June 2, 2005

To My Fellow Shareholders,

On behalf of the Directors and employees of Sturgis Bancorp, Inc. and Sturgis Bank & Trust Company, I am pleased to provide a copy of our 2004 Annual Report. In this Annual Report you will find many key ratios and measures of performance. I encourage you to study this information and participate as a shareholder. If you do not understand information contained in this report, or have suggestions, do not hesitate to contact me at (269) 651-9345.

Our net income for 2004 was $1,715,080, or $0.62 per share, basic and diluted, compared with net income of $2,605,089, or $0.93 per share, basic and diluted, for 2003. The decrease in net income reflects a 26% decline in noninterest income from the slowdown in residential-mortgage and mortgage-refinance activities.

Our net interest income increased to $8,558,414, from $8,228,325 in 2003. This increase is primarily due to improved Net Interest Margin, along with growth in average interest-earning assets. We have held the course over the last three years on our interest rate sensitivity position. With increasing rates, we expect continued improvement in our net interest income going forward.

Our noninterest income was $4,283,267 for 2004, compared to $5,750,442 for 2003. The reduction includes a 69% drop in mortgage-related fees. Income from mortgage-banking activities totaled $824,861 for 2004, compared to $2,662,112 for all of 2003. However, service charges and fees, primarily on deposit accounts, increased to $1,631,806 in 2004 from $1,438,125 in 2003. Investment brokerage commission income also increased to $1,058,183 in 2004 from $846,902 in 2003. This increase is due to growth in accounts at our brokerage subsidiary, Oakleaf Financial Services, Inc. Trust fees were off a modest 6%. Growth in bank service charges and fees -- along with brokerage and trust fee income -- are important indicators of our success at diversifying our income stream and reducing our reliance on the mortgage-banking sector.

In another positive event, and signaling the strength of our loans outstanding, we lowered the provision for loan losses to $811,597 for 2004, from $819,709 in 2003. We have doubled the loan-loss allowance over the last three years due to the changing loan mix in our loan portfolio.

In anticipation of rising interest rates, and to develop sources of core funding from traditionally lower cost commercial-demand deposits, we have significantly enhanced commercial-accounts operations. We also increased measures to detect and respond quickly to loan delinquencies in 2004. The combination of increased surveillance and collection efforts, and an appropriately funded loan loss allowance, should help us to minimize loan loss provisions in 2005.

At the close of 2004, total assets stood at $313.6 million, loans outstanding were $232.9 million and total deposits were $211.2 million. All three of these benchmarks are higher at yearend 2004, compared to yearend 2003.

During 2004, we redeemed $1.3 million in stock. We also paid cash dividends of $0.36 per common share, totaling $995,791. The combination of these two events reduced shareholders' equity to $28.7 million at the close of 2004, from $29.7 million at the end of 2003. Book value per share, however, increased to $10.53 at December 31, 2004, from $10.38 at December 31, 2003.

Financial performance for any one year, while important, is not the only measure of our success. We also seek to build long-term value for our shareholders through a variety of venues. This includes service to our communities, a core value of Sturgis Bank & Trust Company. We provide direct financial support to

scores of groups and nonprofit organizations whose goals are to enhance and improve our communities. Community service encompasses more than philanthropic support. We are active in a broad array of business and community development efforts. I am proud to report that the Sturgis Bank & Trust Company team is active in virtually every established civic and community group in our service areas. This ensures that we contribute to the communities that we serve and gives us a competitive edge in our markets. This commitment to the betterment of our community is a hallmark of our past and beacon to our future.

Looking forward, we are celebrating our 100th year of operation in 2005. Our Bank was founded as a Building & Loan Association in 1905 to provide basic savings products and to finance homes. And while we are committed to residential financing, we are pursuing new pathways to become a diversified financial services organization whose goal is to profitably meet virtually all of our customers' banking and financial-services needs. This includes commercial loans, consumer loans, trust services, brokerage services, certificates of deposit, checking and savings accounts, supported by proven technology, such as telephone, internet and online banking. Further, we will continue to add products and services to diversify our operations in order to meet the needs and changing demands of our market.

We expect 2005 to be a challenging year from a banking perspective. We benefit from a diversified business environment across the markets that we serve. New-housing starts and existing-home sales are sluggish, but improving.

Commercial -- and to a lesser extent -- consumer loan demand are expected to pick-up. We have a very strong branch team and experienced loan officers. The Federal Reserve's recent interest-rate hikes have helped our Net Interest Margin and profitability. Plus, we anticipate growth, strong performance and profitability from Trust activities and Oakleaf Financial. We believe we have positioned the Bank for long-term shareholder value.

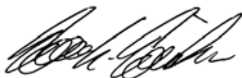
We also encourage our shareholders to consider our products and services when choosing your financial partners. After all, you are contributing to your own success when you bank where you invest.

In summary, our Bank continues to produce sound core earnings and we are focused on growing shareholder value, being a responsible corporate citizen and providing a work environment based on integrity and service. We look forward to our continuing role as the leading financial institution in St. Joseph County, and to continue contributing to the growth and success of all of the communities in our market.

Before closing, I would like to extend my thanks to the members of our Board of Directors for their guidance and counsel; to the talented members of the Sturgis Bancorp and Sturgis Bank & Trust Company team for their dedication and hard work; and to you, our shareholders, for your continued trust and support.

In closing, I invite each of you to visit us at our Main Office or any of our branch offices. In addition, I encourage all of our shareholders to attend our annual meeting, scheduled for 10 a.m. on July 18, 2005 at the Sturges-Young Auditorium. We look forward to seeing you there.

Sincerely,



Eric L. Eishen
President/CEO

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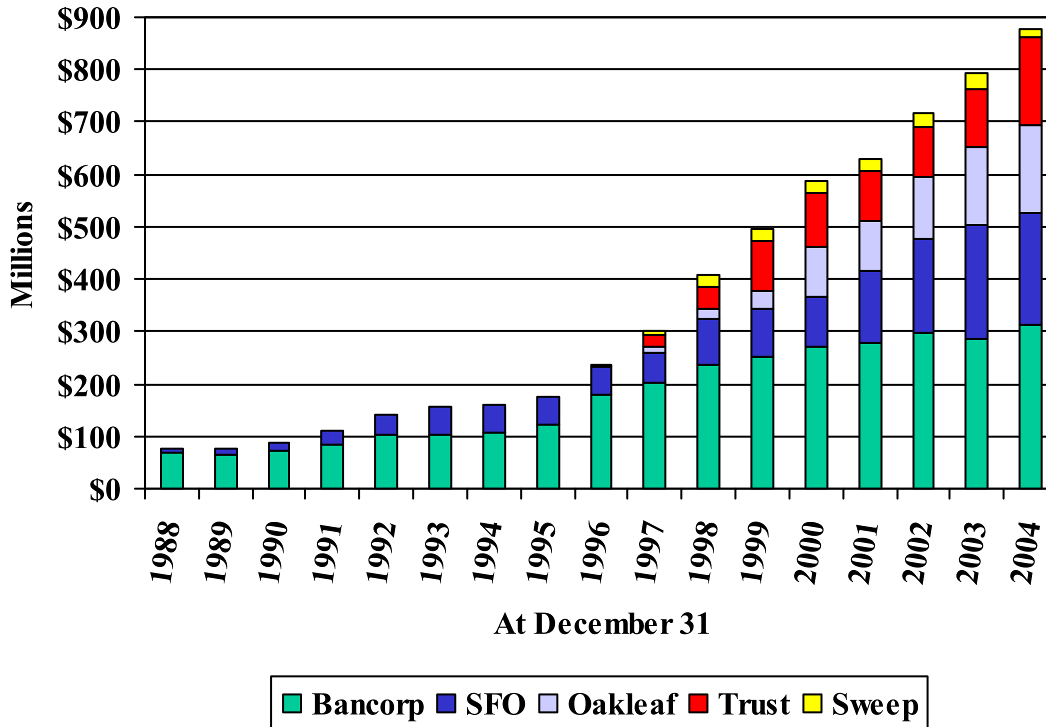
SELECTED FINANCIAL DATA

	At December 31,				
	2004	2003	2002	2001	2000
Total assets	$313,560,695	$287,337,593	$296,684,457	$279,789,272	$271,116,489
Cash and investment securities	25,627,862	29,079,322	39,767,645	28,801,672	25,533,283
Loans and loans held for sale	236,496,270	216,849,239	219,480,856	223,528,846	224,191,073
Mortgage -backed securities	22,634,315	11,720,452	8,912,723	1,034,119	1,261,585
Allowance for loan losses	2,615,566	2,294,157	1,920,037	1,300,000	803,744
Deposits	211,163,742	199,920,213	202,563,796	179,129,827	173,855,324
Short-term borrowings	9,258,583	5,875,538	6,671,907	6,000,000	9,560,855
Long-term borrowings	46,903,283	49,929,132	57,709,489	64,076,863	57,849,521
Stockholders' equity	28,663,461	29,158,351	27,452,528	28,496,934	26,515,396
Book Value per share	10.53	10.38	9.81	9.19	8.55
Shares outstanding (actual number)	2,723,260	2,808,535	2,799,535	3,101,534	3,101,534

	Year Ended December 31,				
	2004	2003	2002	2001	2000
Interest income	$14,896,286	$15,245,598	$17,410,692	$19,938,467	$19,138,924
Interest expense	6,337,872	7,017,273	8,414,100	10,401,412	10,526,202
Provision for loan losses	811,597	819,709	1,494,916	1,056,194	309,000
Noninterest income	4,283,267	5,750,442	5,392,666	4,482,780	3,361,115
Noninterest expense	9,449,802	9,577,955	8,986,026	8,872,803	9,082,503
Federal income tax	865,202	976,014	1,117,929	1,302,901	765,468
Net income	1,715,080	2,605,089	2,790,387	2,787,937	1,816,866
Earnings per share (basic)	0.62	0.93	0.95	0.90	0.59
Earnings per share (diluted)	0.62	0.93	0.95	0.90	0.59
Cash dividends per share	0.36	0.35	0.28	0.26	0.22
Dividend payout ratio	58.06%	37.73%	29.47%	28.89%	37.29%
Equity/Assets ratio	9.14%	10.15%	9.25%	10.19%	9.78%
Return on assets	0.56%	0.89%	0.95%	1.00%	0.69%
Return on equity	5.93%	9.16%	9.96%	10.14%	6.99%
Weighted average shares					
outstanding (actual number):					
Basic	2,762,294	2,808,461	2,949,874	3,101,534	3,099,630
Diluted	2,767,603	2,811,468	2,952,239	3,101,534	3,099,630

Gross Assets Managed



This graph illustrates the growth of relationships for the Company since its initial public offering in 1988. Each of these relationships indicates a point of contact with customers. The categories are defined as follows:

Bancorp – Total assets from the Consolidated Balance Sheet
SFO – Loans serviced for others
Oakleaf – Accounts managed by Oakleaf Financial Services, Inc., Bank subsidiary
Trust – Accounts of the Bank's Trust Department
Sweep – Commercial deposit balances swept daily to an outside mutual fund

Branch acquisitions with related deposits assumed are shown below:

Seller Name	Year	Branch Locations	Total Deposits
First Federal of Michigan	March 12, 1988	Three Rivers	$10,354,773
Fidelity Federal	June 29, 1990	Three Rivers	3,068,392
Standard Federal Bank	July 6, 1991	Sturgis	9,755,357
Great Lakes Bancorp	March 15, 1996	Coldwater and South Haven	24,016,569
KeyBank	December 8, 1997	Bronson and Constantine	16,883,609
First of America Bank, NA	September 11, 1998	Centreville, Climax, Covert, and South Haven	45,140,000

The graph shows growth continuing, even after the most recent branch acquisitions in 1998, to over 200% of the 1998 sum.

CORPORATE YEAR IN REVIEW

On December 11, 2001, the shareholders of Sturgis Bank & Trust Company (the "Bank") approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc. (the "Bancorp"), a financial holding company. The Bancorp is a financial holding company under the Bank Holding Company Act of 1956, as amended. This reorganization was effective January 1, 2002. As a result, historical information in this Annual Report for periods before the January 1, 2002 effective date relate to the Bank. Throughout this Annual Report Sturgis Bancorp, Inc. will be referred to as Bancorp and Sturgis Bank & Trust Company will be referred to as the Bank.

The Bank, a Michigan savings bank, was founded in 1905 as a state chartered mutual building and loan. The original mission of the Bank was to promote personal savings and provide financing for the purchase of homes. Today we remain committed to the same objectives by offering consumer, educational, and property improvement loans, along with a large selection of investment opportunities to our community.

Although the Bank's primary business has historically been and will continue to be the origination of first mortgage loans on 1-4 family unit homes, it has implemented strategies in the last few years that have increased commercial real estate and small business loans within its primary market area. Commercial loan growth was strong during 2004.

Offsetting the commercial loan growth was a reduction in residential mortgage loans. The historically low interest rates induced many borrowers to refinance mortgage and consumer debt into new fixed-rate mortgages. The Bank manages interest rate risk by selling long-term fixed-rate mortgages, so portfolio residential mortgages decreased during 2004. Consumer loans also decreased during 2004, due to borrowers who consolidated debt into mortgages.

The Bank has its main office in Sturgis and branch offices in Bronson, Centreville, Climax, Coldwater, Colon, South Haven, Sturgis, Three Rivers and White Pigeon, Michigan. The Bank's market area includes all of St. Joseph County and parts of Cass, Branch, Calhoun, Van Buren, Allegan, Hillsdale and Kalamazoo counties.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This report contains statements that constitute forward-looking statements. These statements appear in several places in this report and include statements regarding intent, belief, outlook, objectives, efforts, estimates or expectations of Bancorp, primarily with respect to future events and the future financial performance of Bancorp. Any such forward-looking statements are not guarantees of future events or performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statement. Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement include, but are not limited to, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; government and regulatory policy changes; the outcome of any pending and future litigation and contingencies; trends in consumer behavior and ability to repay loans; and changes of the world, national and local economies. Bancorp undertakes no obligation to update, amend or clarify forward-looking statements as a result of new information, future events, or otherwise.

Critical Accounting Policies

The banking industry is highly regulated. Furthermore, the nature of the banking industry is such that, other than described below, the use of estimates and management judgment are not likely to present a material risk to the financial statements. In cases where estimates or management judgment are required, internal controls and processes are established to provide assurance that such estimates and management judgments are materially correct to the best of management's knowledge.

Allowance for loan losses - Accounting for loan classifications, accrual status, and determination of the allowance for loan losses is based on regulatory guidance. This guidance includes, but is not limited to, generally accepted accounting principles, the uniform retail credit classification and account management policy issued by the Federal Financial Institutions Examination Council ("FFIEC"), and the joint policy statement on the allowance for loan losses methodologies issued by the FFIEC. Accordingly, the allowance for loan losses includes a reserve calculation based on an evaluation of loans determined to be impaired, risk ratings, historical losses, loans past due, and other subjective factors. However, there is still a degree of subjectivity when formulating the level of the allowance for loan losses and historical trends may not be indicative of future levels provided to the reserve account.

Commercial loan rating system and identification of impaired loans – Bancorp has a defined risk rating system that is designed to assess the risk of individual loans and overall risk of the commercial loan portfolio. The system assigns a risk weighting to factors such as cash flow, collateral, financial condition, operating performance, repayment history, management, and

strength of the customer's industry. An assessment of risk is performed as a part of the loan approval process as well as periodic updates based on the circumstances of the individual loan. Bancorp employs both internal and external loan review services to assess risk ratings.

Originated mortgage servicing rights ("OMSR") - Bancorp records the original "OMSR" based on market data. The OMSR is amortized into non-interest income in proportion to the period of the estimated future net servicing income of the underlying financial asset. Additionally, an independent third party valuation is performed to determine potential impairment of the OMSR as a result of changes in interest rates and expected future loan prepayment speeds. Significant changes in interest rates or prepayment speeds could have a significant impact on the carrying value of mortgage servicing assets.

Deferred income tax assets –Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Goodwill and Intangible Assets – Bancorp had $5.1 million of goodwill at December 31, 2004 and 2003. Effective January 1, 2002, Bancorp adopted Financial Accounting Standards No. 142 (SFAS 142), Goodwill and Other Intangible Assets, which changes Bancorp's accounting for goodwill and other intangible assets. Generally intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives, such as Bancorp's goodwill, are not amortized. However, such assets are tested for impairment annually after adoption of SFAS 142.

Results of Operations

Bancorp reported net income of $1.7 million, $2.6 million and $2.8 million for the years ended December 31, 2004, 2003 and 2002, respectively. Basic earnings per share were $0.62, $0.93, and $0.95 for the years ended December 31, 2004, 2003 and 2002, respectively. The decrease in noninterest income to 2004 from 2003 is the primary causes of the decrease in net income. The decrease in noninterest income was primarily due to significantly less active mortgage banking activities.

Interest Income

2004 Compared to 2003. Interest income decreased $349,312 to $14.9 million from $15.2 million. This decrease is primarily due to the decreases in average interest rates. The average interest rate earned on loans decreased to 5.85% in 2004 from 6.44% in 2003. This decrease in the average interest rate earned is primarily due to adjustable rate loans repricing lower through 2003 and 2004. Average interest-bearing assets increased to $267.7 million in 2004 from $256.1 million in 2003, including $12.8 million in average loans. Management believes the expansion of commercial lending will lead to an improved interest margin when rates increase. Most commercial credits are priced on a variable basis and the expansion of

commercial deposit accounts, which are non-interest bearing, will help to reduce the average funding costs. The average yield on interest-earning assets decreased to 5.56% in 2004 from 5.95% in 2003.

2003 Compared to 2002. Interest income decreased $2.2 million to $15.2 million from $17.4 million. This decrease is primarily due to the decreases in interest rates and average loans outstanding to $214.5 million in 2003 from $217.6 million in 2002. Due to the general decline in interest rates, and the consumers' preference for fixed rate loan products, Management consciously allowed the residential loan portfolio to decrease, rather than originate long-term, fixed rate portfolio loans in the current interest rate environment. This action resulted in a decrease in residential mortgage loans for 2003. During 2003 the decrease in average loans outstanding reduced interest income from loans by $221,526. The remaining $1.7 million decrease in interest income from loans was due to the reduction in interest rates. Management also believes the expansion of commercial lending will lead to an improved interest margin when rates increase. Most commercial credits are priced on a variable basis and the expansion of commercial deposit accounts, which are non-interest bearing, will help to reduce funding costs. Loan demand was strong in 2003, despite the decrease in loans receivable, as reflected in the increase in loans serviced for others. Loans serviced for others increased by $38.5 million, or 21.50%, in 2003, while the residential mortgage portfolio loans decreased by $9.1 million, or 7.10%. While the residential mortgage loans booked into the loan portfolio was negative, the Bank has a larger customer base than in 2002. This base gives us the ability to cross sell other Bank products and services. The long-term goal of management is to capitalize on the new relationships acquired by the bank during the last two years of record mortgage originations. The average yield on interest-earning assets decreased to 5.95% in 2003 from 6.71% in 2002. This is primarily due to changes in the composition of interest-earning assets and lower yields as interest-earning assets repriced through 2003.

Interest Expense

2004 Compared to 2003. Interest expense decreased $679,401 to $6.3 million in 2004 from $7.0 million in 2003. This was primarily due to the decrease in average interest rates on interest-bearing liabilities to 2.48% in 2004 from 2.87% in 2003. The average rate paid on interest-bearing deposits was 1.86% in 2004, compared to 2.18% in 2003. The average rate paid on borrowed funds decreased to 4.40% in 2004 from 5.05% in 2003.

2003 Compared to 2002. Interest expense decreased $1.4 million to $7.0 million in 2003 from $8.4 million in 2002. This was primarily due to the decrease in rates paid on average interest-bearing deposits and FHLB advances. The rate paid on average interest-bearing liabilities decreased to 2.84% in 2003 from 3.39% in 2002.

Net Interest Income

2004 Compared to 2003. Net interest income for the year ended December 31, 2004 was $8.5 million compared to $8.2 million for the year ended December 31, 2003, an increase of $330,089 or 4.0%. This increase was caused primarily by an increase in net interest-earning assets to $12.0 million in 2004 from $9.5 in 2003. The net interest margin decreased slightly to

3.20% in 2004 from 3.21% in 2003. Although market rates remained relatively stable during 2004, loans and investments continued to reprice lower in accordance with their contractual repricing frequency to a weighted average yield of 5.56% in 2004, compared to 5.95% in 2003. Rates paid on interest-bearing liabilities decreased to 2.48% for 2004 from 2.85% for 2003. The Bank has positioned itself for net interest income to increase with rising interest rates. Management expects rates to gradually increase through 2005.

2003 Compared to 2002. Net interest income for the year ended December 31, 2003 was $8.2 million compared to $9.0 million for the year ended December 31, 2002, a decrease of $0.8 million or 8.9%. This decrease was caused primarily by decreases in the Bank's net interest margin to 3.11% in 2003 from 3.47% in 2002. Although market rates remained relatively stable during 2003, loans and investments continued to reprice lower in accordance with their contractual repricing frequency to a weighted average yield of 5.95% in 2003, compared to 6.71% in 2002. Rates paid on interest-bearing liabilities decreased to 2.85% for 2003 from 3.39% for 2002.

Average Balances, Interest Rates and Yields. Net interest income is affected by the difference ("interest rate spread") between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities and the relative amounts of interest-bearing liabilities and interest-earning assets. When the total of interest-earning assets approximates or exceeds the total of interest-bearing liabilities, any positive interest rate spread will generate net interest income. Financial institutions have traditionally used interest rate spreads as a measure of net interest income. Another indication of an institution's net interest income is its "net yield on interest-earning assets" or "net interest margin," which is net interest income divided by average interest-earning assets. The Bank's net interest margin for 2004, 2003 and 2002 was, 3.20%, 3.21% and 3.47% respectively. This decrease over the last three years demonstrates the effect of the Bank's positive gap position during these years. A positive gap means that interest-bearing assets are repricing at a faster pace than interest-bearing liabilities. Management has anticipated an increase in rates over the last three years and resisted the temptation of placing long-term, fixed rate, assets on the balance sheet. This mitigation of interest rate risk has sacrificed short-term earnings under the recent interest rate environment, but has placed the institution in a more favorable position, now that rates are rising. The most significant risk to this business strategy is that rates do not ultimately rise further. Management does not believe this scenario is likely in the long-term. Management expects interest rates to increase gradually through 2005 if the U.S. economy continues to recover.

Average Balances and Interest Rates
Year Ended December 31,

	2004			2003		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
Interest-Earning Assets:						
Loans (1)	$227,277,239	$13,303,934	5.85%	$214,493,505	$13,820,902	6.44%
Mortgage-backed securities	19,400,203	946,086	4.88%	8,354,243	257,592	3.08%
Investment securities (2)	7,362,304	382,701	5.20%	15,231,418	573,762	3.76%
Interest-bearing deposits	13,672,019	263,565	1.93%	17,991,888	593,342	3.30%
Total interest-earning assets	$267,711,765	$14,896,286	5.56%	$256,071,054	$15,245,598	5.95%
Interest-Bearing Liabilities:						
Deposits	$193,388,888	$3,595,833	1.86%	$189,523,293	$4,134,633	2.18%
FHLB advances	62,358,379	2,742,039	4.40%	57,041,886	2,882,640	5.05%
Total interest-bearing liabilities	$255,747,267	$6,337,872	2.48%	$246,565,179	$7,017,273	2.84%
Net interest income		$8,558,414			$8,228,325	
Interest rate spread			3.08%			3.11%
Net interest-earning assets	$11,964,498			$9,505,875		
Net interest margin			3.20%			3.21%

(1) Interest on loans includes fees. Nonaccrual loans and loans held for sale have been included in the average balances of loans.
(2) Yield on investment securities is reported on an actual and not a tax equivalent basis

	2002		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
Interest-Earning Assets:			
Loans (1)	$217,597,254	$15,729,020	7.23%
Mortgage-backed securities	6,083,847	238,145	3.91%
Investment securities (2)	10,069,556	429,210	4.26%
Interest-bearing deposits	25,879,158	1,014,317	3.92%
Total interest-earning assets	$259,629,815	$17,410,692	6.71%
Interest-Bearing Liabilities:			
Deposits	$184,120,609	$5,042,699	2.74%
FHLB advances	64,034,040	3,371,401	5.27%
Total interest-bearing liabilities	$248,154,649	$8,414,100	3.39%
Net interest income		$8,996,592	
Interest rate spread			3.32%
Net interest-earning assets (liabilities)	$11,475,166		
Net interest margin			3.47%

(1) Interest on loans includes fees. Nonaccrual loans and loans held for sale have been included in the average balances of loans.
(2) Yield on investment securities is reported on an actual and not a tax equivalent basis

The following table presents information regarding the weighted average yields received on loans and other assets and the weighted average rates paid on deposits and borrowings on the last day of the years indicated. Non-accruing loans have been included in the table as loans carrying a zero yield.

	At December 31,		
	2004	**2003**	**2002**
Weighted average rate:			
Loans	5.91%	5.92%	6.89%
Mortgage-backed securities	4.39%	4.34%	5.29%
Investments(1)	4.46%	4.58%	5.12%
Interest-bearing deposits	3.02%	2.66%	3.60%
All interest-earning assets	5.64%	5.60%	6.45%
Weighted average cost:			
Deposits (interest-bearing)	1.88%	1.90%	2.51%
FHLB advances & repo	4.12%	4.62%	4.83%
All interest-bearing liabilities	2.48%	2.52%	3.10%
Interest rate spread	3.16%	3.08%	3.35%

(1) Yield on investment securities is reported on an actual and not a tax equivalent basis.

Rate/Volume Analysis. The following table sets forth certain information regarding changes in interest income and interest expense of Bancorp for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (change in volume multiplied by the prior year rate) and (ii) changes in rate (change in rate multiplied by the prior year volume). Rate/volume variances have been allocated proportionately to the change due to rate and the change due to volume.

	Year Ended December 31, 2004 vs 2003 Increase (Decrease) Due To:			Year Ended December 31, 2003 vs 2002 Increase (Decrease) Due To:		
Interest Income:	Volume	Rate	Total	Volume	Rate	Total
Loans	$793,985	($1,310,953)	($516,968)	($221,526)	($1,686,592)	($1,908,118)
Mortgage-backed securities	478,161	210,333	688,494	76,846	(57,399)	19,447
Investment securities	(361,323)	170,262	(191,061)	199,173	(54,621)	144,552
Interest-bearing deposits	(120,785)	(208,992)	(329,777)	(276,889)	(144,086)	(420,975)
Total interest-earning assets	790,038	(1,139,350)	(349,312)	(222,396)	(1,942,698)	(2,165,094)
Interest Expense:						
Deposits	82,820	(621,620)	(538,800)	144,174	(1,052,240)	(908,066)
FHLB advances	254,093	(394,694)	(140,601)	(357,328)	(131,433)	(488,761)
Total interest-bearing liabilities	336,913	(1,016,314)	(679,401)	(213,154)	(1,183,673)	(1,396,827)
Net Interest Income	$453,125	($123,036)	$330,089	($9,242)	($759,025)	($768,267)

	Year Ended December 31, 2002 vs 2001 Increase (Decrease) Due To:		
Interest Income:	Volume	Rate	Total
Loans	($488,311)	($2,059,230)	($2,547,541)
Mortgage-backed securities	199,755	(36,546)	163,209
Investment securities	113,580	(221,758)	(108,178)
Interest-bearing deposits	339,450	(374,715)	(35,265)
Total interest-earning assets	164,474	(2,692,249)	(2,527,775)
Interest Expense:			
Deposits	337,882	(1,664,760)	(1,326,878)
FHLB advances	(173,773)	(486,661)	(660,434)
Total interest-bearing liabilities	164,109	(2,151,421)	(1,987,312)
Net Interest Income	$ 365	($540,828)	($540,463)

Provision for Loan Losses

2004 Compared to 2003. The provision for loan losses was $811,597 for the year ended December 31, 2004 and $819,709 for the year ended December 31, 2003, a decrease of $8,112. The provision for loan losses was based upon management's assessment of relevant factors, including types and amounts of non-performing loans, historical and anticipated loss experience on such types of loans, and economic conditions. Loans charged off during 2004, net of recoveries, was $490,189, compared to $445,589 during 2003. This small increase of net loans charged off allowed the Bank to reduce the provision for loan losses and still maintain an adequate balance in the allowance for loan losses.

Nonperforming loans have increased to $5.2 million at December 31, 2004 from $4.2

million at December 31, 2003. This increase in nonperforming loans is primarily due to two residential relationships of $1.1 million.

The allowance for loan losses as a percentage of total loans has increased to 1.08% in 2004 from 1.02% in 2003. This increase is primarily due to the increase in commercial mortgage loans. Management monitors the increasing exposure to commercial lending and economic developments the Bank's market area, among other factors, in determining appropriate provisions to the allowance for loan losses.

2003 Compared to 2002. The provision for loan losses was $819,709 for the year ended December 31, 2003 and $1,494,916 for the year ended December 31, 2002, a decrease of $675,207. The provision for loan losses was based upon management's assessment of relevant factors, including types and amounts of non-performing loans, historical and anticipated loss experience on such types of loans, and economic conditions. Loans charged off during 2003, net of recoveries, was $445,589, compared to $874,879 during 2002. This reduction in net loans charged off allowed the Bank to reduce the provision for loan losses and still maintain an adequate balance in the allowance for loan losses.

Nonperforming loans have increased to $4.2 million at December 31, 2003 from $3.0 million at December 31, 2002. This increase in nonperforming loans is primarily due to one commercial relationship for $2.4 million. In 2003 the Bank had a significant commercial credit "out of compliance" with borrowing covenants. The Bank identified this credit and began corrective action. Ultimately, the firm discontinued operations and is in the process of liquidating its assets. The company has been successful at liquidating assets and reducing its debt to the Bank by approximately $2.0 million to $2.4 million. Management is confident we have adequately allowed for possible losses on this credit. A thorough analysis was conducted on the remaining collateral, consisting primarily of real estate in our local market area and a personal guarantee. The result of this analysis indicates the allowance for loan losses has been appropriately funded. This credit is still subject to the liquidation of the remaining assets and possible litigation related to the personal guarantee.

The allowance for loan losses as a percentage of total loans has increased from 2002 to 2004. This increase is due to the increasing exposure of the Bank to commercial lending, weak economic development in the Bank's primary market area (Sturgis, Michigan) and one commercial credit that was impaired in 2003. Because of the Bank's continuing growth in commercial loans, the Bank expects to continue funding the allowance for loan losses due to higher risks related to commercial lending.

The Bank has implemented processes to accelerate its collections and foreclosure actions in an effort to reduce the level of nonperforming assets and net charge-offs. Exclusive of the single commercial credit, nonperforming assets have decreased along with the decrease in net charge-offs. Management expects the enhanced processes will continue to suppress the level of nonperforming assets and net charge-offs.

Noninterest Income

2004 Compared to 2003. Noninterest income was $4.3 million in 2004 compared to $5.8

million in 2003, a decrease of $1.5 million. The primary component of this decrease was noninterest income from mortgage banking activities, which decreased to $824,861 in 2004 from $2.7 million in 2003. Loan sales in 2003 were very strong due to residential loans refinanced and sold. This refinance activity was driven by the historically low levels of interest rates available on long-term fixed rate mortgages. Mortgage banking activity was dominated primarily by purchases and sales, rather than refinances, during 2004. Proceeds from sale of loans decreased to $35.6 million in 2004 from $126.3 million in 2003. Service charges and other fees increased to $1.6 million in 2004 from $1.4 million in 2003, primarily due to an increase in the insufficient funds fee to $25 per item from $20 per item, which became effective on February 1, 2004. Brokerage commission income increased to $1.1 million in 2004 from $846,902 in 2003. Brokerage income is influenced by the U.S. economy and stock market values. This income presently makes up 24.71% of non-interest income for 2004 and will continue to be a large component of noninterest income.

2003 Compared to 2002. Noninterest income was $5.8 million in 2003 compared to $5.4 million in 2002, an increase of $357,776. The primary component of this increase was noninterest income from mortgage banking activities. The increase in mortgage banking activities was due to the increase in loan sales during 2003 compared to 2002. Management does not believe this level of mortgage banking activity will be sustainable in 2004 and beyond. The level of activity for 2002 and 2003 was primarily driven by mortgage refinance activity. This refinance activity was driven by the historically low levels of interest rates available on long-term fixed rate mortgages. Most consumers qualifying to refinance have taken advantage of the low rates and are not likely to refinance in the next year. Management expects mortgage banking activity will be dominated primarily by purchases and sales, rather than refinances, during 2004. Proceeds from sale of loans increased to $126.3 million in 2003 from $108.7 million in 2002. Service charges and other fees decreased to $1.4 million in 2003 from $1.5 million in 2002, primarily due to a decrease in credit life insurance premiums earned to $19,589 in 2003 from $74,679 in 2002. This decrease in credit life insurance premiums earned was due to changes in consumer credit laws for insurance on second mortgages and refinance of consumer loans with credit life insurance during 2003. Brokerage commission income will continue to be a large proportion of non-interest income. Brokerage income is influenced by the U.S. economy and stock market values. This income presently made up 14.73% of non-interest income for 2003.

Noninterest Expense

2004 Compared to 2003. Noninterest expense was $9.5 million in 2004, compared to $9.6 million in 2003, a decrease of $101,153. The largest component of the decrease was office occupancy and equipment, which decreased $165,343 to $1.2 million in 2004 from $1.4 million in 2003. Real estate owned expense decreased $145,457 to $79,606 in 2004 from $225,063 in 2003. Service bureau expense decreased $129,998 to $611,876 in 2004 from $753,998 in 2003 due to expenses incurred converting to a different servicer in the first quarter of 2003. Salaries and employee benefits increased $340,707 to $5.3 million in 2004 from $4.9 million in 2003. These increases are primarily due to lower deferral of loan origination costs. Loan origination costs deferred in 2004 were $587,382 compared to $1.0 million in 2003. Other changes in salaries and employee benefits are primarily due to salary adjustments and increases in the cost of employer-provided medical insurance. Salary adjustments were the result of staffing changes and cost of living increases that took effect January 2004. At December 31, 2004, goodwill was not

impaired. Management actively minimizes noninterest expense, although certain noninterest expenses are outside of Management's direct control. Management expects salaries and employee benefits to increase by 3-5% annually.

2003 Compared to 2002. Noninterest expense was $9.6 million in 2003, compared to $9.0 million in 2002, an increase of $591,929. The largest component of the increase was salaries and employee benefits, which increased $270,191 to $4.9 million in 2003 from $4.7 million in 2002. These increases are due to increases in the cost of employer-provided medical insurance and salary adjustments. Salary adjustments were the result of staffing changes and cost of living increases which took effect January 2003. To offset the increase in health insurance premiums for employees, the Bank instituted a premium sharing program in August 2003. Additional staffing has been added in 2003 to meet the increasing sophistication of the Bank's operations. The increase in sophistication relates primarily to commercial lending operations and the Bank's wholly owned subsidiary, Oakleaf Financial. The expansion into these areas was undertaken in an effort to diversify operations and reduce the Bank's reliance on mortgage banking activities for non-interest income. Management believes that fee income produced by Oakleaf Financial will help to stabilize non-interest income from operations. The Bank's compensation expense was also impacted by the payment of overtime to staff involved in the mortgage banking operations. Data processing expense increased $102,007, due to expenses incurred converting to a different servicer in the first quarter of 2003. At December 31, 2003, goodwill was not impaired.

The effective federal income tax rate was 33.5% in 2004, 27.3% in 2003 and 28.6% in 2002.

Cash Flows

Operating. Cash flows from operating activities are most significantly affected by net income and mortgage banking activities. Net income was $1,715,080, $2,605,089, and $2,790.387 for the years ended December 31, 2004, 2003 and 2002, respectively. Gain on sale of loans was $433,824, $2.7 million and $2.0 million for the years ended December 31, 2004, 2003, and 2002, respectively. Loans originated for sale and proceeds from the sale of loans also decreased with the historically low mortgage loan rates in 2003. Loans originated for sale were $37.3 million, $118.7 million, and $111.1 million for the years ended December 31, 2004, 2003, and 2002, respectively. The increases in loans originated for sale in 2003 and 2002 are primarily due to the low residential mortgage rates. Proceeds from sales of loans were $35.6 million, $126.3 million, and $108.7 million for the years ended December 31, 2004, 2003, and 2002, respectively. Because the Bank generally has a policy of selling long-term fixed rate mortgage loans, the volume of loan sales varies with customer demand for these loans. Also affecting cash flows from operating activities are the add-backs of non-cash expenses, which include the provision for loan losses, depreciation and amortization of mortgage servicing rights.

Investing. Cash flows from investing activities are most significantly affected by loans made to customers net of principal payments, changes in the Bank's investment portfolio, and increases in interest-bearing deposits in banks. For the year ended December 31, 2004 there was a net increase in loans of $19.1 million, primarily commercial mortgages. For the year ended December 31, 2003 there was an increase in loans of $5.0 million and for the year ended December 31, 2002 there was a decrease in loans of $4.0 million, primarily due to refinanced

loans. Investment purchases and maturities also affect cash flows from investing activities. The Bank's management maintains investments at levels that balance returns with various risks. The Bank decreased its holdings of interest-bearing deposits in banks by $4.8 to $10.5 million at December 31, 2004 from $15.3 million at December 31, 2003. The Bank decreased its holdings of interest-bearing deposits in banks by $7.7 million to $15.3 million at December 31, 2003 from $15.3 million at December 31, 2002. Management seeks to use loans as its primary investment option. But in the absence of attractive loan opportunities or to further leverage the Bank's capital, the Bank may pursue additional investment alternatives. Considerations for investment decisions include interest rate risk, liquidity needs, liquidity risk, prepayment risk and credit risk.

Financing. Cash flows from financing activities are mostly affected by changes in deposits and borrowed funds. Deposits increased $11.2 million for the year ended December 31, 2004, decreased $2.6 million for the year ended December 31, 2003 and increased $23.4 million for the year ended December 31, 2002. Certificates of deposit with balances greater than or equal to $100,000 (commonly referred to as jumbo certificates), which carry greater interest rate sensitivity, increased by $9.4 million to $38.8 million at December 31, 2004. The Bank views jumbo certificates of deposit as a source of liquidity. Transaction savings accounts and checking accounts increased $2.2 million, or 2.2%, from December 31, 2003 to December 31, 2004. Transaction savings accounts and checking accounts represent 48.96% of deposits at December 31, 2004, compared to 50.59% of deposits at December 31, 2003. Bank management is actively attempting to increase these core deposit account relationships. The increase in transaction savings accounts and checking accounts provides relatively inexpensive funding for future growth, compared to alternative certificates of deposit and FHLB advances at higher interest rates. The Bank also used FHLB advances and repurchase agreements for financing its operating and investing activities. The FHLB advances increased $357,196 for the year ended December 31, 2004 and decreased $8.6 and $5.7 million, respectively, for the years ended December 31, 2003 and 2002. FHLB advances are secured by Bank assets. The primary assets used by the FHLB as collateral for advances are loans secured by real estate. The Bank may pledge as collateral specific loans or categories of loans for advance purposes. This poses risk to the Bank and stockholders in the fact these assets may become less liquid or subject to set-off. The borrowing base of the Bank is calculated by the FHLB, based substantially on mortgage loans outstanding. If the Bank's mortgage loan portfolio diminishes, it can impact the Bank's ability to utilize the FHLB as a source of funding and liquidity. The Bank also entered repurchase agreements for $15.0 million in 2004. The repurchase agreements are collateralized by mortgage-backed securities with a market value at December 31, 2004 of $16.7 million. Bancorp redeemed $1.3 million of its common stock in open market transactions during 2004. The Bank will continue to use jumbo certificates of deposit, FHLB advances and repurchase agreements to supplement core deposits as its preferred source of funds.

Financial Condition

General. Bancorp's total assets at December 31, 2004 were $313.6 million compared to $287.3 million at December 31, 2003, an increase of $26.3 million or 9.2%. Most of the growth in total assets is in securities available for sale and commercial real estate loans. Bancorp continued to sell long-term, fixed rate, residential mortgage loans.

Loans. Net loans increased to $233.0 million at December 31, 2004 from $215.5 million at December 31, 2003. This increase was primarily due to residential mortgage loans and commercial real estate loans. Most of the increase in residential mortgages can be attributed to advances on revolving home equity loans, which were $34.9 at December 31, 2004, compared to $27.7 million at December 31, 2003. The Bank sells long-term, fixed rate, residential mortgages in the secondary market. Historically, the major buyer of these loans has been the Federal Home Loan Mortgage Corporation (FHLMC). In 2003, the Bank entered into an arrangement to sell loans to Federal Home Loan Bank of Indianapolis (FHLBI). This relationship provides an alternative buyer for Bank loans. Commercial mortgage loans increased to $82.8 million, or 34.7% of gross loans at December 31, 2004 from $66.4 million, or 29.6% of gross loans, at December 31, 2003. The proceeds from sales of loans (primarily fixed-rate, residential mortgages) were $35.6 million and $126.3 million for the year ended December 31, 2004 and 2003, respectively. The mortgage loans originated for sale ($37.3 million at December 31, 2004 and $118.7 million at December 31, 2003) were primarily funded by the secondary mortgage market sales. The decision to sell fixed-rate mortgages with original maturities of 10-years or greater protects the Bank from the interest rate risk inherent in holding these longer term, fixed-rate loans and provides a source of liquidity to fund loan demand. An increase in market interest rates will continue to decelerate the pace of refinance activity in the residential loan portfolio, as the Bank intends to continue focusing its efforts on growing commercial loans.

At December 31, 2004, outstanding loan commitments were $3.8 million and $35.6 million on fixed and variable-rate loans, respectively. Of these loan commitments, Management expects $6.9 million to be disbursed for new loans during the first half of 2005. The additional loan commitments are unused lines of credit, which may be drawn at any time by the borrower. These loan commitments will be funded by interest-bearing deposits, maturing assets, and additional FHLB borrowings, if needed.

Loans serviced for others decreased by $4 million to $213 million at December 31, 2004 from $217 million at December 31, 2003. This servicing portfolio consists of loans originated by the Bank and sold in the secondary mortgage market with servicing retained by the Bank. Management believes this provides the Bank with a competitive advantage in its market. The retention of servicing requires the Bank to keep a higher staffing level than if the servicing is sold. But many consumers have discovered the difficulties encountered when loan servicing is sold. The retention of servicing also allows the Bank to cross-sell other banking products and services to these customers. The value of the right to service is appraised quarterly and any temporary impairment of the value of servicing rights is recognized quarterly. The originated mortgage servicing rights asset required no valuation allowance at December 31, 2004. The Bank will continue to monitor the valuation of the servicing rights asset. If subsequent analysis shows changes in the appraised impairment, the valuation allowance will be adjusted to match the impairment. Management expects the value of servicing will increase as interest rates rise. Generally, consumers are less inclined to refinance a lower-than-market fixed rate mortgage when rates increase. If this logic prevails, the value of servicing should increase due to the expected increase in duration of the underlying cash flows.

Bancorp has no purchased mortgage servicing portfolio.

The following table provides an analysis of the allowance for loan losses:

	For the year ended December, 31,				
	2004	2003	2002	2001	2000
Balance at the beginning of the period	$2,294,157	$1,920,037	$1,300,000	$803,744	$730,000
Charge-offs:					
Residential mortgages	200,541	122,873	448,217	226,230	117,403
Commercial mortgages	306,861	128,959	121,053	42,900	-
Construction loans – residential	-	-	-	-	-
Construction loans – commercial	-	-	-	-	-
Commercial nonmortgage loans	-	121,566	130,718	175,675	25,061
Loans secured by deposits	-	-	-	-	-
Other consumer and installment loans	134,869	142,776	250,118	162,412	188,219
Total charge-offs	642,271	516,174	950,106	607,217	330,683
Recoveries					
Residential mortgages	36,101	10,185	-	21,344	54,261
Commercial mortgages	29,436	5,230	2,966	-	-
Construction loans – residential	-	-	-	-	-
Construction loans – commercial	-	-	-	-	-
Commercial nonmortgage loans	7,570	-	16,548	3,021	2,044
Loans secured by deposits	-	-	-	-	-
Other consumer and installment loans	78,975	55,170	55,713	22,914	39,122
Total recoveries	152,082	70,585	75,227	47,279	95,427
Net charge-offs	490,189	445,589	874,879	559,938	235,256
Provision for loan losses	811,598	819,709	1,494,916	1,056,194	309,000
Balance at the end of the period	$2,615,566	$2,294,157	$1,920,037	$1,300,000	$803,744
Ratio of net charge-offs during the period to Average loans outstanding during the period	0.22%	0.21%	0.40%	0.25%	0.11%
Allowance for loan losses to total loans	1.12%	1.02%	0.88%	0.58%	0.36%
Nonperforming assets to total assets	2.01%	1.90%	1.76%	1.55%	0.86%
Allowance for loan losses to nonperforming assets	41.58%	41.22%	36.82%	29.91%	34.50%

The following table shows the allocation of the allowance for loan losses at the dates indicated by loan type:

	December 31,									
	2004		2003		2002		2001		2000	
	Amount	Percent of Loans in Each Category To Total Loans	Amount	Percent of Loans in Each Category To Total Loans	Amount	Percent of Loans in Each Category To Total Loans	Amount	Percent of Loans in Each Category To Total Loans	Amount	Percent of Loans in Each Category To Total Loans
Residential mortgages	$478,345	51.49%	$448,026	52.90%	$491,171	58.87%	$304,503	67.13%	$391,768	71.96%
Commercial mortgages	1,687,081	34.73%	1,457,075	29.59%	956,217	23.24%	470,459	15.92%	189,927	11.73%
Construction loans – residential	14,089	4.14%	15,577	4.53%	5,651	3.70%	35,014	3.62%	23,871	2.14%
Construction loans – commercial	313	0.12%	3,506	2.18%	16,914	1.75%	-	0.20%	-	0.14%
Commercial nonmortgage loans	334,967	5.77%	267,229	6.59%	314,963	6.94%	165,188	5.89%	92,594	5.72%
Loans secured by deposits	-	0.44%	-	0.50%	-	0.26%	-	0.26%	-	0..19%
Other consumer and installment	100,771	3.31%	102,744	3.71%	132,121	5.23%	324,836	6.98%	105,584	8.14%
Total allowance for loan losses	$2,615,566	100.00%	$2,294,157	100.00%	$1,920,037	100.00%	$1,300,000	100.00%	$803,744	100.00%

Loans past due 90 days or greater and still accruing at December 31, 2004 increased to $675,876 from $473,102 at December 31, 2003, primarily due to two large residential mortgages. Loans in nonaccrual status at December 31, 2004 of $5.2 million consisted primarily of residential and commercial real estate loans, for which foreclosure has begun or full collection of the loan is questionable. The following table presents the aggregate amount of troubled asset categories as of the dates indicated:

	December 31,			
	2004	2003	2002	2001
Past due – 90 days or greater	$ 675,876	$ 473,102	$ 899,975	$1,073,625
Nonaccrual loans	5,175,474	4,245,716	2,955,666	2,821,965
Real estate owned	438,494	749,899	1,358,759	451,173
Total nonperforming assets	6,289,844	5,468,717	5,214,400	4,346,763
Restructured assets	571,783	426,414	626,882	1,381,920
Total troubled assets	$6,861,627	$5,895,131	$5,841,282	$5,728,683
Ratio of troubled assets to total loans	2.91%	2.71%	2.73%	2.60%
Ratio of troubled assets to total assets	2.17%	2.04%	1.96%	2.04%

Interest-bearing Deposits in Banks. Interest-bearing deposits in banks were $10.5 million at December 31, 2004, compared to $15.3 million at December 31, 2003, a decrease of $4.8 million. The decrease was reinvested in commercial loans.

Securities – Available for sale. Investment securities available for sale of $16.7 million at December 31, 2004 and $4.0 million at December 31, 2003 consisted of a mortgage-backed security issued by the Federal National Mortgage Association. The Bank's investment strategy has historically been to carry its mortgage-backed securities in the held-to-maturity portfolio. Management has changed this strategic decision, so that a balanced investment portfolio can more directly contribute to future liquidity needs by being carried as available-for-sale.

Securities – Held-to-maturity. Investment securities held-to-maturity consist of U.S agency mortgage-backed securities, municipal obligations, and a trust preferred security. The investment securities held-to-maturity were $9.2 million at December 31, 2004 compared to $10.9 million at December 31, 2003, a decrease of $1.7 million. The decrease was primarily due to matured municipal obligations and principal payments on mortgage-backed securities.

Deposits and Borrowed Funds. Deposits were $211.1 million at December 31, 2003 compared to $199.9 million at December 31, 2003, an increase of $11.2 million or 5.6%. The increase in interest-bearing deposits to $195.5 million at December 31, 2004 from $187.6 million at December 31, 2003 is primarily due to increases in certificates of deposit. Certificates of deposit with balances greater than or equal to $100,000 (commonly referred to as Jumbo Certificates), which carry greater interest rate sensitivity, increased by $9.4 million to $38.8 million at December 31, 2004 from $29.4 at December 31, 2003. The Bank views Jumbo Certificates of deposit as a source of liquidity. Other certificates of deposit decreased to $53.3 million at December 31, 2004 from $57.1 million at December 31, 2003. Transaction savings accounts and checking accounts increased $2.2 million, or 2.2%, from December 31, 2003 to December 31, 2004. Transaction savings accounts and checking accounts represent 48.96% of deposits at December 31, 2004, compared to 50.59% of deposits at December 31, 2003. Bank management is actively attempting to increase these core deposit account relationships. Transaction savings accounts and checking accounts provide relatively inexpensive funding for future growth, compared to alternative certificates of deposit and borrowed funds at higher interest rates. The Bank offers competitive rates on its time deposits and uses borrowed funds, when that strategy enhances net interest income.

The Bank has an available line of credit with the Federal Home Loan Bank of Indianapolis ("FHLB") which provides for advances up to $10.0 million and matures annually in March. The Bank anticipates renewal of the line of credit at maturity in March 2005. All borrowings from FHLB are collateralized by substantially all mortgage loans.

Long-term advances were $46.9 million at December 31, 2004 compared to $49.9 million at December 31, 2003 a decrease of $3.0 million. Short-term advances were $9.3 million at December 31, 2004 compared to $5.9 million at December 31, 2003 an increase of $3.4 million. Management anticipates increasing FHLB advances, as demand for portfolio loans increases.

Capital Resources

The stockholders' equity of the Bancorp was $28.7 million at December 31, 2004 compared to $29.2 million at December 31, 2003, a decrease of $494,889 or 1.70%. The primary components of this change in stockholders' equity were retained earnings and common stock redemption. Cash dividends of $0.36 per share for 2004 reduced retained earnings by $995,791.

On May 19, 2004, Bancorp announced a program to repurchase up to 10% of Bancorp's issued and outstanding common stock, or 280,928 shares, in the open market. Through December 31, 2004, Bancorp redeemed 86,400 shares of its common stock at a total redemption price of $1.3 million. The stockholders' equity was 9.14% of total assets at December 31, 2004. Management continues to monitor and evaluate the best capital structure of Bancorp. A structure that provides sufficient capital to fund future growth, yet maximizes earnings per share, is deemed optimal. Management does not project a need for capital beyond what can be provided by retained earnings.

The Federal Reserve Board ("FRB") has adopted risk-based capital guidelines applicable to Bancorp. These guidelines require that financial holding companies, such as Bancorp, maintain capital commensurate with both on and off balance sheet credit risks of their operations. Under the guidelines, a financial holding company must have a minimum ratio of total capital to risk-weighted assets of 8.0%.

In addition, a financial holding company must maintain a minimum ratio of Tier 1 capital equal to 4.0% of risk-weighted assets. Tier 1 capital includes common stockholders equity, qualifying perpetual preferred stock and minority interest in equity accounts of consolidated subsidiaries less goodwill.

As a supplement to the risk-based capital requirements, the FRB has also adopted leverage capital ratio requirements. The leverage ratio requirements establish a minimum ratio of Tier 1 capital to total assets, less goodwill, of 3% for the most highly rated financial holding companies. All other financial holding companies are required to maintain additional Tier 1 capital yielding a leverage ratio of 4%-5%, depending on the particular circumstances and risk profile of the institution. Management deems the current capitalization level adequate for current and anticipated strategies.

The following table summarizes the capital ratios of Bancorp at the dates indicated:

		December 31, 2004	December 31, 2003
Equity to assets		9.1%	10.1%
Tier I leverage		7.6%	8.4%
Risk-based:	Tier I capital	10.0%	11.4%
	Total capital	11.1%	12.5%

The decrease in capital ratios of Bancorp from December 31, 2003 to December 31, 2004 is primarily the result of the stock redemption program and growth in assets.

Asset/Liability Management

The primary component of Bancorp's earnings is net interest income of the Bank. The Bank's asset/liability management strategy is to maximize net interest income over time by reducing the impact of fluctuating interest rates. This is accomplished by matching the mix and maturities of its assets and liabilities. At the same time the Bank's asset/liability strategies for managing interest rate risk must also accommodate customer demands for particular types of deposit and loan products. The Bank uses asset/liability management techniques in an attempt to maintain a profitable mix of financial assets and liabilities, provide deposit and loan products that

meet the needs of its market area, and maintain control over interest rate risk resulting from changes in interest rates.

Net interest income, the primary component of the Bank's net income, is derived from the difference or "spread" between the yield on interest-earning assets and the cost of interest-bearing liabilities. The Bank has sought to reduce its exposure to changes in interest rates by matching more closely the effective maturities and repricings of its interest-sensitive assets and liabilities. At the same time, the Bank's asset/liability management strategies must also accommodate customer demands for particular types of deposit and loan products.

While much of the Bank's asset/liability management efforts involve strategies that increase the rate sensitivity of its loans and investments, such as the sale of long-term fixed rate loans, originations of adjustable rate loans and purchases of adjustable rate mortgage-backed securities or relatively short average life fixed-rate investments, it also uses techniques to reduce the rate sensitivity of its deposits and borrowed money. Those techniques include attracting longer-term certificates of deposit when the market will permit, emphasizing core deposits, which are less sensitive to changes in interest rates, and borrowing through long-term FHLB advances. The Bank's asset/liability management strategy will change when market rates change.

The Bank measures its exposure to interest rate fluctuations primarily by using a computer modeling system designed for savings institutions such as the Bank. The model uses assumptions which management believes are reasonable for the analysis. These assumptions include (but are not limited to) prepayment and decay rates based on nine interest rate scenarios. These assumptions are based on national statistics and may not reflect the Bank's own experience. It allows the Bank to adjust its asset-liability mix based on the interest rate risk identified. The analysis estimates the changes in the market value of the Bank's equity using interest rate change scenarios ranging from +4% to –4%, in 1% increments from current market rates. At December 31, 2004, the following table illustrates the interest rate sensitivity of the Bancorp's consolidated equity to changes in market interest rates.

(in Thousands of Dollars)	
Book value of stockholders' equity	$28,663
4% increase in market rates	42,727
3% increase in market rates	43,310
2% increase in market rates	43,410
1% increase in market rates	44,572
No change (current market value of equity)	43,684
1% decrease in market rates	42,366
2% decrease in market rates	41,083
3% decrease in market rates	39,232
4% decrease in market rates	36,401

As the table shows, Bancorp's book value of equity is less than estimated market value in all of the scenarios. That indicates that Bancorp is able to withstand fluctuations in market interest rates without posting a significant threat to either Bancorp's stockholders' equity or the federal deposit insurance system, and therefore, Bancorp can be deliberate in its actions to adjust the asset-liability mix. Bancorp would meet the regulatory minimum capital requirements in all of the interest-rate scenarios.

The Bank has an Asset-Liability Management Committee (ALCO) that meets as needed. The purpose of this Committee is to communicate, coordinate, and monitor asset-liability management procedures. The Committee establishes and monitors the volume and mix of both assets and funding sources. The objective is to manage assets and funding sources to produce results consistent with Bancorp's liquidity requirements, capital adequacy, growth, and profitability goals. To accomplish this objective, the ALCO uses internal budget variance reports, forecasts for changes in interest rates and consumer deposit activity, as well as forecasts of loan demand in each of the Bank's loan types, investment maturities and new investment alternatives, and various other internal and external reports.

Static Gap Analysis: The management of interest rate sensitivity includes monitoring the maturities and repricing opportunities of interest-earning assets and interest-bearing liabilities. The following table summarizes the Bancorp's consolidated interest rate repricing gaps for selected maturity periods as of December 31, 2004:

(In Thousands)

	1 Mo.	2-3 Mos.	4-6 Mos.	7-9 Mos.	10-12 Mos.	>1-5 Yrs.	>5 Yrs.	Total
Non-loan interest-earning assets	$ 8,064	$ 5,014	$ 2,468	$ 815	$ 2,720	$ 19,726	$ 3,107	$ 41,914
Loans	97,752	15,920	18,412	16,625	18,500	58,115	4,940	230,264
Total interest-earning assets	$ 105,816	$ 20,934	$ 20,880	$ 17,440	$ 21,220	$ 77,841	$ 8,047	$272,178
Savings accounts	$ 1,355	$ 2,709	$ 3,928	$ 3,928	$ 3,928	$ 22,917	$ 7,735	$ 46,500
Checking accounts	1,575	3,153	4,961	4,961	4,961	28.536	8,734	56,881
Certificates & Term IRA's	3,182	12,519	12,172	12,991	6,113	44,317	864	92,158
Other IB liabilities (FHLB advances & repo agreements)	9,259	10,057	0	0	00	20,846	31,000	71,162
Total interest-bearing liabilities	$ 15,371	$ 28,438	$ 21,061	$ 21,880	$ 15,002	$116,616	$ 48,333	$266,701
Asset (liability) gap	$ 90,445	-$ 7,504	-$ 181	-$ 4,440	$ 6,218	-$38,775	-$40,286	$ 5,477
Cumulative asset gap	90,445	82,941	82,760	78,320	84,538	45,763	5,477	
Cumulative gap as a percentage of cumulative earning assets	85.5%	65.4%	56.1%	47.4%	45.4%	17.3%	2.0%	

Total interest-earning assets exceeded interest-bearing liabilities by $5.5 million at December 31, 2004. This difference was funded mainly through non-interest-bearing liabilities. The above table shows that total assets maturing or repricing within one year exceed liabilities maturing or repricing within one year by $84.5 million. This indicates the Bancorp's net interest income would increase with rising interest rates, because more of its assets than liabilities would reprice at the higher rates in the next year. However, the repricing and cash flows of certain categories of assets and liabilities are subject to competitive and other influences that are beyond the control of the Bancorp. As a result, certain assets and liabilities indicated as maturing or repricing within a stated period may, in fact, mature or reprice in other periods or at different volumes.

Simulation: Bancorp recognizes the limitations of static gap analysis as a tool for managing its interest rate risk. Bancorp also uses a computer-based earnings simulation model to estimate the effects of various interest rate environments on the balance sheet structure and net interest income. These simulation techniques involve changes in interest rate relationships, asset and liability mixes, and prepayment options inherent in financial instruments, as well as interest rate levels in order to quantify risk. Bancorp's sensitivity is estimated by first forecasting the next twelve months of net interest income under an assumed environment of constant market interest rates. Next, immediate parallel interest rate shocks are constructed in

the model. The rate shocks reflect changes of equal magnitude to all market interest forecast under each of the rate shock scenarios. The resulting change in net interest income is an indication of the sensitivity change in net earnings to directional changes in market interest rates. This model is based solely on parallel changes in market rates and does not reflect the levels of interest rate risk that may arise from other factors such as changes in the spreads between key market rates or in the shape of the Treasury yield curve. The net interest income simulation model includes on-balance sheet loan, investment, deposit, and debt instruments as well as off-balance sheet interest rate swaps.

Bancorp's Board of Directors compares net interest income sensitivity to established tolerance limits for fluctuation. Throughout 2004, the forecasted exposure was within the Bancorp's established policy limits, except in falling rate change scenarios. Management recognizes the "out of policy" condition in the falling rate environment and has reported this condition to the Board quarterly. The Bancorp's Board of Directors and Management consider further significant rate decreases from December 31, 2004 unlikely and have not changed the Bank policy's tolerance limits to conform to the existing rate environment.

Net Interest Income Sensitivity: Change in Projected Results vs. Constant Rates

Year-End 2004 12 Month Projection

	Rate Shock Amount				
	(2.00%)	(1.00%)	0.00%	1.00%	2.00%
Percent Change in net interest income vs. constant rates	(15.14%)	(7.01%)	0.00%	5.18%	9.80%
ALCO Policy Limit	(6.00%)	(3.00%)	0.00%	(4.00%)	(8.00%)

Effect of Interest Rate Fluctuations

Bancorp's consolidated results of operations depend to a large extent on the Bank's level of net interest income, which is the difference between interest income earned on its loan and investment portfolios versus the interest paid on deposits and borrowed funds. If the cost of funds increases faster than the yield on its interest-earning assets, net interest income will be reduced.

Bancorp measures its interest rate risk primarily using simulation analysis. This analysis is prepared by the Chief Financial Officer and reviewed by the ALCO. ALCO is comprised of the Chief Executive Officer, Chief Financial Officer, Executive Vice President and Senior Officers of the Bank. Bancorp's Board of Directors review quarterly reports that estimate Bancorp's sensitivity to changes in interest rates. Sensitivity is estimated for net interest income and market value of portfolio equity.

While Bancorp uses various tools to monitor interest rate risk, it is unable to predict

future fluctuations in interest rates or the specific impact thereof. The market value of most of Bancorp's financial assets is sensitive to fluctuations in market interest rates. Fixed-rate investments and mortgage loans decline in value as interest rates rise. Adjustable-rate investments and loans generally have less market value volatility than fixed-rate assets.

Liquidity

Bancorp maintains certain levels of liquid assets (the most liquid of which are cash and cash equivalents and investment securities) in order to meet demands from loan commitments, savings withdrawals and other obligations. Bancorp manages liquidity by maintaining a portion of its liquid assets in overnight accounts and by keeping various maturities in its portfolio of investment securities. The primary sources of liquidity are loan repayments, loan sales, maturing investments, deposit accounts, and other borrowed funds, such as FHLB borrowings.

The primary market factor that impacted liquidity throughout 2003 and 2004 was low interest rates for residential mortgages. The residential mortgages that have refinanced into low fixed-rate terms have been sold to the secondary mortgage market, providing funds for Bancorp to redeploy. Bancorp originated commercial mortgage and commercial nonmortgage loans to hold in its portfolio, so the percentage of commercial loans to total loans increased. An increase in loan rates would probably reduce Bancorp's liquidity position, because borrowers would be more likely to prefer adjustable-rate mortgages, which Bancorp holds in its portfolio. Management expects market interest rates to gradually increase in 2005 as the U.S. economy continues to recover.

Contractual Obligations

The long-term debt obligations consist of certificates of deposit and advances from the Federal Home Loan Bank. The following schedule represents principal payments only and does not include interest.

	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Certificates of deposit	$92,158,492	$46,976,795	$25,480,640	$18,837,201	$ 863,856
FHLB advances	46,903,283	2,557,211	3,346,072	10,000,000	31,000,000
Total contractual obligations	$139,061,775	$49,534,006	$28,826,712	$28,837,201	$31,863,856

Off-balance Sheet Activities

Other Commercial Credits – The Bank is a party to credit related financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of its customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet of the Bank.

Commitments to extend credit are agreements to lend to a customer as long as there are no violations of any condition established in the contract. Commitments for equity lines of credit or overdraft protection may expire without being drawn. Therefore, total commitments do not

necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on Management's credit evaluation of the customer. 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 are collateralized, may not contain a specified maturity date and may be drawn to the total extent of the Bank's commitment.

Commercial and standby letters of credit are a conditional commitment issued by the Bank to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit have expiration dates within one year.

At December 31, 2004, the Bank had total commitments of $3.8 million and $35.6 million on fixed rate and variable rate loans, respectively.

All of the commercial credits are underwritten using the commercial loan underwriting guidelines.

Collateral Requirements – To reduce credit risks related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Bank's credit evaluation of the borrower. Collateral held varies, but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate. Although these items are used to secure loans, they are not included on the balance sheet of Bancorp.

Legal Contingencies – Various legal claims also arise from time to time in the normal course of business which, in the opinion of Management, will have no material effect on Bancorp's consolidated financial statements.

Other Off-balance Sheet Activities – During the year ended December 31, 2003, Bancorp purchased an investment for $25,000 in a venture capital company. During the year ended December 31, 2004, Bancorp contributed an additional $12,500 to the venture capital company. Bancorp has a minority interest of approximately 1% in the venture capital company. The venture capital company seeks viable projects in various stages of development for investment. Bancorp has committed to contribute an additional $212,500 as capital is required to fund projects.

Impact of Inflation

The majority of assets and liabilities of financial institutions are monetary in nature. Generally, changes in interest rates have a more significant impact on earnings of the Bank than inflation. Although influenced by inflation, changes in rates do not necessarily move in either the same magnitude or direction as changes in the price of goods and services. Inflation does impact the growth of total assets, creating a need to increase equity capital at a higher rate to maintain an adequate equity to assets ratio, which in turn reduces the amount of earnings available for cash dividends. Through 2003 and 2004, inflation did not have a material impact on the Bancorp.

DIRECTORS OF BANCORP

Raymond H. Dresser, Jr.	Chairman, Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer, Sturgis Bank & Trust Company
Leonard L, Eishen	Retired President and Chief Executive Officer, Sturgis Bank & Trust Company
Lawrence A. Franks	Chairman of the Board President, Burr Oak Tool and Gauge Company, Inc.
Donald A. Frost	President, LTI Printing, Inc.
James A. Goethals	Vice Chairman of the Board Retired President, Sturgis Foundry Corporation
Philip G. Ward	President Emeritus, Glen Oaks Community College

OFFICERS OF BANCORP

Eric L. Eishen	President, Chief Executive Officer
Ronald W. Scheske	Vice President
Brian P. Hoggatt	Chief Financial Officer, Secretary/Treasurer

DIRECTORS OF THE BANK

Raymond H. Dresser, Jr.	Chairman, Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer
Leonard L. Eishen	Retired President and Chief Executive Officer
Lawrence A. Franks	Vice Chairman of the Board President, Burr Oak Tool and Gauge Company, Inc.
Donald L. Frost	President, LTI Printing, Inc.
James A. Goethals	Chairman of the Board President, Sturgis Foundry Corporation – Retired
Philip G. Ward	President Emeritus, Glen Oaks Community College

OFFICERS OF THE BANK

Eric L. Eishen	President, Chief Executive Officer
Steven G. Gage	Senior Vice President, Commercial Lending
Brian P. Hoggatt	Senior Vice President, Chief Financial Officer, Treasurer, Corporate Secretary
Christine M. Moline	First Vice President, Private Banking
Tracey L. Parker	Senior Vice President, Retail Lending
Ronald W. Scheske	Executive Vice President
David E. Watters	Vice President, Senior Trust Officer
Jose D. Albarran	Vice President
Donald G. Baldwin	Vice President, Operations, Compliance Officer
Sandra J. Cagle	Vice President
Debora L. Capman	Vice President, Trust Officer
Emily D. Haller	Vice President, Human Resources
Steven A. Haller	Vice President, Loss Mitigation
Jason J. Hyska	Vice President
Gary E. Metz	Vice President
Larry W. Miller	Vice President
Marilee I. Miller	Controller
Janet M. Stahl	Vice President
Jason A. Wagner	Vice President
Brandon L. Cropsey	Assistant Vice President
Trudy R. Gloy	Assistant Vice President
Camille M. Wilson	Assistant Vice President

BANK CORPORATE INFORMATION

Location	Address	City, ST ZIP	Telephone	Fax
Sturgis (Main Office)	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5512
				(269) 651-8263
				(269) 865-5902
Branch Offices				
Bronson	863 West Chicago Road	Bronson, MI 49028	(517) 369-7322	(517) 369-2347
Centreville	158 West Main	Centreville, MI 49032	(269) 467-8525	(269) 467-4180
Climax	125 North Main	Climax, MI 49034	(269) 746-4256	(269) 746-4108
Coldwater	290 East Chicago Road	Coldwater, MI 49036	(517) 278-5634	(517) 278-5613
Colon	110 South Blackstone Street	Colon, MI 49040	(269) 432-3229	(269) 432-2971
South Haven	1121 LaGrange Street	South Haven, MI 49090	(269) 637-8444	(269) 637-5560
Sturgis	1001 South Centerville Road	Sturgis, MI 49091	(269) 651-9379	(269) 651-1514
Sturgis	1501 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5609
Three Rivers	115 North Main Street	Three Rivers, MI 49093	(269) 273-8481	(269) 273-1732
White Pigeon	122 West Chicago Road	White Pigeon, MI 49099	(269) 483-9668	(269) 483-2725

MARKET INFORMATION

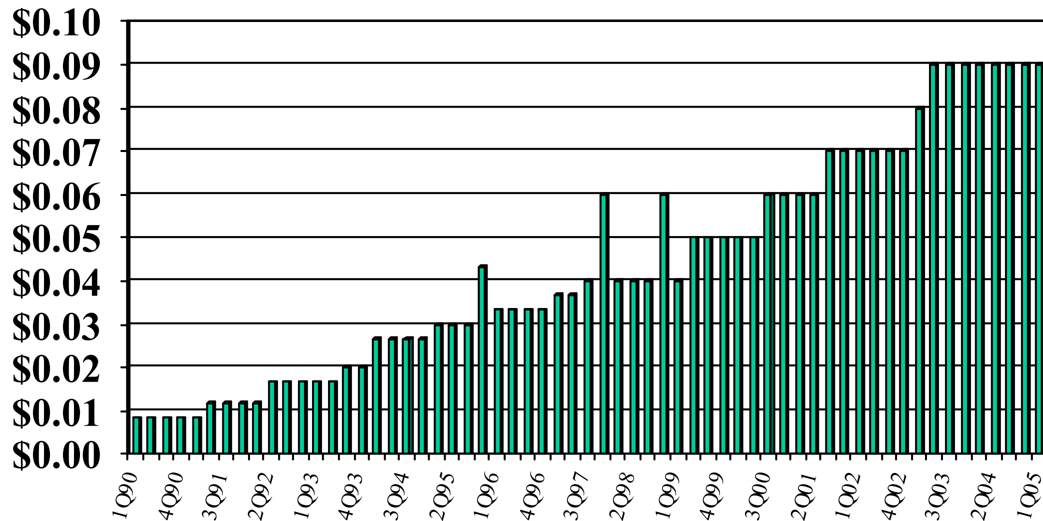
Shares of common stock of Bancorp were held by approximately 430 shareholders as of December 31, 2004. Bancorp's shares are traded on the NASDAQ Small Cap Market under the symbol of "STBI". Trading activity has been infrequent, and previous price information had not been regularly published.

The range of high and low trade prices for each quarterly period during the past two years is presented below:

	Year ended December 31,			
	2004		2003	
	High	Low	High	Low
First quarter	$15.87	$12.26	$10.60	$ 9.16
Second quarter	14.80	12.41	11.50	10.00
Third quarter	14.79	13.50	12.45	10.50
Fourth quarter	15.00	14.42	15.36	11.50

The trade prices listed above are based on actual transactions obtained from public Internet sources obtained by Bancorp.

Cash Dividends Per Share



On December 11, 2001, the shareholders of the Bank approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc., a financial holding company. Sturgis Bancorp, Inc. is a financial holding company under the Bank Holding Company Act of 1956, as amended (the "Bancorp"). This reorganization was approved at a special meeting of the shareholders of the Bank on December 11, 2001. Bancorp received all of the various federal and state regulatory approvals for this reorganization.

This reorganization became effective as of the opening of business on January 1, 2002. Bancorp is a legal entity separate and distinct from its subsidiaries. Substantially all of Bancorp's revenues result from dividends paid to it by the Bank and from earnings on investments. There are statutory and regulatory requirements applicable to the payment of dividends by the Bank to Bancorp, as well as by Bancorp to its shareholders.

Under the Michigan Savings Bank Act, Bancorp may not declare a cash dividend or a dividend of any kind except out of net income then on hand after deducting all losses and bad debts, and then only if it will have a surplus amounting to not less than 20% of its capital after the payment of the dividend. Moreover, the Bank may not declare or pay any cash dividend or dividend in kind until the cumulative dividends on its preferred stock, if any, have been paid in full. Further, if the surplus of the Bank is at any time less than the amount of its capital, before the declaration of a cash dividend or dividend in kind, it must transfer to surplus not less than 10% of its net income for the preceding 6 months (in the case of quarterly or semi-annual dividends) or the preceding two consecutive 6 month periods (in the case of annual dividends).

Pursuant to the Michigan Business Corporation Act, Bancorp may not make distributions to its shareholders if, after giving effect to the distribution, the corporation would not be able to pay its debts as they become due in the usual course of business, or the corporation's total assets would

be less than the sum of it total liabilities plus, unless the corporation's articles of incorporation permit otherwise, the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

The payment of dividends by Bancorp and its subsidiaries may also be affected or limited by other factors, such as the requirements to maintain adequate capital above regulatory guidelines. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the Bank, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice or prohibit the payment of future dividends. The Federal Reserve has indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the FDIC and the Division of Financial Institutions of the Michigan Department of Consumer & Industry Services Office of Financial and Insurance Services ("DFI") have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

INDEPENDENT ACCOUNTANTS

Bancorp has employed the accounting firm of Plante & Moran, PLLC as Independent Accountants for the years ended December 31, 2004, 2003, and 2002. There have been no disagreements on accounting or financial disclosure matters within this time period.

Plante & Moran, PLLC
Suite 500
2601 Cambridge Court
Auburn Hills, MI 48326
Tel: 248.375.7100
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Independent Auditor's Report

To the Board of Directors and Stockholders
Sturgis Bancorp, Inc. and Subsidiaries
Sturgis, Michigan

We have audited the accompanying consolidated balance sheet of Sturgis Bancorp, Inc and Subsidiaries as December 31, 2004 and 2003 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each year in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Corporation'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 consolidated 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 consolidated financial position of Sturgis Bancorp, Inc. and Subsidiaries as of December 31, 2004 and 2003 and the consolidated results of their operations and their cash flows for each year in the three-year period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

March 8, 2005

Sturgis Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2004	2003
Assets		
Cash and due from banks	$ 12,003,905	$ 10,184,272
Federal funds sold	-	283,905
Other short-term investments	38,935	27,124
Total cash and cash equivalents	12,042,840	10,495,301
Interest-bearing deposits in banks	10,486,435	15,339,462
Securities - Held-to-maturity (Note 2)	9,170,866	10,938,761
Securities - Available for sale (Note 2)	16,663,428	4,026,250
Federal Home Loan Bank stock, at cost (Note 2)	4,472,500	4,274,700
Loans held for sale	3,535,317	1,321,674
Loans, net (Note 3)	232,960,953	215,527,565
Real estate owned	438,494	749,899
Bank owned life insurance (Note 11)	6,894,611	6,628,534
Accrued interest receivable	1,640,681	1,591,414
Investment in limited partnerships (Note 5)	1,128,125	1,192,077
Premises and equipment, net (Note 6)	6,065,981	6,488,123
Goodwill, net of accumulated amortization	5,109,419	5,109,419
Originated mortgage servicing rights (Note 4)	1,773,969	1,974,988
Other assets	1,177,076	1,679,426
Total assets	$ 313,560,695	$ 287,337,593
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 15,624,764	$ 12,282,992
Interest bearing (Note 7)	195,538,978	187,637,221
Total Deposits	211,163,742	199,920,213
Federal Home Loan Bank advances (Note 8)	56,161,866	55,804,670
Repurchase agreements (Note 9)	15,000,000	-
Deferred federal income taxes (Note 10)	610,299	484,715
Accrued interest payable	731,895	678,547
Other liabilities	1,229,431	1,291,097
Total liabilities	284,897,233	258,179,242
Stockholders' Equity (Notes 1, 12, and 13)		
Preferred stock - $1 par value:		
Authorized - 1,000,000 shares		
Issued and outstanding – 0 shares		
Common stock – $1 par value:		
Authorized – 9,000,000 shares		
Issued and outstanding – 2,723,260 shares and 2,808,535 shares at December 31, 2004 and 2003, respectively	2,723,260	2,808,535
Additional paid-in capital	16,644,975	17,805,688
Accumulated other comprehensive income	33,460	1,650
Retained earnings	9,261,767	8,542,478
Total stockholders' equity	28,663,462	29,158,351
Total liabilities and stockholders' equity	$ 313,560,695	$ 287,337,593

Sturgis Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income

	Year Ended December 31		
	2004	2003	2002
Interest income			
Loans	$ 13,401,090	$ 13,820,902	$ 15,729,020
Investment securities:			
Taxable	1,112,246	870,309	1,209,703
Tax-exempt	120,661	137,235	142,034
Dividends	262,289	417,152	329,935
Total interest income	14,896,286	15,245,598	17,410,692
Interest expense			
Deposits	3,595,833	4,134,633	5,042,699
Borrowed funds	2,742,039	2,882,640	3,371,401
Total interest expense	6,337,872	7,017,273	8,414,100
Net interest income	8,558,414	8,228,325	8,996,592
Provision for loan losses (Note 3)	811,597	819,709	1,494,916
Net interest income - After provision for loan losses	7,746,817	7,408,616	7,501,676
Noninterest income:			
Service charges and other fees	1,631,806	1,438,125	1,536,181
Investment brokerage commission income	1,058,183	846,902	970,737
Mortgage banking activities	824,861	2,662,112	2,028,497
Trust fee income	454,452	485,327	478,653
Increase in value of bank owned life insurance	266,077	293,105	332,470
Other income	47,888	24,871	46,128
Total noninterest income	4,283,267	5,750,442	5,392,666
Noninterest expenses:			
Salaries and employee benefits (Note 11)	5,262,685	4,921,978	4,651,787
Occupancy and equipment	1,219,777	1,385,120	1,304,802
Data processing	611,876	753,998	651,991
Professional services	422,993	376,751	353,039
Real estate owned expense	79,606	225,063	201,698
Advertising	197,650	220,850	176,265
Other	1,655,215	1,694,195	1,646,444
Total noninterest expenses	9,449,802	9,577,955	8,986,026
Income - Before income tax expense	2,580,282	3,581,103	3,908,316
Provision for federal income tax (Note 10)	865,202	976,014	1,117,929
Net income	$ 1,715,080	$ 2,605,089	$ 2,790,387
Basic earnings per share	$ 0.62	$ 0.93	$ 0.95
Diluted earnings per share	$ 0.62	$ 0.93	$ 0.95

Sturgis Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance – January 1, 2002	$ 3,101,534	$ 20,435,912	$ -	$ 4,959,488	$ 28,496,934
Stock Redemption	(301,999)	(2,703,295)	-	-	(3,005,294)
Net income for the year ended December 31, 2002	-	-	-	2,790,387	2,790,387
Cash dividends ($.28 per share)	-	-	-	(829,499)	(829,499)
Balance – December 31, 2002	2,799,535	17,732,617	-	6,920,376	27,452,528
Stock options exercised (including tax effect of $1,071)	9,000	73,071	-	-	82,071
Net income for the year ended December 31, 2003	-	-	-	2,605,089	2,605,089
Unrealized gain on AFS securities	-	-	1,650	-	1,650
Total comprehensive income					2,606,739
Cash dividends ($.35 per share)	-	-	-	(982,987)	(982,987)
Balance – December 31, 2003	2,808,535	17,805,688	1,650	8,542,478	29,158,351
Stock options exercised (including tax effect of $1,682)	1,125	11,807	-	-	12,932
Stock Redemption	(86,400)	(1,172,520)	-	-	(1,258,920)
Net income for the year ended December 31, 2004	-	-	-	1,715,080	1,715,080
Unrealized gain on AFS securities	-	-	31,810	-	31,810
Total comprehensive income					1,746,890
Cash dividends ($.36 per share)	-	-	-	(995,791)	(995,791)
Balance – December 31, 2004	$ 2,723,260	$ 16,644,975	$ 33,460	$ 9,261,767	$ 28,663,462

Sturgis Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31		
	2004	2003	2002
Cash Flows from Operating Activities			
Net Income	$ 1,715,080	$ 2,605,089	$ 2,790,387
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation	525,146	624,228	605,318
Amortization of mortgage servicing rights	577,507	826,420	1,155,206
Provision for loan losses	811,597	819,709	1,494,916
Deferred income taxes	109,197	176,348	58,334
Accretion and amortization of securities	82,590	95,270	61,319
Gain on sale of loans	(433,824)	(2,743,952)	(2,032,156)
Proceeds from the sale of loans held for sale	35,564,794	126,277,169	108,718,408
Loans originated for sale	(37,344,613)	(118,716,871)	(111,084,772)
Gain on real estate owned	(9,331)	(17,275)	(37,685)
Loss on disposal of premises and equipment	-	48,467	-
Loss of equity in limited partnership	63,952	19,003	63,000
Loss on sale of available-for-sale securities	-	36,342	-
Loss on impairment of investment	-	75,000	-
Increase in cash value of bank owned life insurance	(266,077)	(293,105)	(332,470)
Stock dividend from Federal Home Loan Bank stock	(197,800)	(159,300)	-
Changes in assets and liabilities:			
Increase (decrease) in accrued interest and other assets	76,595	28,404	(429,008)
(Increase) decrease in accrued interest and other liabilities	(6,636)	(8,505)	142,755
Net cash provided by operating activities	1,268,117	9,692,441	1,173,552
Cash Flows from Investing Activities			
Net change in interest-bearing deposits in banks	4,853,027	7,678,913	(12,176,995)
Proceeds from maturities of securities held-to-maturity	415,000	360,000	1,105,000
Purchase of securities held-to-maturity	(310,000)	-	(10,213,700)
Principal reductions of mortgage-backed securities held-to-maturity	1,583,338	1,121,678	361,147
Principal reductions of mortgage-backed securities available-for-sale	2,407,986	-	-
Purchase of securities available-for-sale	(15,000,000)	(13,099,117)	(9,235,451)
Proceeds from sales of securities available-for-sale	-	9,039,025	9,235,451
Net (increase) decrease in loans	(19,111,112)	(5,001,089)	4,022,934
Proceeds from sale of real estate owned	1,186,863	1,323,300	682,839
Purchase of investment in limited partnership	-	(1,050,000)	-
Additions to premises and equipment	(105,691)	(541,881)	(877,138)
Proceeds from the sale of premises and equipment	2,687	23,043	-
Net cash used in investing activities	(24,077,902)	(146,128)	(17,095,913)

Consolidated Statements of Cash Flows (Continued)

	Year Ended December 31		
	2004	2003	2002
Cash Flows from Financing Activities			
Net increase in demand and savings account deposits	5,582,914	9,060,424	6,016,796
Net increase (decrease) in certificates of deposits	5,660,615	(11,704,007)	17,417,173
Repayment of FHLB advances	(15,142,804)	(14,452,264)	(28,367,374)
Proceeds from FHLB advances	15,500,000	5,875,538	22,671,907
Proceeds from repurchase agreements	15,000,000	-	-
Cash dividends paid on common stock	(995,791)	(982,987)	(829,499)
Stock options exercised	11,250	81,000	-
Stock redemption	(1,258,920)	-	(3,005,294)
Net cash provided by (used in) financing activities	24,357,264	(12,122,296)	13,903,709
Net increase (decrease) in Cash and Cash Equivalents	1,547,539	(2,575,983)	(2,018,652)
Cash and Cash Equivalents - Beginning of year	10,495,301	13,071,284	15,089,936
Cash and Cash Equivalents - End of year	**$ 12,042,840**	**$ 10,495,301**	**$ 13,071,284**
Supplemental Information			
Cash paid for:			
Interest	$ 6,284,524	$ 7,274,680	$ 8,471,931
Income taxes	925,000	1,288,033	1,374,118
Noncash Investing and Financing Activities			
Loans transferred to real estate owned	$ 866,127	$ 697,165	$ 1,552,740

Note 1 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation – The consolidated financial statements include the accounts of Sturgis Bancorp, Inc. (Bancorp), Sturgis Bank & Trust Company (Bank) and the Bank's wholly-owned subsidiaries. The Bank's wholly-owned subsidiaries include Oakleaf Financial Services, Inc., Ludington Service Corporation, Inc., and First Michiana Development Corporation of Sturgis, Inc. Accounts of Oak Mortgage, LLC, a subsidiary jointly owned by the Bank and Oakleaf Financial Services, Inc., are also consolidated. All significant intercompany transactions and balances have been eliminated in consolidation.

The Bank, which has been in continuous operation since 1905, formed Bancorp on January 1, 2002 via an equal exchange of common stock of Bank for common stock of Bancorp.

Use of Estimates – In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, and the valuation of real estate owned, deferred tax assets, mortgage servicing rights, and the impairment of goodwill.

Nature of Operations – Bancorp operates predominantly in the southwestern portion of Michigan's lower peninsula. Its primary services include accepting deposits, making commercial and mortgage loans, engaging in mortgage banking activities, and providing investment brokerage advisory services.

Significant Group Concentrations of Credit Risk – Most of Bancorp's activities are with customers located within Southern Michigan. Note 2 discusses the types of securities in which Bancorp invests. Note 3 discusses the types of lending in which Bancorp engages. Bancorp's loan portfolio is concentrated in residential and commercial mortgage loans. Bancorp does not have any significant concentrations to any one industry or customer.

Cash and Cash Equivalents – For the purpose of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold and other short-term investments, all of which mature within ninety days.

Interest-bearing Deposits in Banks - Interest-bearing Deposits in Banks mature within nine years and are carried at cost.

Note 1 – Summary of Significant Accounting Policies (Continued)

Securities – Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost, that are deemed to be other than temporary, are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of Bancorp to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Federal Home Loan Bank Stock – Bancorp's minimum investment in the stock of the Federal Home Loan Bank of Indianapolis (FHLB) is an amount equal to at least 1.0% of the unpaid principal balances of Bancorp's residential mortgage loans or 0.3% of its total assets, whichever is greater. Purchases and sales of stock are made directly with the FHLB at par value. The stock is recorded at cost.

Loans Held for Sale – Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

Loans – Bancorp grants mortgage, commercial, and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well-secured and in the process of collection. In all cases, if collection of principal and interest is considered doubtful, loans are placed on nonaccrual, charged off, or charged down to the fair value of collateral.

When a loan is placed in nonaccrual status, all interest accrued but not collected is reversed against interest income. Interest payments received on loans in nonaccrual status are accounted as reductions to the carrying value of the principal until the loan again qualifies for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses – The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance, when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Note 1 – Summary of Significant Accounting Policies (Continued)

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision with any new information.

The allowance consists of specific, general and unallocated components. The specific components relate to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for quantitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired, based on current information and events, when it is probable that Bancorp will be unable to collect the scheduled payments of principal or interest in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payments status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls are not generally 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 length of the delay, reasons for the delay, the borrower's prior payment history, and the amount of the shortfall in relation to the amount due and collateral value. Impairment on a loan is measured on a loan-by-loan basis for commercial and construction loans. Impairment is the difference between the carrying value of the loan and the loan's obtainable market price, present value of expected future cash flows discounted using the loan's effective interest rate, or the fair value of collateral for collateral-dependent loans.

Large groups of homogenous loans are collectively evaluated for impairment. Accordingly, Bancorp does not separately identify individual consumer and residential loans for impairment disclosures.

Servicing – Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights compared to amortized costs. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

Note 1 – Summary of Significant Accounting Policies (Continued)

Off-Balance Sheet Instruments – In the ordinary course of business, Bancorp has entered into commitments to extend credit, including commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Real Estate Owned – Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in real estate owned expense.

Bank Owned Life Insurance – The Bank has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

Investment in Limited Partnership – Bancorp has investments in limited partnerships that are structured to generate low income housing tax credits and an investment in a Michigan partnership structured to generate commissions from the sale of title insurance. Bancorp accounts for these investments under the equity method, whereby Bancorp annually records its proportionate share of partnership profits and losses as an adjustment to the carrying value of the investment.

Goodwill– Effective January 1, 2002, Bancorp adopted SFAS No. 142, “Goodwill and Other Intangible Assets”, which changed Bancorp’s accounting for goodwill acquired in a business combination. Generally intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill with indefinite lives are not amortized. However, such assets are tested for impairment at adoption of SFAS 142 and at least annually thereafter. There has been no impairment of goodwill.

Premises and Equipment – Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets.

Repurchase Agreements - Bancorp enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, Bancorp transfers legal control over the assets but still retains effective control through an agreement that both entitles and obligates Bancorp to repurchase the assets. As a result, repurchase agreements are accounted for as financing arrangements and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Balance Sheet while the dollar amount of securities underlying the agreements remains in the respective asset accounts as pledged assets.

Note 1 – Summary of Significant Accounting Policies (Continued)

Income Taxes – Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and the tax bases of the various balance sheet assets and liabilities. This method gives current recognition to changes in tax rates and laws. When necessary, valuation allowances are established to reduce deferred tax assets to the amount expected to be realized.

Bancorp is qualified under provisions of the Internal Revenue Code to deduct from taxable income a provision for bad debts in excess of such provision charged to income in the consolidated financial statements. Accordingly, retained earnings at December 31, 2004 and 2003 include approximately $918,000 for which no provision for federal income taxes has been made. Unrecognized deferred taxes on this amount are approximately $312,000. In the future, if this portion of retained earnings is used for any purpose other than to absorb bad debt losses, federal income taxes would be imposed at the then applicable rates.

Stock Compensation Plans – Employee compensation expense under stock option plans is reported using the intrinsic value method. No stock-based compensation cost is reflected in net income. The following table illustrates the effect on net income and earnings per share if expense was measured using the fair value recognition provisions of FASB Statement 123, Accounting for Stock-based Compensation.

Bancorp's reported and pro forma information for the years ended December 31 follows:

	Year ended December 31		
	2004	2003	2002
As reported net income available to common shareholders	$ 1,715,080	$ 2,605,089	$ 2,790,387
Less: stock-based compensation expense determined under fair value method, net of tax	$ -	$ 26,865	$ 93,887
Pro forma net income	$ 1,715,080	$ 2,578,224	$ 2,696,500
As reported earnings per share	$ 0.62	$ 0.93	$ 0.95
Pro forma earnings per share	$ 0.62	$ 0.92	$ 0.92
As reported earnings per diluted share	$ 0.62	$ 0.93	$ 0.95
Pro forma earnings per diluted share	$ 0.62	$ 0.92	$ 0.92

All of Bancorp's outstanding stock option grants are fully vested. Bancorp has no stock option plans with authority for additional grants. However, if Bancorp adopts a new stock option plan and grants options under it, the pro forma disclosures above are not necessarily indicative of future amounts.

Earnings Per Common Share – Basic earnings per share represents income available to common stockholder divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes as outstanding additional common shares that would have been outstanding, if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential shares that may be issued by Bancorp relate solely to outstanding stock options, and are determined using the treasury stock method.

Note 1 – Summary of Significant Accounting Policies (Continued)

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

	Year ended December 31		
	2004	2003	2002
Net income	$ 1,715,080	$ 2,605,089	$ 2,790,387
Weighted average number of common shares outstanding	2,762,294	2,808,461	2,949,874
Effect of dilutive options	5,309	3,007	2,365
Weighted average number of common shares outstanding used to calculate diluted earnings per share	2,767,603	2,811,468	2,952,239

Outstanding non-dilutive options were 95,700 shares at December 31, 2004, 2003, and 2002.

Comprehensive Income – Accounting principles generally require that recognized revenue, expense, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

Legal Contingencies – Various legal claims arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on Bancorp's consolidated financial statements.

Reclassification – Certain amounts appearing in the prior years' financial statements have been reclassified to conform to the current year's financial statements.

Recent Accounting Pronouncement – In December 2004, the FASB re-issued Statement 123 "Accounting for Stock-Based Compensation." The provisions of the reissued statement become effective for the year ended December 31, 2006. This revised statement requires entities to recognize the cost of employee services received in exchange for stock options. The financial statement impact of this pronouncement is not expected to be material.

Note 2 – Securities

The amortized cost and fair value of securities with gross unrealized gains and losses follows:

December 31, 2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Mortgage backed	$ 16,612,732	$ 61,673	$ (10,977)	$ 16,663,428
Held-to-maturity securities:				
Obligations of states and political subdivisions	$ 2,724,283	$ 110,905	$ (8,096)	$ 2,827,092
Mortgage-backed securities	6,021,583	28,919	(46,240)	6,004,262
Other Securities	425,000	75,000	-	500,000
Total securities held-to-maturity	$ 9,170,866	$ 204,824	$ (54,336)	$ 9,331,354

December 31, 2003	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Mortgage backed	$ 4,023,750	$ 2,500	$ -	$ 4,026,250
Held-to-maturity securities:				
Obligations of states and political subdivisions	$ 2,817,060	$ 75,961	$ (5,803)	$ 2,887,218
Mortgage-backed securities	7,696,701	32,474	(20,987)	7,708,188
Other Securities	425,000	-	-	425,000
Total securities held-to-maturity	$ 10,938,761	$ 108,435	$ (26,790)	$ 11,020,406

Note 2 – Securities (Continued)

Securities with a carrying value of $22,459,723 and $1,413,296 were pledged at December 31, 2004 and 2003 respectively to secure U.S. Treasury Tax & Loan payments, FHLB advances, Trust Department activities and repurchase agreements.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2004 are shown below. Actual and expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 109,947	$ 110,399	$ -	$ -
Due after one through five years	895,525	931,830	-	-
Due after five through ten years	306,202	300,303	-	-
Due after ten years	1,837,609	1,909,560	-	-
Total	3,149,283	3,252,092	-	-
Mortgage-backed securities	6,021,583	6,004,262	16,612,732	16,663,428
Total	$ 9,170,866	$ 9,256,354	$16,612,732	$16,663,428

For the years ended December 31, 2004, 2003 and 2002, proceeds from sales of securities available for sale amounted to $0, $9,039,025, and $9,235,451, respectively. Gross realized losses amounted to $0, $36,342, and $0 for the years ended December 31, 2004, 2003, and 2002, respectively. The tax benefit applicable to these net realized losses amounted to $0, $12,356 and $0, respectively.

Information pertaining to the securities with gross unrealized losses at December 31, 2004, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		Twelve or More Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
Mortgage-backed	$ -	$ -	$ 10,977	$ 7,443,953
Held-to-maturity securities:				
Obligations of states and political subdivisions	$ 2,095	$ 320,631	$ 6,001	283,999
Mortgage-backed securities	820	202,138	45,420	3,743,936
Total held-to-maturity Securities	$ 2,915	$ 522,769	$ 51,421	$ 4,027,935

Note 2 – Securities (Continued)

Unrealized losses on securities have not been recognized into income, because the issuers' bonds are of high credit quality, Bancorp has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

Other securities, totaling $4,472,500 and $4,274,700 at December 31, 2004 and 2003, respectively, consist of Federal Home Loan Bank stock. Federal Home Loan Bank stock is carried at cost, which approximates market value.

Note 3 – Loans

A summary of the balances of loans follows:

	December 31	
	2004	2003
Mortgage loans:		
Residential 1-4 family	$ 122,731,229	$ 118,704,063
Commercial	82,771,520	66,409,139
Construction loans – residential	9,873,731	10,174,106
Construction loans – commercial	284,193	4,891,400
Total mortgage loans	215,660,673	200,178,708
Commercial nonmortgage loans	13,764,203	14,784,799
Consumer and installment loans:		
Consumer and installment	7,888,738	8,324,967
Other	1,042,973	1,129,623
Total consumer and installment loans	8,931,711	9,454,590
Subtotal	238,356,587	224,418,097
Less:		
Allowance for loan losses	2,615,566	2,294,157
Unearned interest	13,592	18,262
Undisbursed portion of loans in process - Residential	3,004,576	3,757,494
Undisbursed portion of loans in process - Commercial	127,861	3,138,158
Subtotal	232,594,992	215,210,026
Add:		
Deferred loan origination and other costs, net of fees	365,961	317,539
Loans, net	$ 232,960,953	$ 215,527,565

Note 3 – Loans (Continued)

An analysis of the allowance for loan losses follows:

	December 31		
	2004	2003	2002
Balance – Beginning of year	$ 2,294,157	$ 1,920,037	$ 1,300,000
Provision for loan losses	811,597	819,709	1,494,916
Loans charged off	(642,270)	(516,174)	(950,106)
Recoveries of loans previously charged off	152,082	70,585	75,227
Balance – End of year	$ 2,615,566	$ 2,294,157	$ 1,920,037

The following is a summary of information pertaining to impaired loans:

	December 31		
	2004	2003	2002
Impaired loans with a valuation allowance	$ 3,171,822	$ 3,049,619	$ 971,607
Impaired loans without a valuation allowance	-	-	-
Total impaired loans	$ 3,171,822	$ 3,049,619	$ 971,607
Valuation allowance related to impaired loans	$ 446,120	$ 466,595	$ 265,663
Average investment in impaired loans	$ 3,377,468	$ 3,027,784	$ 1,257,324
Interest income recognized on impaired loans	$ 7,093	$ 134,029	$ 49,937
Interest income recognized on a cash basis on impaired loans	$ 7,093	$ 144,003	$ 47,394

No additional funds are committed to be advanced in connection with impaired loans.

Note 4 – Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheet. The unpaid principal balance of mortgages and other loans serviced for others approximated $213,000,000 and $217,000,000 at December 31, 2004 and 2003, respectively.

The fair values of the rights to service these loans were $2,324,532 and $2,346,913 at December 31, 2004 and 2003, respectively. The fair value of servicing rights was determined using the discount rate of 8% and PSA prepayment speeds of 150%.

The following summarizes the activity in mortgage servicing rights and the related valuation allowance:

	Year ended December 31		
	2004	2003	2002
Mortgage servicing rights:			
Balance at beginning of year	$ 1,974,988	$ 1,501,922	$ 1,281,208
Mortgage servicing rights capitalized	354,214	1,299,486	1,375,920
Mortgage servicing rights amortized	(577,507)	(1,077,998)	(881,354)
Provision for loss in fair value	22,274	251,578	(273,852)
Balance at end of year	$ 1,773,969	$ 1,974,988	$ 1,501,922
Valuation allowance:			
Balance at beginning of year	$ (22,274)	$ (273,852)	$ -
Additions	-	(37,387)	(273,852)
Reductions	22,274	288,965	-
Write-downs	-	-	-
Balance at end of year	$ -	$ (22,274)	$ (273,852)

Note 5 – Real Estate Investment – Limited Partnership

In February 2003, Bancorp acquired 24.75% interest in a limited partnership operating in Elkhart County, Indiana. The limited partnership was formed to construct and operate multi-family housing units. All income, expenses and tax credits will be allocated to Bancorp based upon ownership percentage. As an investor, Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreement that require a majority approval of the limited partners. At such time as the project is sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreement, Bancorp contributed $1,050,000 in cash, and is allocated tax losses and affordable housing federal income tax credits.

Condensed financial information for the investee partnership is summarized as follows:

	December 31 2004	December 31 2003
Balance Sheet:		
Cash	$ 17,159	$ 28,545
Bond fund and development costs	-	14,414,905
Property and land	14,641,056	-
Other assets	63,520	126,851
Total assets	$ 14,721,735	$ 14,570,301
Accrued and other liabilities	$ 479,158	$ 46,261
Bridge loan	2,100,000	2,100,000
Note payable – mortgage	8,900,000	8,900,000
Note payable – developer	2,054,043	1,280,190
Partners' equity	1,188,534	2,243,850
Total liabilities and partners' equity	$ 14,721,735	$ 14,570,301
Net loss	$ 378,651	$ -

Bancorp's share of tax credits generated by the investee partnership totaled $46,124 in 2004. There were no tax credits generated by this investee partnership prior to 2004.

Note 6 – Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follow:

	December 31	
	2004	2003
Land	$ 701,677	$ 701,677
Land improvements	47,465	46,807
Office buildings	6,197,076	6,178,087
Furniture, fixtures and equipment	3,540,867	3,459,929
Total premises and equipment	10,487,085	10,386,500
Less accumulated depreciation	(4,421,404)	(3,898,377)
Net carrying amount	$ 6,065,981	$ 6,488,123

Depreciation expense for the years ended December 31, 2004, 2003 and 2002 amounted to $525,146, $624,228, and $605,318, respectively.

Note 7 – Deposits

Interest-bearing deposit balances at December 31 are summarized as follows:

	Dec. 31, 2004	
	2004	2003
Passbook and savings deposits	$ 46,498,471	$ 43,604,746
NOW accounts	56,882,015	57,534,598
Time:		
$100,000 and over	38,834,917	29,440,282
Under $100,000	53,323,575	57,057,595
Total interest-bearing deposits	$ 195,538,978	$ 187,637,221

At December 31, 2004, the scheduled maturities of time deposits are as follows:

Maturing in the year ending December 31	Under $100,000	$100,000 and over
2005	$ 19,980,236	$ 26,996,559
2006	660,500	7,085,265
2007	7,482,445	10,252,430
2008	6,754,305	5,780,548
2009	3,759,246	2,543,102
Thereafter	198,185	665,671
Total time deposits	$ 38,834,917	$ 53,323,575

Note 8 – Federal Home Loan Bank Advances

The Bank has advances from the Federal Home Loan Bank of Indianapolis (FHLB) of $56,161,866 and $55,804,670 at December 31, 2004 and 2003, respectively, which mature through 2012. At December 31, 2004 and 2003, the interest rates ranged from 1.95 percent to 7.34 percent and from 1.11 percent to 7.34 percent, respectively. The advances are subject to prepayment penalties as defined in the credit policy of FHLB.

The advances are collateralized by securities held in safekeeping at FHLB, performing residential and commercial non-employee mortgage loans. The unpaid principal balance of pledged loans was approximately $154,000,000 and $140,000,000 at December 31, 2004 and 2003, respectively. Mortgage backed securities with a carrying value of $5,581,295 (market value $5,568,702) were held in safekeeping at FHLB and were pledged at December 31, 2004. No securities were pledged as collateral for FHLB advances at December 31, 2003.

Annual payments of FHLB advances are as follows:

	Amount
2005	$ 11,815,794
2006	3,346,072
2007	-
2008	10,000,000
2009	-
2010 and thereafter	31,000,000
	$ 56,161,866

Note 9 – Repurchase Agreements

Repurchase agreements are secured by available-for-sale mortgage-backed securities held by a third party trustee with a carrying value of $16,663,428.

These agreements are fixed rate financing arrangements that, at December 31, 2004, mature in 2005 ($7,500,000) and 2007 ($7,500,000). At maturity, the securities underlying the agreements are returned to Bancorp. Information concerning repurchase agreements is summarized as follows:

	2004
Average daily balance during the year	$ 9,036,885
Average interest rate during the year	2.67%
Maximum month-end balance during the year	15,000,000
Weighted average interest rate at year-end	2.97%

If the fair values of the pledged available-for-sale securities decline, either through principal reductions or market value fluctuations, so that the aggregate fair values is insufficient collateral for the repurchase agreements, additional alternative collateral will be pledged.

Note 10 – Federal Income Taxes

Sturgis Bancorp, Inc. and Subsidiaries file a consolidated federal income tax return. The following is a summary of the provision for income taxes for the three years ended December 31:

	2004	2003	2002
Current expense	$ 756,005	$ 799,666	$ 1,059,595
Deferred expense	109,197	176,348	58,334
Total income tax expense	$ 865,202	$ 976,014	$ 1,117.929

A reconciliation of the difference between total federal income tax expense and the amount computed by applying the statutory tax rates to income before income taxes is as follows:

	2004	2003	2002
Amount computed at statutory rate	$ 877,296	$ 1,217,575	$ 1,328,827
Dividends received deduction	(7,191)	(10,054)	(4,256)
Tax-exempt income from Bank-owned life insurance	(90,466)	(99,655)	(113,040)
Tax-exempt interest income	(47,696)	(51,603)	(58,866)
Low-income housing tax credits	(46,124)	(76,367)	(75,000)
Other, net	179,383	(3,882)	40,264
Total	$ 865,202	$ 976,014	$ 1,117,929

Note 10 – Federal Income Taxes (Continued)

The components of the net deferred tax asset (liability) are as follows:

	2004	2003
Deferred tax assets:		
Investment impairment	$ 25,500	$ 25,500
Allowance for loan losses	626,765	600,611
Other	120,860	10,895
Total deferred tax assets	773,125	637,006
Deferred tax liabilities:		
Deferred loan fees	(166,093)	(232,089)
Mortgage servicing rights	(409,936)	(540,746)
Amortization	(347,820)	(190,940)
Depreciation	(302,366)	(149,949)
FHLB stock dividends	(119,342)	-
Unrealized gain on available-for-sale securities	(17,237)	(850)
Other	(20,630)	(7,147)
Total deferred tax liabilities	(1,383,424)	(1,121,721)
Net deferred tax liability	$ (610,299)	$ (484,715)

Note 11 – Retirement Benefits

Bancorp is a participant in the multi-employer Financial Institutions Retirement Fund (FIRF or the Plan), which covers substantially all of the officers and employees of the Bank and its Subsidiaries. The defined benefit plan provides benefits to all full-time employees with one year of service, based on basic compensation and years of service. Bancorp contributions are determined by FIRF and generally represent the normal cost of the Plan. Specific Plan assets and accumulated benefit information for Bancorp's portion of the Fund are not available. Under the Employee Retirement Income Security Act (ERISA), a contributor to a multi-employer pension plan may be liable in the event of complete or partial withdrawal for the benefit payments guaranteed under ERISA. Bancorp has no present intention to withdraw from the Fund. The expense of the Plan allocated to Bancorp for the years ended December 31, 2004, 2003 and 2002, were $381,040, $239,353 and $194,273, respectively.

The Bank sponsors a non-qualified defined benefit (DB) to provide supplemental retirement benefits for certain executives. These benefits include pre-retirement disability and death benefits, as well as post-retirement payments for 15 years. The following table sets forth the DB activity and other information as of and for the years ended December 31, 2004 and 2003.

	2004	2003
Plan assets at fair value	$ -	$ -
Benefit obligation	213,323	177,280
Underfunded status	$ (213,323)	$ (177,280)
Pension liability	$ 213,323	$ 177,280
Intangible assets	$ 111,683	$ 116,240
Net periodic pension cost	$ 44,241	$ 36,995
Change in minimum liability	$ 111,683	$ 116,240
Actuarial assumptions:		
Weighed average discount rate	6.00%	6.00%
Increase in future compensation levels	4.00%	4.00%

To fund the DB obligation and other employee benefits, the Bank has purchased insurance policies on the lives of certain officers of the Bank. The Bank is owner and beneficiary of these policies. At December 31, 2004 and 2003, the cash value of all bank-owned life insurance policies was $6,894,611 and $6,628,534, respectively. The cash value is available to fund future benefit obligations. There were no supplemental retirement benefits paid by DB during 2004 or 2003. The Bank does not anticipate paying benefits in connection with this plan over the next ten years.

Note 12 – Common Stock and Options

The Bank has had three stock option plans under which grants have been extended to employees and directors.

Director Plan - All options granted under the Director Plan were exercised before December 31, 1988. Because the Director Plan expired in May 1998, no new stock options will be granted under the Director Plan.

Employee Plan – Options granted under the Employee Plan expire ten years after the date of the grant for active and retired employees. If employment is terminated prior to that time for reasons other than death or disability, the options expire 30 days after termination of employment. If employment with the Bank is terminated by reason of death or disability, the options expire 90 days after termination of employment. Unexercised stock option grants under the Employee Plan were 105,351 and 105,726 shares at December 31, 2004 and 2003, respectively. All outstanding options under the Employee Plan became fully vested in 2001. Because the Employee Plan expired in May 1998, no new stock options will be granted under the Employee Plan.

New Director Plan – The New Director Plan provided active directors with stock options that expire 10 years and one day after the grant date. If a grantee ceases to be a director prior to that time for reasons other than death or disability, the options expire 30 days after cessation of director status. If cessation of director status results from death or disability, the options expire ninety days after cessation of director status. Unexercised stock option grants under the New Director Plan were 5,100 and 5,850 at December 31, 2004 and 2003, respectively. Because the New Director Plan expired in December 1999, no new stock options will be granted under the Director Plan.

Note 12 – Common Stock and Options (Continued)

The following is a summary of the activity with respect to Bancorp's stock option plans for the years ended December 31, 2004, 2003 and 2002:

	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding – January 1, 2002	123,851	$ 13.28
Granted	-	-
Cancelled	-	-
Exercised	-	-
Outstanding – December 31, 2002	123,851	13.28
Granted	-	-
Cancelled	(3,275)	13.66
Exercised	(9,000)	9.00
Outstanding – December 31, 2003	111,576	13.62
Granted	-	-
Cancelled	-	-
Exercised	(1,125)	10.00
Outstanding – December 31, 2004	110,451	$ 13.66

For options outstanding at December 31, 2004, the exercise price ranged from $9.00 to $15.88 and the weighted average remaining contractual life of the options was approximately 39 months.

Note 13 – Minimum Regulatory Capital Requirements

Bancorp (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on Bancorp's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Bancorp and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies, such as Bancorp.

Quantitative measures established by regulation to ensure capital adequacy require Bancorp and the Bank to maintain minimum amounts and ratios, as set forth in the following table. Total capital, Tier 1 capital, risk-weighted assets and average assets are measures used to analyze capital adequacy. These measures are defined in federal banking regulations. Ratios must be met regarding total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. At December 31, 2004 and 2003, Bancorp and the Bank met all minimum capital requirements to which they are subject.

At December 31, 2004, the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since December 31, 2004 that management believes have changed the Bank's well-capitalized status.

Note 13 – Minimum Regulatory Capital Requirements (Continued)

Bancorp's and the Bank's actual capital amounts and ratios at December 31, 2004 and 2003 were as follows (000s omitted):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2004:						
Total capital to risk-weighted assets:						
Bancorp	25,847	11.1%	18,656	8.0%	N/A	N/A
Bank	24,139	10.4%	18,621	8.0%	23,277	10.0%
Tier 1 capital to risk-weighted assets						
Bancorp	23,232	10.0%	9,328	4.0%	N/A	N/A
Bank	21,523	9.2%	9,311	4.0%	13,966	6.0%
Tier 1 capital to adjusted total assets						
Bancorp	23,232	7.6%	12,194	4.0%	N/A	N/A
Bank	21,523	7.1%	12,176	4.0%	15,220	5.0%

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2003:						
Total capital to risk-weighted assets:						
Bancorp	26,028	12.5%	16,705	8.0%	N/A	N/A
Bank	25,522	12.3%	16,643	8.0%	20,804	10.0%
Tier 1 capital to risk-weighted assets						
Bancorp	23,734	11.4%	8,352	4.0%	N/A	N/A
Bank	23,228	11.2%	8,321	4.0%	12,482	6.0%
Tier 1 capital to adjusted total assets						
Bancorp	23,734	8.4%	11,248	4.0%	N/A	N/A
Bank	23,228	8.3%	11,229	4.0%	14,036	5.0%

Note 14 – Off-balance Sheet Activities

Credit Related Financial Instruments – Bancorp is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing need of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. To various degrees, such commitments involve elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

Bancorp's exposure to credit loss is represented by the contractual amount of the commitments. Bancorp follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2004 and 2003, the following financial instruments with credit risk were outstanding:

	Contract Amount	
	2004	2003
Commitments to grant loans	$ 6,850,000	$ 12,910,000
Unfunded commitments under lines of credit	32,276,112	33,662,000
Commercial and standby letters of credit	255,000	230,000

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may requirement the payment of fees. These commitments, especially related to equity lines of credit, may expire without being drawn. Therefore the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral secured by Bancorp is based on management's credit evaluation of the customer.

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. The equity and commercial lines of credit are collateralized, may not have a specified maturity date, and may be drawn to the full extent of Bancorp's commitment.

Commercial and standby letters of credit are conditional commitments issued by Bancorp to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit issued by Bancorp have expiration dates within one year.

Collateral Requirements – To reduce credit risk related to the use of credit-related financial instruments, Bancorp might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on Bancorp's credit evaluation of the customer. Collateral types vary, including cash, securities, accounts receivable, inventory, real estate, property, plant and equipment.

If the counterparty does not have the right or ability to redeem the collateral or Bancorp is permitted to sell or repledge the collateral on short notice, Bancorp records the collateral in its balance sheet at fair value with a corresponding obligation to return it.

Note 14 – Off-balance Sheet Activities (Continued)

Commitments - During 2003, Bancorp committed to purchase an investment for $250,000 in a venture capital company. Advances on this commitment totaled $37,500 and $25,000 during the years ended December 31, 2004 and 2003, respectively. At December 31, 2004, $212,500 remains committed to the purchase of this investment. Bancorp owns approximately 1.23% of the venture capital company and accounts for the investment under the equity method.

Note 15 – Related Party Transactions

In the ordinary course of business, Bancorp has granted loans to principal officers, directors and affiliates. A summary of the related party loan transactions for the years ended December 31, 2004 and 2003 is as follows:

	2004	2003
Related party loans - beginning of the year	$ 1,726,521	$ 1,379,152
Advances	36,678	1,153,570
Principal repayments	(498,925)	(806,201)
Related party loans – end of the year	$ 1,264,274	$ 1,726,521

Deposit from related parties held by the Bank at December 31, 2004 and 2003 approximated $6,800,000 and $6,000,000, respectively.

A Director of Bancorp is the majority stockholder in a law firm that provides legal counsel to Bancorp and its subsidiaries. Legal fees and disbursements to the law firm totaled $195,000, $189,000, and $132,000 for 2004, 2003, and 2002, respectively.

Note 16 – Fair Value 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 Bancorp'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. SFAS 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of Bancorp.

The following methods and assumptions were used by Bancorp in estimating fair value disclosures for financial instruments:

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

Note 16 – Fair Value of Financial Instruments (Continued)

Interest-bearing Deposits in Banks - The carrying amounts of interest-bearing deposits maturing within ninety days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Securities - Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market prices. The carrying value of Federal Home Loan Bank stock and other securities approximate fair value based on the redemption provisions of the Federal Home Loan Bank. If quoted market prices are not available, fair values are based on quoted market prices of comparable investment.

Mortgage loans held for sale - Fair values of mortgage loans held 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, as adjusted for estimated credit losses. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

FHLB Advances - The carrying amount of short-term FHLB advances is a reasonable estimate of their fair value due to their variable interest rates and short-term maturities. The estimated fair value of long-term FHLB is determined by discounting the future cash flows of outstanding advances using rates currently available on advances from the FHLB with similar characteristics.

Repurchase Agreements - The estimated fair value of repurchase agreements is determined by discounting the future cash flows of outstanding advances using rates currently available on similar instruments.

Accrued Interest - The carrying amounts of accrued interest approximate fair value.

Off-balance Sheet Instruments - Fair values for off-balance-sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Note 16 – Fair Value of Financial Instruments (Continued)

The estimated fair values and related carrying or notional amounts of Bancorp's financial instruments are as follows (000s omitted):

	2004		2003	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 12,043	$ 12,043	$ 10,495	$ 10,495
Interest-bearing deposits in banks	10,486	10,535	15,339	15,560
Held-to-maturity investment securities	9,171	9,256	10,939	11,020
Available-for-sale investment securities	16,663	16,663	4,026	4,026
FHLB stock	4,473	4,473	4,275	4,275
Loans held for sale	3,535	3,576	1,322	1,323
Loans in portfolio, net	232,961	233,549	215,528	218,153
Accrued interest receivable	1,641	1,641	1,591	1,591
Financial liabilities:				
Deposits	211,164	212,174	199,920	202,203
Accrued interest payable	732	732	679	679
FHLB advances	56,162	57,674	55,805	57,932
Repurchase agreements	15,000	14,966	-	-

Note 17 – Condensed Financial Statements of Parent Company

The financial statements of the parent company as of December 31, 2004 and 2003 are presented below:

Balance Sheet

	December 31	
	2004	2003
Assets:		
Cash and due from banks	$ 978,928	$ 194,547
Investment in limited partnership	29,551	25,000
Advances to Bank	142,211	21,133
Dividends receivable Bank	1,000,000	-
Other assets	263,686	748,425
Investment in Bank	26,955,238	28,653,111
Total assets	$ 29,369,614	$ 29,642,216
Liabilities and stockholders' equity:		
Deferred federal income taxes	$ 593,062	$ 483,865
Other liabilities	113,090	-
Total liabilities	706,152	483,865
Stockholders' equity	28,663,462	29,158,351
Total liabilities and stockholders' equity	$ 29,369,614	$ 29,642,216

Note 17 – Condensed Financial Statements of Parent Company (Continued)

Statement of Income	Year Ended December 31,		
	2004	2003	2002
Revenue			
Dividend from Bank	$ 3,740,614	$ 2,500,000	$ 3,000,000
Interest income on federal tax refund	-	761	-
Total revenue	3,740,614	2,500,761	3,000,000
Operating expenses			
Compensation expense	69,456	-	-
Stockholder expenses	191,118	50,828	92,861
Professional fees	105,329	87,644	82,999
Other	47,289	39,315	41,237
Total operating expenses	413,192	177,787	217,097
Income before income taxes and equity in undistributed net income of Bank	3,327,422	2,322,974	2,782,903
Applicable income tax provision (benefit)	(117,340)	(61,260)	(73,813)
Income before equity in undistributed net income of Bank	3,444,762	2,384,234	2,856,716
Under (Over) distributed net income of Bank	(1,729,682)	220,855	(66,329)
Net income	$ 1,715,080	$ 2,605,089	$2,790,387

Note 17 – Condensed Financial Statements of Parent Company (Continued)

Statement of Cash Flows	Year Ended December 31,		
	2004	2003	2002
Cash flows from operating activities:			
Net income	$ 1,715,080	$ 2,605,089	$ 2,790,387
Adjustments to net income to net cash from operating activities:			
Equity in over- (under-) distributed net income of Bank	1,729,682	(220,855)	66,329
Loss in equity of limited partnership	7,949	-	-
Deferred income taxes	109,197	176,348	58,334
Increase in dividends receivable	(1,000,000)	-	-
Decrease (increase) in other assets	484,740	(654,299)	(328,808)
Increase in other liabilities	114,773	1,071	-
Net cash provided by operating activities	3,161,421	1,907,354	2,586,242
Cash flows from investing activities:			
Purchase of investment in limited partnership	(12,500)	(25,000)	-
Cash flows from financing activities:			
Stock redeemed	(1,258,920)	-	(3,005,294)
Stock options exercised	11,250	81,000	-
Proceeds from advance from Sturgis Bank & Trust Company	-	-	1,248,551
Payments on advance from Sturgis Bank & Trust Company	(121,079)	(785,820)	-
Cash dividends paid on common stock	(995,791)	(982,987)	(829,499)
Net cash used in financing activities	(2,364,540)	(1,687,807)	(2,586,242)
Net increase in cash and cash equivalents	784,381	194,547	-
Cash and cash equivalents – beginning of year	194,547	-	-
Cash and cash equivalents – end of year	$ 978,928	$ 194,547	$ -

Note 18 – Restrictions on Dividends

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to Bancorp. The total amount of dividends that may be paid at any date is generally limited to the retained earnings of the Bank. However dividends paid by the Bank would be prohibited, if the effect thereof would cause the Bank's capital to be reduced below applicable minimum standards. At December 31, 2004, the Bank's retained earnings available for the payment of dividends was $1,373,401. Accordingly, approximately $25,582,000 of Bancorp's investment in the Bank was restricted at December 31, 2004.

Loans or advances made by the Bank to Bancorp are generally limited to 10% of the Bank's capital stock and surplus and require the pledging of collateral.

Note 19 – Quarterly Financial Data (Unaudited)

	2004			
	1Q	2Q	3Q	4Q
Interest income	$ 3,584,583	$ 3,611,704	$ 3,795,314	$3,904,685
Interest expense	1,542,624	1,500,512	1,645,138	1,649,598
Net interest income	2,041,959	2,111,192	2,150,176	2,255,087
Provision for loan losses	248,767	200,724	121,782	240,324
Securities gain (loss)	-	-	-	-
Net income	395,716	395,813	552,437	371,114
Earnings per share:				
Basic	0.14	0.14	0.20	0.14
Diluted	0.14	0.14	0.20	0.14

	2003			
	1Q	2Q	3Q	4Q
Interest income	$ 4,089,947	$ 3,922,503	$ 3,648,691	$3,584,457
Interest expense	1,905,733	1,792,753	1,688,769	1,630,018
Net interest income	2,184,214	2,129,750	1,959,922	1,954,439
Provision for loan losses	318,688	710,787	53,600	(263,366)
Securities gain (loss)	-	-	-	(36,632)
Net income	764,976	558,059	716,801	565,253
Earnings per share:				
Basic	0.27	0.20	0.26	0.20
Diluted	0.27	0.20	0.26	0.20

Note 20 – Subsequent Events

A special meeting of Bancorp's shareholders was held on February 22, 2005 to vote on termination of Bancorp's registration under the Securities Exchange Act of 1934. The termination required reduction of the number of shareholders of record to fewer than 300. The proposed transaction was structured as a merger into a newly-formed, wholly-owned subsidiary of Bancorp with and into Bancorp. Under the terms of the Agreement and Plan of Merger, each share of common stock owned by a record holder of fewer than 500 shares immediately prior to the effective time of the merger would be converted into the right to receive $16.00 per share in cash, and each share of common stock owned by a record holder of 500 or more shares would remain outstanding as Bancorp common stock after the merger. At the meeting, shareholders approved the proposal with 1,542,772 shares voted in favor of the transaction, or 90.78% of shares voting. The effective time of the transaction was 5:00 PM, Eastern Time, February 22, 2005. Accordingly, approximately 200,000 shares of common stock were cancelled in the first quarter of 2005 with a transfer of $3.3 million from equity to accounts payable.