceeds from sales of foreclosed assets	905	
Purchases of premises and equipment	(1,122)	(1,615)
Bank acquisition, net of cash acquired	(9,465)	
Title company joint venture formation, net of cash exchanged	(4,542)	
Purchase of corporate owned life insurance policies	(450)	
Net Cash Used In Investing Activities	**(49,882)**	**(48,695)**
FINANCING ACTIVITIES		
Net increase (decrease) in noninterest bearing deposits	3,513	(983)
Net decrease in interest bearing deposits	(17,711)	(700)
Net increase in other borrowed funds	58,999	9,003
Cash dividends paid on common stock	(1,810)	(1,518)
Proceeds from the issuance of common stock	1,156	990
Common stock repurchased	(6,258)	(978)

Net Cash Provided By Financing Activities		**37,889**		**5,814**
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**1,347**		**(1,517)**
Cash and cash equivalents at beginning of year		25,583		31,359
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$**	**26,930**	**$**	**29,842**
Supplemental cash flows information:				
Transfer of foreclosed loans to other real estate owned	$	1,450	$	242

See notes to condensed consolidated financial statements.

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ISABELLA BANK CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals with the exception of the fair value reporting election described in Note 6 and the adoption of EITF 06-4 described in Note 7) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation s annual report for the year ended December 31, 2007.

All amounts other than share and per share amounts have been rounded to the nearest thousand ($000) in this report.

Effective January 1, 2008, the Corporation acquired Greenville Community Financial Corporation (GCFC). The condensed consolidated financial statements include the results of operations of GCFC since January 1, 2008 (see Note 2). Effective March 1, 2008, the Corporation entered into a joint venture with Corporate Title Agency, LLC. The condensed consolidated financial statements include the results of operations from this new entity since March 1, 2008 (see Note 2). Refer to Management s Discussion and Analysis for further consideration of the impact of these transactions on the condensed consolidated financial statements.

The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation s annual report for the year ended December 31, 2007, with the addition of new pronouncements adopted during 2008 (see Note 7).

NOTE 2 BUSINESS COMBINATION AND JOINT VENTURE FORMATION

Bank Acquisition

On the opening of business on January 1, 2008, Isabella Bank Corporation acquired 100 percent of Greenville Community Financial Corporation (GCFC). As a result of this acquisition, Greenville Community Bank, a wholly owned subsidiary of GCFC, merged with and into Isabella Bank (the Bank). Under the terms of the merger agreement, each share of GCFC common stock was automatically converted into the right to receive 0.6659 shares of Isabella Bank Corporation common stock and $14.70 per share in cash. Exclusive of the effects of the 10% stock dividend paid February 29, 2008, the Corporation issued 514,809 shares of Isabella Bank Corporation common stock valued at $22,652 and paid a total of $11,365 in cash to GCFC shareholders. The total consideration exchanged including the value of the common stock issued, cash paid to shareholders, plus cash paid for $564 in transaction costs resulted in a total purchase price of $34,581. The purchase price was determined using the latest transaction price known to management as of November 27, 2007, the date of the merger agreement. The acquisition of Greenville has increased the overall market share for Isabella Bank Corporation in furtherance of the Bank s strategic plan to pursue certain acquisitions.

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The following table summarizes the estimate of the total purchase price of the transaction as well as adjustments to allocate the purchase price based on the preliminary estimates of fair values of the assets and liabilities of GCFC.

	Greenville January 1, 2008	Fair Value Adjustments of Nonintangible Net Assets Acquired	Fair Value of Net Assets Acquired
ASSETS			
Cash and cash equivalents	$ 2,339	$	$ 2,339
Federal funds sold	125		125
Trading securities	5,679		5,679
Securities available for sale	6,307		6,307
Loans, net	88,613	(398)	88,215
Bank premises and equipment	2,054	194	2,248
Other assets	2,870		2,870
Total assets acquired	**107,987**	**(204)**	**107,783**
LIABILITIES AND SHAREHOLDERS EQUITY			
Liabilities			
Deposits	90,151	(102)	90,049
Other borrowed funds	5,625	181	5,806
Accrued interest and other liabilities	146		146
Total liabilities assumed	**95,922**	**79**	**96,001**
Net assets acquired	**$ 12,065**	**$ (283)**	**11,782**
Core deposit intangible			1,480
Goodwill			21,319
Total consideration paid			**$ 34,581**

The fair value adjustments of tangible net assets acquired are being amortized over two years using the straight line amortization method. The core deposit intangible is being amortized using a 15 year sum-of-the-years digits amortization schedule. Goodwill, which is not amortized, is tested for impairment at least annually. As the acquisition was considered a stock transaction, goodwill is not deductible for federal income tax purposes.

The 2008 interim consolidated statements of income include operating results of GCFC since the date of acquisition. The unaudited pro forma information presented in the following table has been prepared based on Isabella Bank Corporation s historical results combined with GCFC. The information has been combined to present the results of operations as if the acquisition had occurred at the beginning of the earliest period presented. The pro forma results are not necessarily indicative of the results which would have actually been attained if the acquisition had been consummated in the past or what may be attained in the future (as adjusted for the 10% stock dividend paid February 29, 2008):

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Net interest income	$ 8,980	$ 7,846	$ 17,424	$ 15,389
Net income	$ 1,691	$ 1,966	$ 3,618	$ 4,047
Basic earnings per share	$ 0.23	$ 0.25	$ 0.48	$ 0.52

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Title Joint Venture Formation

On March 1, 2008, IBT Title and Insurance Agency, Inc. (IBT Title), a wholly owned subsidiary of Isabella Bank Corporation, merged its assets and liabilities with Corporate Title Agency, LLC (Corporate Title), a third-party title business based in Traverse City, Michigan, to form CT/IBT Title Agency, LLC. As a result of this transaction, the Corporation became a 50 percent joint venture owner in CT/IBT Title Agency, LLC. The purpose of this joint venture was to help IBT Title and Insurance Agency, Inc. expand its service area and to take advantage of economies of scale. As the Corporation is a 50 percent owner of this new entity, revenues and expenses will now be recorded under the equity method, and as such net income from the joint venture will be included in other income. As of June 30, 2008, the Corporation had a recorded investment of $7,094 in the new entity, which is included in equity securities without readily determinable fair values. The following table summarizes the balance sheet of IBT Title as of March 1, 2008. These amounts were excluded from the balance sheet detail of the Corporation and are now included in investment in equity securities without readily determinable fair values.

	IBT Title March 1, 2008
ASSETS	
Cash and cash equivalents	$ 4,542
Premises and equipment	2,352
Other assets	2,339
Total assets	**9,233**
LIABILITIES AND SHAREHOLDERS EQUITY	
Liabilities	
Escrow funds	$ 1,866
Other liabilities	194
Total liabilities	**2,060**
Total equity	**7,173**
Total liabilities & equity	**$ 9,233**

NOTE 3 COMPUTATION OF EARNINGS PER SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Corporation s Deferred Director fee plan.

Earnings per common share have been computed based on the following amounts:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Average number of common shares outstanding for basic calculation*	7,483,362	6,968,227	7,498,925	6,970,588
Potential effect of shares in the Deferred Director fee plan*	184,127	196,974	183,489	196,162

Average number of common shares outstanding used to calculate diluted earnings per common share	7,667,489	7,165,201	7,682,414	7,166,750

* As adjusted for the 10% stock dividend paid February 29, 2008

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NOTE 4 OPERATING SEGMENTS

The Corporation s reportable segments are based on legal entities that account for at least 10 percent of net operating results. In April 2007, the individual bank charters of Isabella Bank and Trust and FSB Bank were consolidated into one bank charter as a part of the Corporation s strategy to increase efficiencies. As of June 30, 2008 and 2007, retail banking operations represent more than 90 percent of the Corporation s total assets and operating results. As such, no segment reporting is presented.

NOTE 5 DEFINED BENEFIT PENSION PLAN

The Corporation has a non-contributory defined benefit pension plan. In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The effect of the curtailment, which was recognized in the first quarter of 2007, suspended the current participants accrued benefits as of March 1, 2007 and limited participation in the plan to eligible employees as of December 31, 2006. As a result of the curtailment, the Corporation recognized a loss of $37 in the first quarter of 2007 in accordance with SFAS No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*. Due to the curtailment, future salary increases will not be considered and the plan benefits are based on years of service and the employees five highest consecutive years of compensation out of the last ten years of service through March 1, 2007. As a result of the curtailment, the Corporation does not anticipate contributing to the plan in the future.

The components of net periodic benefit (income) cost for the three and six month periods ended June 30 are as follows:

	Pension Benefits			
	Three months ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Net periodic benefit (income) cost				
Service cost on benefits earned for services rendered during the period	$	$ 27	$	$ 55
Interest cost on projected benefit obligation	126	131	252	253
Expected return on plan assets	(165)	(159)	(330)	(318)
Amortization of unrecognized prior service cost		2		2
Amortization of unrecognized actuarial net loss	1	14	2	22
Net periodic benefit (income) cost	**(38)**	**15**	**(76)**	**14**
(Gain) loss on plan curtailment		(3)		37
Total net periodic benefit (income) cost	**$ (38)**	**$ 12**	**$ (76)**	**$ 51**

NOTE 6 FINANCIAL INSTRUMENTS RECORDED AT FAIR VALUE

Fair value is the price that would be expected to be received upon the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Level 1 instruments are those assets for which the identical item is traded on an active exchange, such as publicly-traded instruments. The majority of the fair value amounts included in current period earnings resulted from Level 2 fair value methodologies; that is, the Corporation values the assets and liabilities based on observable market data for similar instruments. The Corporation has no assets or liabilities that meet the Level 3 criteria.

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Description	Fair Value Measurements 6/30/2008	Fair Value Measurements at June 30, 2008 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Fair Value Measurements 6/30/2007	Fair Value Measurements at June 30, 2007 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Recurring Items						
Trading securities	$ 25,092	$	$ 25,092	$ 41,777	$2,985	$ 38,792
Investment securities available for sale	229,568	4,029	225,539	164,201	3,977	160,224
Mortgage loans available for sale	464		464	850		850
Other borrowed funds	17,401		17,401	7,405		7,405
Nonrecurring Items						
Mortgage servicing rights	2,216		2,216	2,191		2,191
Other real estate owned	2,540		2,540	633		633

Description	Changes in Fair Value for the 3-month Period Ended June 30, 2008 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option: Trading Gains and (Losses)	Other Gains and (Losses)	Total Changes in Fair Values Included in Current Period Earnings	Changes in Fair Value for the 6-month Period Ended June 30, 2008 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option: Trading Gains and (Losses)	Other Gains and (Losses)	Total Changes in Fair Values Included in Current Period Earnings
Recurring Items						
Trading securities	$ (485)	$	$ (485)	$ (42)	$	$ (42)
Other borrowed funds		239	239		122	122
Nonrecurring Items						
Mortgage servicing rights		30	30			

			$ (216)			$ 80

Description	Changes in Fair Value for the 3-month Period Ended June 30, 2007 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option			Changes in Fair Value for the 6-month Period Ended June 30, 2007 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option		
	Trading Gains and (Losses)	Other Gains and (Losses)	Total Changes in Fair Values Included in Current Period Earnings	Trading Gains and (Losses)	Other Gains and (Losses)	Total Changes in Fair Values Included in Current Period Earnings
Recurring Items						
Trading securities	$ (282)	$	$ (282)	$ (57)	$	$ (57)
Other borrowed funds		81	81		83	83
Nonrecurring Items						
Mortgage servicing rights		1	1			
Other real estate owned					(26)	(26)
			$ (200)			$

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During the first quarter of 2008, the Corporation recorded impairment charges of $30 related to the carrying value of its mortgage servicing rights, in accordance with the provisions of SFAS No. 156, primarily as a result of declines in the rates offered on new residential mortgage loans. This decline in offering rates decreased the expected lives of the loans serviced and in turn decreased the value of the serving rights. However, in the second quarter of 2008, the Corporation reduced the recorded impairment on mortgage servicing rights by $30 as offering rates increased. As such, the net effect of changes in the fair value of the mortgage servicing rights was $0 for the six month period ended June 30, 2008.

During the three month period ended March 31, 2007, in accordance with the provisions of SFAS No. 144, the Corporation recorded an impairment charge of $26 to other real estate owned. The impairment charge was the result of the real estate held declining in value subsequent to the properties being transferred to other real estate.

The activity in the trading portfolio for the three and six month periods ended June 30, 2008 and 2007 was as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Purchases	$ 2,036	$ 3,337	$ 9,710	$ 3,337
Sales, calls, and maturities	(7,560)	(38,434)	(9,640)	(39,342)
Total	**$ (5,524)**	**$ (35,097)**	**$ 70**	**$ (36,005)**

The net loss on trading securities, which includes mark-to-market adjustments, totaled $485 and $282 for the three month periods ended June 30, 2008 and 2007, respectively, and $42 and $57 for the six month periods ended June 30, 2008. Of the $42 of losses incurred during the six month period ended June 30, 2008, $8 relates to securities that were held in the Corporation s trading portfolio as of June 30, 2008.

The activity in borrowings carried at fair market value for the three and six month periods ended June 30, 2008 and 2007 was as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Purchases	$ 10,000	$	$ 10,000	$

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NOTE 7 RECENT ACCOUNTING PRONOUNCEMENTS

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 163 (SFAS No.163) *Accounting for Financial Guarantee Insurance Contracts-an Interpretation of FASB Statement No.*60. The objective of SFAS No. 163 is to clarify how Statement No. 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. This statement also requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. SFAS No. 163 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and is not expected to have a significant impact on the Corporation s consolidated financial statements.

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 162 (SFAS No.162) T*he Hierarchy of Generally Accepted Accounting Principles.* The objective of SFAS No. 162 is to identify the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS No. 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* and is not expected to have a significant impact on the Corporation s consolidated financial statements.

On March 19, 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 161 (SFAS No.161) *Disclosures about Derivative Instruments and Hedging Activities.* The objective of SFAS No. 161 is to enhance disclosures about an entity s derivative and hedging activities and thereby improve the transparency of financial reporting. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 and is not expected to have a significant impact on the Corporation s consolidated financial statements.

In September of 2006, EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangement*, was ratified by the FASB. The EITF reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits. The Corporation has purchased corporation-owned life insurance on certain of its employees. The cash surrender value of these policies is carried as an asset on the condensed consolidated balance sheets. The carrying value was $13,195 at December 31, 2007. These life insurance policies are generally subject to endorsement split-dollar life insurance arrangements. These arrangements were designed to provide a pre-and postretirement benefit for senior officers of the Corporation. The Corporation adopted EITF Issue No. 06-4 effective January 1, 2008 and as a result recorded an initial liability of $2,375. To establish this liability, the Corporation recorded a one time charge of $1,571, net of tax, directly to retained earnings at that date. The periodic policy maintenance costs were $17 and $35 for the three and six month periods ended June 30, 2008, respectively.

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

The following is management s discussion and analysis of the major factors that influenced Isabella Bank Corporation s financial performance. This analysis should be read in conjunction with the Corporation s 2007 annual report and with the unaudited interim condensed consolidated financial statements and notes, as set forth on pages 3 through 14 of this report.

CRITICAL ACCOUNTING POLICIES: A summary of the Corporation s significant accounting policies is set forth in Note 1 of the Consolidated Financial Statements included in the Corporation s Annual Report for the year ended December 31, 2007. Of these significant accounting policies, the Corporation considers its policies regarding the allowance for loan losses and acquisition intangibles to be its most critical accounting policies.

The allowance for loan losses requires management s most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation s assessments may be impacted in future periods by changes in economic conditions, and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation s allowance for loan losses and related matters, see Provision for Loan Losses and Allowance for Loan Losses in the Corporation s 2007 Annual Report and herein.

Generally accepted accounting principles require the Corporation to determine the fair value of all of the assets and liabilities of an acquired entity, and record their fair value on the date of acquisition. The Corporation employs a variety of means in determination of the fair value, including the use of discounted cash flow analysis, market comparisons, and projected future revenue streams. For certain items that management believes it has the appropriate expertise to determine the fair value, management may choose to use its own calculations of the value. In other cases, where the value is not easily determined, the Corporation consults with outside parties to determine the fair value of the identified asset or liability. Once valuations have been adjusted, the net difference between the price paid for the acquired entity and the value of its balance sheet, including identifiable intangibles, is recorded as goodwill. This goodwill is not amortized, but is tested for impairment on at least an annual basis.

RESULTS OF OPERATIONS

The following table outlines the results of operations for the three and six month periods ended June 30, 2008 and 2007. Return on average assets measures the ability of the Corporation to profitably and efficiently employ its resources. Return on average equity indicates how effectively the Corporation is able to generate earnings on shareholder invested capital.

SUMMARY OF SELECTED FINANCIAL DATA

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
INCOME STATEMENT DATA				
Net interest income	$8,980	$6,985	$17,424	$13,628
Provision for loan losses	1,593	224	2,800	350
Net income	1,691	1,756	3,618	3,566
PER SHARE DATA				
Earnings per share:				
Basic	$ 0.23	$ 0.25	$ 0.48	$ 0.51
Diluted	0.22	0.25	0.47	0.50
Cash dividends per common share	0.12	0.11	0.24	0.22
RATIOS				
Average primary capital to average assets	13.71%	13.43%	13.93%	13.43%
Net income to average assets	0.61	0.76	0.66	0.77
Net income to average equity	4.69	5.95	4.98	6.08
Net income to average tangible equity	7.32	7.73	7.68	7.83

Net Interest Income

Net interest income equals interest income less interest expense and is the primary source of income for Isabella Bank Corporation. Interest income includes loan fees of $551 and $962 for the three and six month periods ended June 30, 2008, respectively, as compared to $345 and $576 during the same periods in 2007. For analytical purposes, net interest income is adjusted to a taxable equivalent basis by adding the income tax savings from interest on tax-exempt loans and securities, thus making year-to-year comparisons more meaningful.

(Continued on page 19)

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AVERAGE BALANCES, INTEREST RATE, AND NET INTEREST INCOME

The following schedules present the daily average amount outstanding for each major category of interest earning assets, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities. This schedule also presents an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a fully taxable equivalent (FTE) basis using a 34% tax rate. Nonaccruing loans, for the purpose of the following computations, are included in the average loan amounts outstanding. Federal Reserve and Federal Home Loan Bank restricted equity holdings are included in Other.

Results for the three month periods ended June 30, 2008 and June 30, 2007 are as follows:

	Three Months Ended					
	June 30, 2008			June 30, 2007		
	Average Balance	Tax Equivalent Interest	Average Yield\ Rate	Average Balance	Tax Equivalent Interest	Average Yield\ Rate
INTEREST EARNING ASSETS:						
Loans	$ 711,073	$ 12,420	6.99%	$ 601,805	$ 10,875	7.23%
Taxable investment securities	111,500	1,367	4.90%	64,899	897	5.53%
Nontaxable investment securities	121,079	1,798	5.94%	96,947	1,438	5.93%
Trading account securities	26,976	362	5.37%	63,939	767	4.80%
Federal funds sold	1,166	6	2.06%	4,400	59	5.36%
Other	17,665	102	2.31%	6,248	69	4.42%
Total earning assets	989,459	16,055	6.49%	838,238	14,105	6.73%
NON EARNING ASSETS:						
Allowance for loan losses	(8,637)			(7,660)		
Cash and due from banks	17,131			20,155		
Premises and equipment	22,539			21,364		
Accrued income and other assets	84,915			56,015		
Total assets	$ 1,105,407			$ 928,112		
INTEREST BEARING LIABILITIES:						
Interest-bearing demand deposits	$ 113,844	179	0.63%	$ 110,883	556	2.01%
Savings deposits	220,705	619	1.12%	187,462	1,057	2.26%
Time deposits	395,363	4,245	4.29%	344,549	4,048	4.70%
Other borrowed funds	131,112	1,336	4.08%	76,351	893	4.68%
Total interest bearing liabilities	861,024	6,379	2.96%	719,245	6,554	3.64%

NONINTEREST BEARING LIABILITIES:				
Demand deposits	93,868		80,366	
Other	6,379		10,450	
Shareholders equity	144,136		118,051	
Total liabilities and equity	$ 1,105,407		$ 928,112	
Net interest income (FTE)		$ 9,676		$ 7,551

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