ISABELLA BANK CORP
Form 10-Q
August 07, 2009

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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, 2009
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.)
401 N. Main St, Mt. Pleasant, MI	48858
(Address of principal executive offices)	(Zip code)

(989) 772-9471

(Registrant s telephone number, including area code)
N/A

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
o 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 (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
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, 7,510,818 as of July 31, 2009

ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q
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PART I FINANCIAL INFORMATION

Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands)

	June 30 2009	December 31 2008
ASSETS		
Cash and demand deposits due from banks	$ 23,063	$ 23,554
Trading securities	16,111	21,775
Available-for-sale securities (amortized cost of $220,090 in 2009; $248,741 in 2008)	216,538	246,455
Mortgage loans held for sale	2,704	898
Loans		
Agricultural	63,610	58,003
Commercial	333,911	324,806
Installment	32,852	33,179
Residential real estate mortgage	294,921	319,397
Total loans	**725,294**	**735,385**
Less allowance for loan losses	12,052	11,982
Net loans	**713,242**	**723,403**
Accrued interest receivable	5,540	6,322
Premises and equipment	23,780	23,231
Corporate-owned life insurance policies	16,465	16,152
Acquisition intangibles and goodwill, net	47,613	47,804
Equity securities without readily determinable fair values	17,756	17,345
Other assets	12,691	12,324
TOTAL ASSETS	**$ 1,095,503**	**$ 1,139,263**
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 94,427	$ 97,546
NOW accounts	114,186	113,973
Certificates of deposit and other savings	415,210	422,689
Certificates of deposit over $100,000	149,010	141,422
Total deposits	**772,833**	**775,630**
Borrowed funds ($17,913 carried at fair value in 2009; $23,130 in 2008)	178,571	222,350
Accrued interest and other liabilities	8,467	6,807
Total liabilities	**959,871**	**1,004,787**
Shareholders Equity		
Common stock no par value 15,000,000 shares authorized; outstanding 7,510,818 (including 18,029 shares to be issued) in 2009 and 7,518,856 (including 5,248 shares to be issued) in 2008	133,178	133,602

Shares to be issued for deferred compensation obligations	4,208	4,015
Retained earnings	4,074	2,428
Accumulated other comprehensive loss	(5,828)	(5,569)
Total shareholders equity	**135,632**	**134,476**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 1,095,503**	**$ 1,139,263**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands except per share data)

	Common Stock Shares Outstanding	Common Stock	Shares to be issued for deferred compensation obligations	Retained Earnings	Accumulated Other Comprehensive Loss	Totals
Balances, January 1, 2008	6,364,120	$ 112,547	$ 3,772	$ 7,027	$ (266)	$ 123,080
Cumulative effect to apply EITF 06-4, net of tax				(1,571)		(1,571)
Comprehensive income				3,618	(1,041)	2,577
Common stock dividends (10%)	687,599	30,254		(30,254)		
Regulatory capital transfer		(28,000)		28,000		
Bank acquisition	514,809	22,652				22,652
Issuance of common stock	23,689	1,156				1,156
Common stock issued for deferred compensation obligations	26,427	338	(338)			
Share-based payment awards under equity compensation plan			286			286
Common stock repurchased pursuant to publically announced repurchase plan	(143,839)	(6,258)				(6,258)
Cash dividends ($0.24 per share)				(1,810)		(1,810)
Balances, June 30, 2008	7,472,805	$ 132,689	$ 3,720	$ 5,010	$ (1,307)	$ 140,112
Balances, January 1, 2009	7,518,856	$ 133,602	$ 4,015	$ 2,428	$ (5,569)	$ 134,476
Comprehensive income				3,530	(259)	3,271
Issuance of common stock	46,778	1,133				1,133
Common stock issued for deferred	10,067	274	(144)			130

compensation obligations						
Share-based payment awards under equity compensation plan			337			337
Common stock purchased for deferred compensation obligations		(488)				(488)
Common stock repurchased pursuant to publically announced repurchase plan	(64,883)	(1,343)				(1,343)
Cash dividends ($0.25 per share)				(1,884)		(1,884)
Balances, June 30, 2009	7,510,818	$ 133,178	$ 4,208	$ 4,074	$ (5,828)	$ 135,632

See notes to interim condensed consolidated financial statements.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Interest Income				
Loans, including fees	$ 12,018	$ 12,420	$ 23,916	$ 24,945
Investment securities				
Taxable	1,083	1,367	2,370	2,735
Nontaxable	1,179	1,157	2,342	2,305
Trading account securities	179	307	385	635
Federal funds sold and other	46	108	165	265
Total interest income	**14,505**	**15,359**	**29,178**	**30,885**
Interest Expense				
Deposits	3,465	5,043	7,092	10,947
Borrowings	1,561	1,336	3,162	2,514
Total interest expense	**5,026**	**6,379**	**10,254**	**13,461**
Net interest income	**9,479**	**8,980**	**18,924**	**17,424**
Provision for loan losses	1,535	1,593	3,007	2,800
Net interest income after provision for loan losses	**7,944**	**7,387**	**15,917**	**14,624**
Noninterest Income				
Service charges and fees	2,065	1,675	3,414	3,123
Gain on sale of mortgage loans	260	73	528	157
Net (loss) gain on trading securities	(57)	(485)	30	(42)
Net gain on borrowings measured at fair value	73	239	216	122
Gain on sale of investment securities	427	15	648	15
Title insurance revenue				234
Other	363	261	652	686
Total noninterest income	**3,131**	**1,778**	**5,488**	**4,295**
Noninterest Expenses				
Compensation and benefits	4,720	4,203	9,396	8,537
Occupancy	548	493	1,077	1,021
Furniture and equipment	1,013	937	2,029	1,870
FDIC insurance premiums	415	42	1,300	85
Other	1,772	1,666	3,710	3,384
Total noninterest expenses	**8,468**	**7,341**	**17,512**	**14,897**
Income before federal income tax expense	**2,607**	**1,824**	**3,893**	**4,022**
Federal income tax expense	406	133	363	404

NET INCOME	**$ 2,201**	**$ 1,691**	**$ 3,530**	**$ 3,618**
Earnings per share				
Basic	**$ 0.29**	**$ 0.23**	**$ 0.47**	**$ 0.48**
Diluted	**$ 0.29**	**$ 0.22**	**$ 0.46**	**$ 0.47**
Cash dividends per basic share	**$ 0.13**	**$ 0.12**	**$ 0.25**	**$ 0.24**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands)

	Three months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net Income	**$ 2,201**	**$ 1,691**	**$ 3,530**	**$ 3,618**
Unrealized gains on available-for-sale securities:				
Unrealized holding losses arising during the period	(1,240)	(4,053)	(618)	(1,563)
Reclassification adjustment for net realized gains included in net income	(427)	(15)	(648)	(15)
Net unrealized losses	(1,667)	(4,068)	(1,266)	(1,578)
Tax effect	812	1,383	1,007	537
Other comprehensive loss	(855)	(2,685)	(259)	(1,041)
Comprehensive income (loss)	**$ 1,346**	**$ (994)**	**$ 3,271**	**$ 2,577**

See notes to interim condensed consolidated financial statements.

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INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

	Six Months Ended June 30	
	2009	2008
OPERATING ACTIVITIES		
Net income	$ 3,530	$ 3,618
Reconciliation of net income to net cash provided by operations:		
Provision for loan losses	3,007	2,800
Provision for foreclosed asset losses	34	
Depreciation	1,166	1,063
Amortization and impairment of mortgage servicing rights	483	134
Amortization of acquisition intangibles	191	211
Net amortization of available-for-sale investment securities	364	131
Realized gain on sale of available-for-sale investment securities	(648)	(15)
Unrealized (gains) losses on trading securities	(30)	42
Unrealized gains on borrowings measured at fair value	(216)	(122)
Increase in cash value of corporate owned life insurance policies	(313)	(221)
Share-based payment awards under equity compensation plan	337	286
Deferred income tax benefit		(212)
Net changes in operating assets and liabilities which provided (used) cash, net in 2008 of bank acquisition and joint venture formation:		
Trading securities	5,694	5,609
Loans held for sale	(1,806)	1,750
Accrued interest receivable	782	435
Other assets	(1,392)	(747)
Escrow funds payable		(46)
Accrued interest and other liabilities	1,660	(1,376)
Net Cash Provided By Operating Activities	**12,843**	**13,340**
INVESTING ACTIVITIES		
Activity in available-for-sale securities		
Maturities, calls, and sales	98,274	39,578
Purchases	(69,339)	(51,406)
Loan principal collections (originations), net	5,764	(23,380)
Proceeds from sales of foreclosed assets	2,494	905
Purchases of premises and equipment	(1,715)	(1,122)
Bank acquisition, net of cash acquired		(9,465)
Cash contributed to title company joint venture formation		(4,542)
Redemption of corporate owned life insurance policies		(450)
Net Cash Provided By (Used In) Investing Activities	**35,478**	**(49,882)**
FINANCING ACTIVITIES		
Net decrease in deposits	(2,797)	(14,198)
Net (decrease) increase in other borrowed funds	(43,563)	58,999
Cash dividends paid on common stock	(1,884)	(1,810)
Proceeds from issuance of common stock	989	1,156
Common stock repurchased	(1,069)	(6,258)
Common stock purchased for deferred compensation obligations	(488)	

Net Cash (Used In) Provided By Financing Activities	**(48,812)**	**37,889**
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(491)**	**1,347**
Cash and cash equivalents at beginning of period	23,554	25,583
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$ 23,063**	**$ 26,930**
Supplemental cash flows information:		
Interest paid	$ 10,405	$ 13,417
Transfer of loans to foreclosed assets	1,390	1,450

See notes to interim condensed consolidated financial statements.

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

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim 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 considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. 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, 2008.

In preparing these interim condensed consolidated financial statements, we have evaluated, for potential recognition or disclosure events or transactions subsequent to the end of the most recent quarterly period through August 7, 2009, the issuance date of these interim condensed consolidated financial statements.

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 interim condensed consolidated financial statements include the results of operations of GCFC since January 1, 2008.

Effective March 1, 2008, the Corporation entered into a joint venture with Corporate Title Agency, LLC. The investment in the joint venture is accounted for under the equity method and is included in the line item equity securities without readily determinable fair values on the consolidated balance sheets. The results of operations since the date of the joint venture are recorded in other income on the accompanying statements of income.

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, 2008.

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NOTE 2 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, which includes shares held in the Rabbi Trust controlled by the Corporation. 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. In accordance with SFAS No. 128 (as amended), *Earnings Per Share*, the Corporation s obligations to issue shares of stock to participants in its deferred directors plan have been treated as outstanding shares of common stock in the diluted earnings per share calculation. 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	
	2009	2008	2009	2008
Average number of common shares outstanding for basic calculation*	7,518,185	7,483,362	7,518,471	7,498,925
Potential effect of shares in the Deferred Director fee plan*	196,522	184,127	195,630	183,489
Average number of common shares outstanding used to calculate diluted earnings per common share	7,714,707	7,667,489	7,714,101	7,682,414
Net income	$ 2,201	$ 1,691	$ 3,530	$ 3,618
Earnings per share				
Basic	$ 0.29	$ 0.23	$ 0.47	$ 0.48
Diluted	$ 0.29	$ 0.22	$ 0.46	$ 0.47

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

NOTE 3 OPERATING SEGMENTS

The Corporation s reportable segments are based on legal entities that account for at least 10 percent of net operating results. As of June 30, 2009 and 2008 and each of the three and six month periods then ended, retail banking operations represented more than 90 percent of the Corporation s total assets and operating results. As such, no segment reporting is presented.

NOTE 4 DEFINED BENEFIT PENSION PLAN

The Corporation has a non-contributory defined benefit pension plan, which was curtailed effective March 1, 2007. Due to the curtailment, future salary increases are no longer considered and 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 reasonably foreseeable future.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Net periodic benefit cost (income)				
Interest cost on projected benefit obligation	126	126	$ 252	$ 252
Expected return on plan assets	(131)	(165)	(262)	(330)
Amortization of unrecognized actuarial net loss	42	1	85	2
Net periodic benefit cost (income)	**$ 37**	**$ (38)**	**$ 75**	**$ (76)**

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NOTE 5 FINANCIAL INSTRUMENTS RECORDED AT FAIR VALUE

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading securities and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held-for-sale, impaired loans, loans held for investment in foreclosed assets, mortgage servicing rights and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

Under SFAS 157, the Corporation groups assets and liabilities at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability.

The Corporation has invested $11,000 in auction rate preferred stock investment security instruments, which are classified as available-for-sale securities and reflected at fair value. Due to recent events and uncertainty in credit markets, these investments have become illiquid.

Due to the current illiquidity of these securities, these assets were classified as Level 3 during the third quarter of 2008. The fair values of these securities were estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology as of June 30, 2009. These analyses consider, among other factors, the collateral underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, estimates of the next time the security is expected to have a successful auction, and the Corporation s ability to hold such securities until credit markets improve.

The table below represents the activity in investment securities available for sale measured with Level 3 inputs measured on a recurring basis for the three and six month periods ended June 30:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Level 3 inputs at beginning of period	$ 23,417	$ 14,862	$ 19,391	$ 12,694
Purchases			3,300	2,379
Maturities	(606)	(469)	(868)	(725)
Net unrealized gains (losses) on available-for-sale investment securities	70	(215)	1,058	(170)
Level 3 inputs June 30	$ 22,881	$ 14,178	$ 22,881	$ 14,178

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The tables below present the recorded amount of assets and liabilities measured at fair value on:

Description	June 30, 2009 Total	(Level 2)	(Level 3)	December 31, 2008 Total	(Level 2)	(Level 3)
Recurring Items						
Trading securities	$ 16,111	$ 16,111	$	$ 21,775	$ 21,775	$
Available-for-sale investment securities	216,538	193,657	22,881	246,455	227,064	19,391
Mortgage loans available for sale	2,704	2,704		898	898	
Borrowed funds	17,913	17,913		23,130	23,130	
Nonrecurring Items						
Impaired loans	9,097		9,097	10,014		10,014
Mortgage servicing rights	2,436	2,436		2,105	2,105	
Foreclosed assets	1,785	1,785		2,923	2,923	
	$ 266,584	$ 234,606	$ 31,978	$ 307,300	$ 277,895	$ 29,405
Percent of assets and liabilities measured at fair value		88.00%	12.00%		90.43%	9.57%

In previous Form 10-Q and Form 10-K filings the Corporation disclosed that a portion of trading securities, available-for-sale investment securities and other borrowed funds were measured at Level 1. The Corporation recently determined that documentation provided to the Corporation by its third party securities pricing vendor more closely reflects a Level 2 categorization than Level 1 as previously reported. No significant measurement methodology changes have been made by the Corporation s securities pricing vendor. As a result, $10,175 of trading securities, $89,507 of available-for-sale investment securities and $23,130 of other borrowed funds were reclassified from level 1 to level 2 classification at December 31, 2008.

The changes in fair value of assets and liabilities recorded at fair value through earnings on a recurring basis and changes in assets and liabilities recorded at fair value on a nonrecurring basis, for which impairment was recognized in the three and six month periods ended June 30, 2009 and 2008, are summarized as follows:

	Three Months Ended June 30					
	2009			2008		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring Items						
Trading securities	$ (57)	$	$ (57)	$ (485)	$	$ (485)
Other borrowed funds		73	73		239	239
Nonrecurring Items						
Mortgage servicing rights		205	205		30	30
Foreclosed assets		(34)	(34)			

	$ 187	$ (216)

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	Six Months Ended June 30					
	2009			2008		
Description	Trading Gains and (Losses)	Other Gains and (Losses)	Total	Trading Gains and (Losses)	Other Gains and (Losses)	Total
Recurring Items						
Trading securities	$ 30	$	$ 30	$ (42)	$	$ (42)
Borrowed funds		216	216		122	122
Nonrecurring Items						
Mortgage servicing rights		(8)	(8)			
Foreclosed assets		(34)	(34)			
			$ 204			$ 80

As a result of declines in the rates offered on new residential mortgage loans, the Corporation recorded impairment charges related to the carrying value of its mortgage servicing rights in the first quarter of 2009, in accordance with the provisions of SFAS No. 156. This decline in offering rates decreased the expected lives of the loans serviced and in turn decreased the value of the serving rights. During the second quarter of 2009, the Corporation reduced much of the first quarter s impairment as a result of a strong demand for new residential mortgages in the second quarter, coupled with an increased demand for refinancing. These new loans coupled with the refinancing activity increased the size and duration of the Corporation s servicing portfolio, and in turn increased the value of the servicing portfolio.
The activity in the trading portfolio of investment securities was as follows for the three and six month periods ended June 30, 2009 and 2008:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Purchases	$	$ 2,036	$	$ 9,710
Sales, calls, and maturities	(3,011)	(7,560)	(5,694)	(9,640)
Total	**$ (3,011)**	**$ (5,524)**	**$ (5,694)**	**$ 70**

During the second quarter of 2009, a $5,001 borrowing facility carried at fair market value matured. There were no changes in the level of borrowings measured at fair value; only recurring fair value adjustments occurred during the first six months of 2008.

NOTE 6 FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation 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 estimated amounts provided herein do not necessarily indicate amounts which could be realized in a current exchange. Furthermore, as the Corporation typically holds the majority of its financial instruments until maturity, it does not expect to realize all of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments, but which have significant value. These include such items as core deposit intangibles, the future earnings of significant customer relationships and the value of other fee generating businesses. The Corporation believes the imprecision of an estimate could be significant.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments.

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are unavailable, fair values are based on quoted market prices of comparable instruments or other model-based valuation

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techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions.

Mortgage loans available for sale: Fair values of mortgage loans available for sale are based on commitments on hand from investors or prevailing market prices.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans (e.g. , real estate mortgage, agricultural, commercial, and installment) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage servicing rights: Fair value is determined using prices for similar assets with similar characteristics when applicable, or based upon discounted cash flow analyses.

Deposit liabilities: Demand, savings, and money market deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate certificates of deposit approximate their recorded carrying value. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings: The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing rates for similar types of borrowing arrangements.

Borrowings: The fair values of the Corporation s long-term borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing arrangements. The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair value. The fair values of other borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Derivative financial instruments: Fair values for derivative loan commitments and forward loan sale commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised.

Off-balance-sheet credit-related instruments: Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into consideration the remaining terms of the agreements and the counterparties credit standings. The Corporation does not charge fees for lending commitments; thus it is not practicable to estimate the fair value of these instruments.

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The following sets forth the estimated fair value and recorded carrying values of the Corporation s financial instruments as of June 30:

	2009	
	Estimated Fair Value	Carrying Value
ASSETS		
Cash and demand deposits due from banks	$ 23,063	$ 23,063
Trading securities	16,111	16,111
Investment securities available for sale	216,538	216,538
Mortgage loans available for sale	2,793	2,704
Net loans	718,942	713,242
Accrued interest receivable	5,540	5,540
Mortgage servicing rights	2,436	2,436
LIABILITIES		
Deposits with no stated maturities	381,432	381,432
Deposits with stated maturities	394,864	391,401
Borrowed funds	183,942	178,571
Accrued interest payable	1,183	1,183

NOTE 6 FEDERAL INCOME TAXES

The reconciliation of the provision for federal income taxes and the amount computed at the federal statutory tax rate of 34% of income before federal income tax expense is as follows for the three and six month periods ended June 30:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Income taxes at 34% statutory rate	$ 886	$ 620	$ 1,324	$ 1,367
Effect of nontaxable income	(491)	(503)	(980)	(984)
Effect of nondeductible expenses	11	16	19	21
Federal income tax expense	**$ 406**	**$ 133**	**$ 363**	**$ 404**

Included in other comprehensive loss for the three and six month periods ended June 30, 2009 are unrealized gains related to auction rate preferred stock investment securities of $726 and $1,696, respectively. For federal income tax purposes, these securities are considered equity investments for which no federal deferred income taxes are expected or recorded.

NOTE 7 RECENT ACCOUNTING PRONOUNCEMENTS

On April 1, 2009 the FASB staff issued Staff Position No. FSP 141R-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.* This FASB Staff Position (FSP) amends and clarifies FASB Statement No. 141 (revised 2007), *Business Combinations,* to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP 141R-1 is expected to impact accounting by the Corporation of future business combinations.

On April 9, 2009 the FASB staff issued Staff Position No. FSP 157-4 *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. FSP 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, *Fair Value Measurements,* when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4, also includes guidance on identifying circumstances that indicate a market is distressed or not orderly. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On April 9, 2009 the FASB staff issued Staff Position No. FSP 115-2 *Recognition and Presentation of Other-Than-Temporary Impairments.* The objective of an other-than-temporary impairment analysis under existing U.S. generally accepted accounting principles (GAAP) is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. FSP 115-2 amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On April 9, 2009 the FASB staff issued Staff Position FSP No. 107-1 and APB 28-*1 Interim Disclosures about Fair Value of Financial Instruments*. This FASB Staff Position (FSP) amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. The Corporation adopted this statement for the quarterly reporting period ended June 30, 2009. The adoption of this standard did not have a material impact on the Corporation s consolidated financial statements.

On May 28, 2009 FASB issued FASB No. 165 *Subsequent Events.* The objective is to establish general standards for disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard has been adopted for the period ended June 30, 2009 and did not have a material impact on the Corporation s consolidated financial statements.

On June 12, 2009 FASB issued FASB No. 166 *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* The objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. FASB No. 166 addresses (1) practices that have developed since the issuance of FASB Statement No. 140, that are not consistent with the original intent and key requirements of that Statement and (2) concerns of financial statement users that many of the financial assets (and related obligations) that have been derecognized should continue to be reported in the financial statements of transferors. The adoption of this standard will be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and is not expected to have a material impact on the Corporation s consolidated financial statements.

On June 12, 2009 the FASB issued FASB No. 167 *Amendments to FASB Interpretation No. 46(R).* The objective is to improve financial reporting by enterprises involved with variable interest entities. This addresses (1) the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as a result of the elimination of the qualifying special-purpose entity concept in FASB Statement No. 166, *Accounting for Transfers of Financial Assets,* and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting

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and disclosures under the Interpretation do not always provide timely and useful information about an enterprise s involvement in a variable interest entity. The adoption of this standard will be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and the adoption of this standard is not expected to have a material impact on the Corporation s consolidated financial statements.

On June 29, 2009 the FASB issued FASB No. 168 *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162.* The *FASB Accounting Standards Codification* (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. Following this Statement, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates. The FASB will not consider Accounting Standards Updates as authoritative in their own right. Accounting Standards Updates will serve only to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the change(s) in the Codification. This standard will be adopted for the quarter ended September 30, 2009 and the disclosures will be modified consistent with the Codification.

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 2008 annual report and with the unaudited interim condensed consolidated financial statements and notes, beginning on page 3 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, 2008. Of these significant accounting policies, the Corporation considers its policies regarding the allowance for loan losses, acquisition intangibles, and the determination of the fair value of investment securities 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 2008 Annual Report and herein.

United States 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.

The Corporation currently has both available-for-sale and trading investment securities which are carried at their fair value. Changes in the fair value of available-for-sale investment securities are included in other comprehensive income, while declines in the fair value of these securities below their cost that are considered to be other than temporary are reflected as realized losses in the consolidated statements of income. The change in value of trading investment securities is included in current earnings.

The market values for available-for-sale and trading investment securities are typically obtained from outside sources and applied to individual securities within the portfolio. The fair values of investment securities with illiquid markets are estimated utilizing a discounted cash flow analysis or other type of valuation adjustment methodology. These securities are also compared, when possible, to other securities with similar characteristics.

RESULTS OF OPERATIONS

The following table outlines the results of operations for the three and six month periods ended June 30, 2009 and 2008. 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	
	2009	2008	2009	2008
INCOME STATEMENT DATA				
Net interest income	$ 9,479	$ 8,980	$ 18,924	$ 17,424
Provision for loan losses	1,535	1,593	3,007	2,800
Net income	2,201	1,691	3,530	3,618
PER SHARE DATA				
Earnings per share (annualized):				
Basic	$ 0.29	$ 0.23	$ 0.47	$ 0.48
Diluted	0.29	0.22	0.46	0.47
Cash dividends per common share	0.13	0.12	0.25	0.24
Book value (at end of period)	18.06	18.75	18.06	18.75
RATIOS (annualized)				
Average primary capital to average assets	13.32%	13.71%	13.19%	13.93%
Net income to average assets	0.79	0.61	0.63	0.66
Net income to average equity	6.38	4.69	5.10	4.98
Net income to average tangible equity	9.70	7.32	7.80	7.68

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 $538 and $988 for the three and six month periods ended June 30, 2009, respectively, as compared to $551 and $962 during the same periods in 2008. 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.

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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, 2009 and June 30, 2008 are as follows:

	Three Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Tax Equivalent Interest	Average Yield\ Rate	Average Balance	Tax Equivalent Interest	Average Yield\ Rate
INTEREST EARNING ASSETS:						
Loans	$ 723,854	$ 12,018	6.64%	$ 711,073	$ 12,420	6.99%
Taxable investment securities	106,912	1,083	4.05%	111,500	1,367	4.90%
Nontaxable investment securities	122,609	1,832	5.98%	121,079	1,798	5.94%
Trading account securities	17,886	225	5.03%	26,976	362	5.37%
Federal funds sold	108		0.00%	1,166	6	2.06%
Other	23,453	46	0.78%	17,665	102	2.31%
Total earning assets	994,822	15,204	6.11%	989,459	16,055	6.49%
NON EARNING ASSETS:						
Allowance for loan losses	(12,197)			(8,637)		
Cash and due from banks	21,984			17,131		
Premises and equipment	23,880			22,539		
Accrued income and other assets	86,794			84,915		
Total assets	$ 1,115,283			$ 1,105,407		
INTEREST BEARING LIABILITIES:						