

ANNUAL REPORT

2012

welcome to community banking.



## **Annual Shareholder Meeting**

May 7, 2013 at 5:00 p.m.

Comfort Inn & Conference Center ▪ 2424 S. Mission St., Mt. Pleasant, MI 48858

## **Mission Statement**

To create an operating environment that will provide shareholders with sustained growth in their investment while maintaining our independence and subsidiaries' autonomy.

## **Equal Employment Opportunity**

The equal employment opportunity clauses in Section 202 of the Executive Order 11246, as amended; 38 USC 4212, Vietnam Era Veterans Readjustment Act of 1974; Section 503 of the Rehabilitation Act of 1973, as amended; relative to equal employment opportunity and implementing rules and regulations of the Secretary of Labor are adhered to and supported by Isabella Bank Corporation and its subsidiaries.





*Richard J. Barz, Chief Executive Officer & David J. Maness, Chairman*



# welcome to community banking.

In 2012, our company achieved several milestones - \$2.05 billion in assets under management, net income of \$12.21 million, and total per share cash dividends of \$0.80. We could not have accomplished this without you. It is the support of our customers, shareholders, and employees that prove every day, without a doubt, community banking is alive and well.

## **STRESSING THE IMPORTANCE OF INDEPENDENCE**

The challenging economy and the intense regulatory environment have both taken their toll on the financial industry. Just five years ago, there were 8,560 FDIC insured banks in the United States, and today, this number has fallen by 16% to 7,181. This statistic certainly paints a picture of the consolidation happening in our industry. On a positive note, it is

gratifying to see that we have not only made it through these tough times, but we have been profitable and delivered a consistent return to our shareholders.

Despite this consolidation trend, our vision is to remain independent. Our organization feels so strongly about independence that it is written directly

into our strategic plan and shared with all employees. We recognize that in order for us to remain independent, we need to continue to build customer relationships, grow in new and existing markets, and deliver consistent returns to our shareholders.

### **POSITIONING OURSELVES FOR THE FUTURE**

Our strategic plan is a vital ingredient to the future success and sustainability of our organization. It outlines our core values and lays the groundwork for where we plan to go in the future. By sharing this vision with all employees, they become active participants in helping us achieve our goals.

An important component of our strategic plan is employee development. Over the past several years we have strategically focused resources to this area and we are now recognized not only statewide, but nationally, for the success we have achieved. Investing in our greatest asset, our employees, directly impacts the quality of service we provide to our customers and the financial growth and profitability of our company.

### **BANKING WITH LOCAL DECISION MAKERS**

When it comes to selecting a bank, customers have many options. In order to stand out from the competition,

we need to offer something different and better. Our competitive advantage is our local decision making. This cannot be said for all banks where, in some cases, out-of-state bankers make the decisions. We believe that by empowering our employees, we are able to better serve the needs of our customers within their communities. This has paid-off for us over and over again as we hear positive remarks from our customers and experience growth which surpasses most of our competitors.

**"Investing in our greatest asset, our employees, directly impacts the quality of service we provide to our customers and the financial growth and profitability of our company."**

### **LEVERAGING ORGANIC GROWTH AND EXPANDING INTO NEW MARKETS**

In the June 2012 FDIC reports, we were the deposit leader in 12 of our 19 communities. We ranked second in three other markets. Last year, our overall market deposits grew by 6.21% as a result of our organic

growth within our current locations and new market expansion initiatives.

Within our own markets, we have tremendous opportunities to attract new customers and to build deeper relationships with those already with us. We want our customers to think of us beyond their checking account needs and to be the first bank that comes to mind when they remodel their

## **Grand Opening with a Twist in Freeland.**

Ribbon-cutting ceremonies and special rates are standard practices for grand opening celebrations. In October, when we opened our Freeland Office, we decided to add a twist to the festivities. We selected four different local non-profit organizations and asked them to be part of our "Community Counts" project. Then we invited the Freeland community to cast their vote for one of these organizations. The group with the most votes (Barton Woods) received \$1,500 and the other three organizations (Freeland Cognitive Learning Center, CAN Council and Junior Achievement) took home \$750 each.



home, start a business, or plan for retirement. We are able to measure our progress by monitoring the number of households we serve and the number of products and services each customer has with us. In 2012, we are proud to say we grew in both of these areas.

Our expansions into new markets have also proven successful. As of December 31, 2012, our Midland office had \$23.62 million and Freeland had \$2.49 million in deposits. We are very appreciative to those customers who have given the new bank in town the opportunity to serve their financial needs.

### DELIVERING A RETURN TO OUR SHAREHOLDERS

In 2012, we celebrated 31 years of consecutive dividend growth. Given the challenges facing our industry, few banks can say the same thing. The good news is that our industry, as a whole, is getting stronger. A recent report from the FDIC indicated that sixty percent of all financial institutions showed an increase in their net income during the fourth quarter of 2012 compared to the same period in 2011.

On behalf of our Board and employees, thank you for your support in 2012. We look forward to seeing you at our annual shareholder meeting on May 7, 2013 at the Comfort Inn and Conference Center in Mt. Pleasant. ■

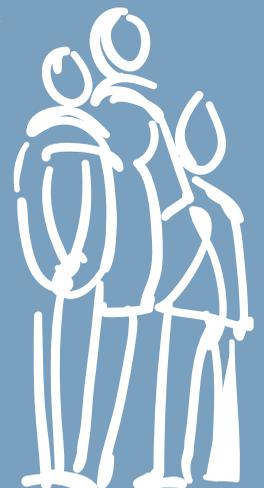
## Recognizing the Contributions of Our Employees

We would like to take this opportunity to recognize our officer promotions in December. Mrs. Deb Campbell (Shareholder Services) and Mr. Aaron Wirsing (Accounting) were promoted to Vice Presidents. Mrs. Deb Markley (Breckenridge), Mrs. Connie Katt (Retail Lending), and Mr. Miles Coffland (Investment & Trust Services) were promoted to Assistant Vice Presidents. Mr. Bob Byram (Commercial Lending) and Mr. Pat Netzley (Commercial Lending) were promoted to Business Development Officers and Mrs. Nora Colthorp (Hemlock) was promoted to Branch Officer. In addition, Mr. Jerome Schwind has moved from Big Rapids to Mt. Pleasant and taken on the role of Chief Integration Officer. We also welcomed Mr. Keith Kenney to the Bank to serve as President of our Mecosta Division.

We would also like to recognize Mr. Steven Pung who was promoted to President of Isabella Bank last July. Steve has played a very important role in the growth and development of our Bank over the past 34 years. His experience and wisdom will guide the Bank into the future.

Our congratulations to Tom Wallace, President of Isabella Bank's Northern Division, and Jeff Smith, Vice President of Commercial Lending, on their recent graduation from the Graduate School of Banking - Madison.

## Community Counts







*Dennis P. Angner, President  
& Chief Financial Officer*

## **In 2012, Isabella Bank Corporation's net income was \$12.21 million, an increase of \$2.0 million when compared to 2011.**

This 19.55% increase in net income is primarily attributed to the strategic restructuring of certain investment securities/borrowings in the first quarter of 2012 and the significant increase in the gain on the sale of residential mortgages to the secondary market.

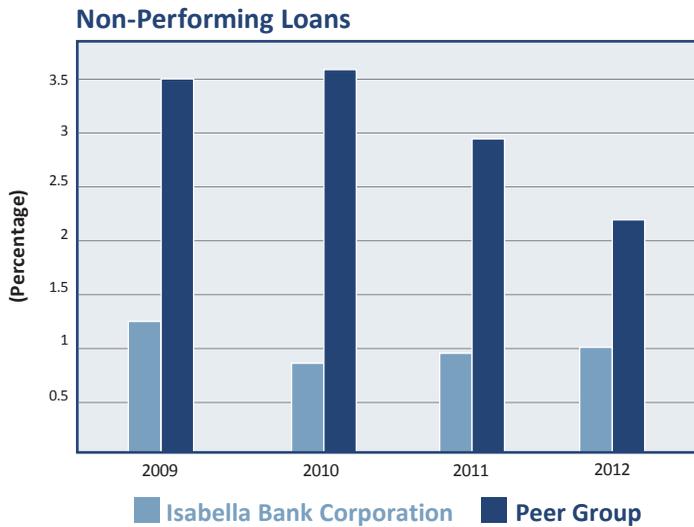
Our loan quality for the Corporation continues to be solid. As of December 31, 2012, the percentage of the total loans classified as "non-performing" was 1.00%.

### **2012 Financial Highlights**

#### *Safe, Growing and Profitable*

- Record net income in 2012 of \$12.21 million, a 19.55% increase over 2011
- Assets at year end 2012 of \$1.43 billion, a 6.93% increase over 2011
- Total assets under management at year end was \$2.05 billion, a 5.96% increase over 2011. This includes loans sold and serviced and assets managed by our Investment and Trust Services Department.
- Record Earnings Per Share of \$1.61
- Cash Dividends of \$0.80 per share, a 5.26% increase over 2011

The graph below shows the Corporation's percentage of non-performing loans compared to our peer group over the past four years.



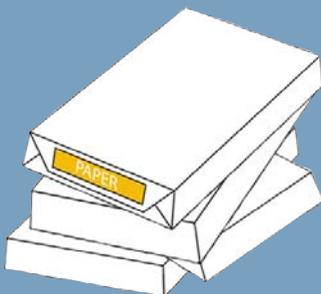
The Consumer Financial Protection Bureau (CFPB) was created under the Dodd-Frank Act. In 2013, the bureau issued final regulations which impacted both the origination and subsequent servicing of mortgages. The new regulations were drafted to protect consumers from harmful mortgage products, foreclosure practices, and other unethical practices. However, these rules may also unintentionally restrict or even eliminate services that customers have used for years. As a result, banks may have less flexibility when working with unique customer circumstances and have higher costs associated with providing mortgage loans. Communication of these changes by banks to their customers and communities will be key during this transition.

The Federal Reserve has proposed new capital requirements which, if adopted, would require banks to hold more capital as a percentage of assets. It would also dramatically increase the amount of capital banks would need to hold for residential real estate loans under the proposed new risk based capital requirements. We are fortunate to have maintained a solid base of capital and are hopeful that these proposed rules will have a minimal effect on us in the future.

Over the past five years, the Federal Reserve has reduced the short-term borrowing rate to near zero and kept long-term interest rates at historically low levels. For consumers, this policy reduces the interest rate paid by borrowers at the expense of savers. For financial institutions, it has placed additional pressure on interest margins.

This dynamic is having a negative effect on the Corporation's interest income. The Corporation has been inundated with loan requests from commercial and residential mortgage customers to lower their interest rates over the past 18 months. Fifteen year mortgage rates are around 2.50% and a six year car loan is 2.94%. It is challenging to maintain a 4.0% margin when lending at these rates.

While the Corporation's assets grew by \$92.7 million last year, we anticipate our 2013 net interest income to increase by less than 1.0%. As a result of the decline in interest margins, we anticipate that 2013 earnings might decline slightly from the tremendous 19.55% increase in 2012. We, like all banks, continue to face new regulations and shrinking margins but I am confident our community bank is prepared to meet these challenges. ■



*project paper*



Our schools work very hard to stretch their dollars. This past fall, we had a wonderful opportunity to help our schools while promoting our new Facebook page at the same time. We called the contest Project Paper. For every "like" our page received, we donated a ream of paper to a local school. As a result, we delivered 2,400 reams (1.2 million sheets) of paper to schools in our area.

## Peer Group Comparison

Regularly sharing our peer group information is important as it gives insight into our financial strength and compares us to other bank holding companies across the country. Isabella Bank Corporation has consistently performed well in comparison to our peers. It is also important to note that the financial performance of the peer group has rebounded from 2008 which is good for the growth of the American economy.

We subscribe to reports that compare the financial performance of Isabella Bank Corporation to other bank holding companies in the United States who are similar in size (\$1.0 billion-\$3.0 billion in assets). In all, there are 351 bank holding companies in our peer group. There are several key ratios that we use to monitor the strength and soundness of Isabella Bank Corporation: (1) Return on Assets; (2) Problem Loans; (3) Risk Based Capital to Risk Weighted Assets; and (4) Problem Loans to Allowance for Bad Debt.

### Return on Assets (ROA)

**Isabella Bank Corporation 0.88%**  
**Peer Group 0.80%**

This measures net income by the average asset size of the bank holding company. Our ROA exceeded the peer group by 0.08%.

### Problem Loans (Nonperforming)

**Isabella Bank Corporation 1.00%**  
**Peer Group 2.19%**

This measures the percent of loans that are over 90 days past due and still accruing, or placed in non-accrual because collection is doubtful. Our total problem loans as a percentage of loans is 1.00% compared to 2.19% for our peer group. The peer group average is over two times higher than Isabella Bank Corporation.

### Risk Based Capital to Risk Weighted Assets

**Isabella Bank Corporation 14.48%**  
**Peer Group 15.41%**

This measures the amount of capital held against risk based assets. The Corporation's ratio of 14.48% is strong when compared to the required ratio of 8.00% necessary to be considered adequately capitalized under the Federal Reserve Board's risk based capital rules. The Corporation continues to be profitable, well capitalized and has funds available to meet our customers' borrowing needs.

### Allowance for Bad Debt to Problem Loans (Nonperforming)

**Isabella Bank Corporation 154.39%**  
**Peer Group 121.08%**

Allowance for Bad Debt to Problem Loans measures the amount of reserves needed for probable loan losses on non-performing loans. We have \$1.54 in reserves for every \$1.00 of nonperforming loans, which means we have more in reserves than we have problem loans.



With a total of 2,400 reams of paper, Isabella Bank donated enough paper to surpass the vertical clearance on the Mackinaw Bridge!

152  
146

# Celebrating a Culture Rich in Philanthropy.

Whether it is during or after work, our employees do a wonderful job serving our local communities. In fact, they feel so strongly about community involvement, that they created an internal website last year to help increase awareness surrounding community organizations and volunteer opportunities.

Together, our employees volunteered over 4,300 hours with more than 150 different community organizations last year. In addition, they reached more than 8,400 children, teens, adults and senior citizens with their financial literacy efforts. These numbers speak volumes for our employees and their focus on their communities.

**"Culture is what defines your organization, the base, the foundation from which you build. It is the fabric of your organization and each employee represents the threads that weave the fabric."**

**- Rick Barz**



(Photos Left to Right) Dave King, Isabella Bank Breckenridge Division Board Member (left) and Nora Colthorp, Isabella Bank Hemlock Branch Officer (right) presented Dan Keane, Hemlock Farmers Market (center) with a donation to be used for the new Hemlock Farmers Market Barn.



Isabella Bank made a donation to the College of Business at Central Michigan University in Mt. Pleasant to create the Isabella Bank Institute for Entrepreneurship. Pictured (left to right) are Jae Evans, Isabella Bank Chief Operations Officer, Rick Barz, Isabella Bank Corporation Chief Executive Officer, Steve Pung, Isabella Bank President and Dr. Chuck Crespy, Dean of the College of Business Administration.

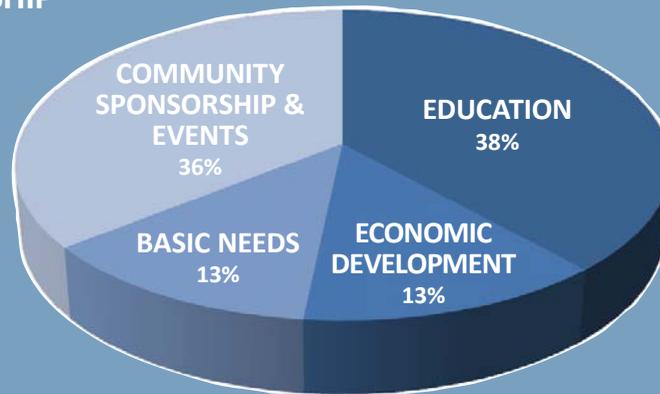
Vice President Greg Mapes serves members of the community at the 2012 Shareholder Barbeque at the Comfort Inn in Mt. Pleasant.

Isabella Bank employees volunteer their time organizing bidder information, auction items and checking out individuals to help raise funds for the Clare Sports Boosters.

# 2012 Community Giving

## COMMUNITY SPONSORSHIP & EVENTS

Festivals, Expos & County Fairs  
Customer Appreciation Days  
Service Organization Support



## EDUCATION

Financial Literacy  
Scholarships for High School Seniors  
Building Campaigns  
After School Programs  
Athletic Boosters

## BASIC NEEDS

Food  
Shelter  
Healthcare  
Senior Services  
Emergency Relief

## ECONOMIC DEVELOPMENT

Community Projects  
Leadership Development  
Entrepreneurship Programs

(Photos Left to Right) Assistant Vice President Sue Hansen and Consumer Loan Processor Kim Wilson serve customers refreshments during their annual Customer Appreciation Day in Greenville.



Isabella Bank employees Mary Welsh and Nancy Stabenow volunteer their time organizing bidder information, auction items and checking out individuals to help raise funds for the Goodrow Foundation in Mt. Pleasant.



Mecosta Division President Keith Kenney and Assistant Vice President Josh Eling present a donation to Cindy Havens, Director of the Mecosta-Osceola Red Cross, to help aid Mecosta area Flood Victims.



Isabella Bank employees donated monetary funds, diapers, laundry detergent and other household cleaning supplies to the Department of Human Services (DHS) during the holiday season. Pictured with donations are Isabella Bank employee Kerri Hansen and DHS representative Andi Pelligrini.

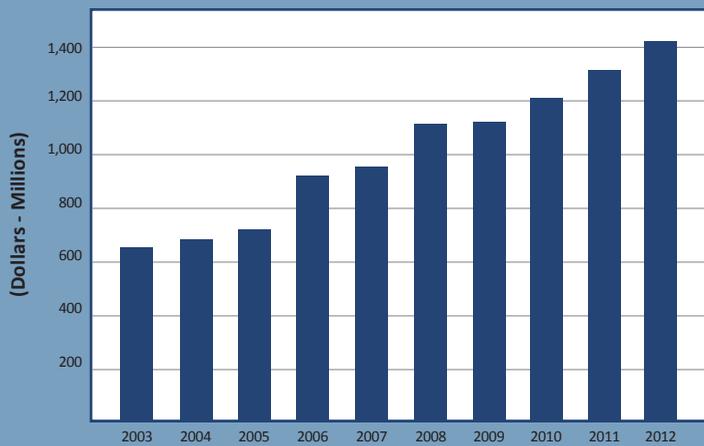


# Financial Highlights

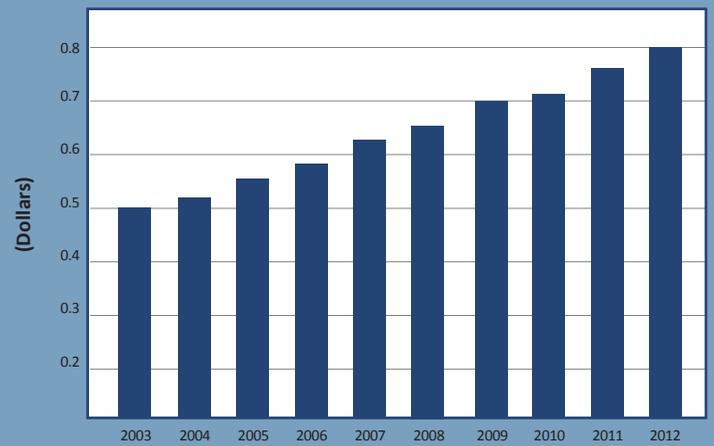
(Dollars in thousands except per share data)

	2012	2011	2010	2009	2008
<b>Income Statement Data</b>					
Total Interest Income	\$ 56,401	\$ 57,905	\$ 57,217	\$ 58,105	\$ 61,385
Net Interest Income	\$ 42,978	\$ 41,702	\$ 40,013	\$ 38,266	\$ 35,779
Provision for Loans Losses	\$ 2,300	\$ 3,826	\$ 4,857	\$ 6,093	\$ 9,500
Net Income	\$ 12,206	\$ 10,210	\$ 9,045	\$ 7,800	\$ 4,101
<b>Balance Sheet Data</b>					
End of Year Assets	\$ 1,430,639	\$ 1,337,925	\$ 1,225,810	\$ 1,143,944	\$ 1,139,263
Daily Average Loans	\$ 754,304	\$ 743,441	\$ 725,534	\$ 725,299	\$ 717,040
Daily Average Assets	\$ 1,381,083	\$ 1,287,195	\$ 1,182,930	\$ 1,127,634	\$ 1,113,102
Daily Average Deposits	\$ 984,927	\$ 927,186	\$ 840,392	\$ 786,714	\$ 817,041
Daily Average Equity	\$ 160,682	\$ 151,379	\$ 145,304	\$ 137,910	\$ 142,597
<b>Per Share Data</b>					
Basic	\$ 1.61	\$ 1.35	\$ 1.20	\$ 1.04	\$ 0.55
Diluted	\$ 1.56	\$ 1.31	\$ 1.17	\$ 1.01	\$ 0.53
Cash Dividends	\$ 0.80	\$ 0.76	\$ 0.72	\$ 0.70	\$ 0.65
Market Value (at year end)	\$ 21.75	\$ 23.70	\$ 17.30	\$ 18.95	\$ 25.50
Tangible Book Value (at year end)	\$ 14.72	\$ 13.90	\$ 13.22	\$ 12.67	\$ 12.27
<b>Financial Ratios</b>					
Shareholders' Equity to Assets (at year end)	11.50%	11.57%	11.84%	12.31%	11.80%
Return on Average Equity	7.60%	6.74%	6.22%	5.66%	2.88%
Return on Average Tangible Equity	11.41%	10.30%	9.51%	8.53%	4.41%
Cash Dividend Payout to Net Income	49.76%	56.51%	59.93%	67.38%	118.82%
Return on Average Assets	0.88%	0.79%	0.76%	0.69%	0.37%

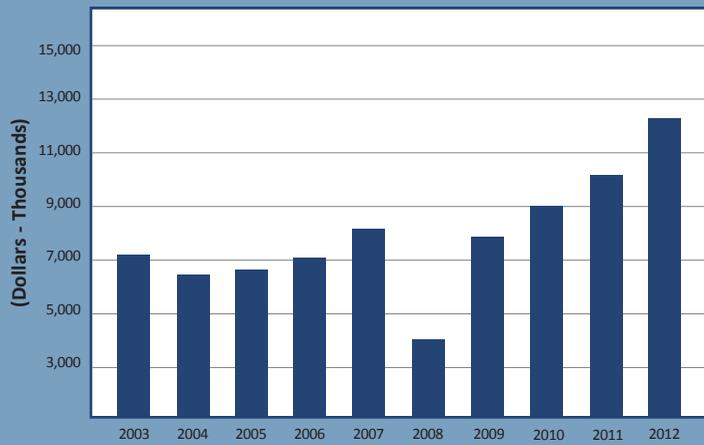
### Total Assets



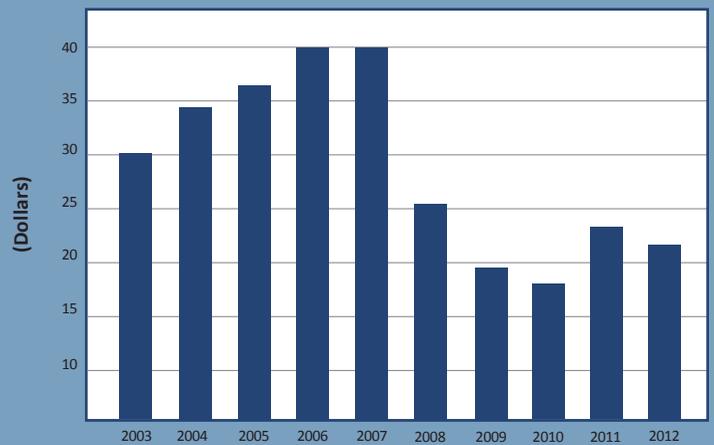
### Dividends Per Share



### Net Income



### Ending Stock Price



# Board of Directors & Senior Officers



David J. Maness



Richard J. Barz



Dennis P. Angner



Jeffrey J. Barnes, MD



Sandra L. Caul



G. Charles Hubscher



Joseph LaFramboise



Wilson C. Lauer



Thomas L. Kleinhardt



W. Joseph Manifold, CPA



W. Michael McGuire



Sarah R. Opperman

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President, Maness Petroleum Corporation

**RICHARD J. BARZ**  
Chief Executive Officer,  
Isabella Bank Corporation

**DENNIS P. ANGNER**  
President and Chief Financial Officer,  
Isabella Bank Corporation

**JEFFREY J. BARNES, MD**  
Physician and Partner,  
Lansing Ophthalmology, PC

**SANDRA L. CAUL**  
State Representative (retired)

**G. CHARLES HUBSCHER**  
President, Hubscher and Son, Inc.

**JOSEPH LaFRAMBOISE**  
Sales and Marketing Executive,  
Ford Motor Company (retired)

**WILSON C. LAUER**  
Principal, Lauer Farms LLC

**THOMAS L. KLEINHARDT**  
President, McGuire Chevrolet

**W. JOSEPH MANIFOLD, CPA**  
Chief Financial Officer,  
Federal Broach & Machine Co.

**W. MICHAEL MCGUIRE**  
Director of the Office of the Corporate  
Secretary, The Dow Chemical Company

**SARAH R. OPPERMAN**  
Principal, Opperman Consulting LLC

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DENNIS P. ANGNER  
President and Chief Financial Officer

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PEGGY L. WHEELER  
Senior Vice President

DEBRA A. CAMPBELL  
Vice President

CYNTHIA J. DIEHM  
Vice President

GREGORY S. MAPES  
Vice President

PATRICIA A. PLAXTON  
Vice President

AMY C. VOGEL  
Vice President

AARON D. WIRSING  
Vice President

### Isabella Bank Officers

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President

JAE A. EVANS  
Chief Operations Officer

JEROME E. SCHWIND  
Chief Integration Officer

DAVID J. REETZ  
Chief Lending Officer

BARBARA B. DIEHM  
Senior Vice President

DANIEL E. EVERSOLE  
Senior Vice President

JAMES L. BINDER  
Vice President

JULIE F. BOLT  
Vice President

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Vice President

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Vice President

PEGGY L. WHEELER  
Vice President

LEO R. WICKERT  
Vice President

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DAVID J. KING  
WILSON C. LAUER  
TIMOTHY M. MILLER  
KIRK L. SMITH  
GREGORY V. VARNER

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President

BRIAN K. GOWARD  
Vice President

BARBARA K. MCKENZIE  
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LARRY R. SCHOFIELD  
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Vice President

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Vice President

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Dr. RALPH P. CREW  
KEVIN J. DEFEVER  
LAWRENCE E. EMIG  
KEITH E. KENNEY  
JOSEPH LaFRAMBOISE  
STEVEN D. PUNG  
JEROME E. SCHWIND

### Mecosta Division Officers

KEITH E. KENNEY  
President

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JAE A. EVANS  
THOMAS L. KLEINHARDT  
JOSEPH LaFRAMBOISE  
W. MICHAEL MCGUIRE  
DAVID J. MANESS  
TIMOTHY M. MILLER  
STEVEN D. PUNG  
JONATHAN J. WAINWRIGHT

### Financial Group Information Services Officers

JONATHAN J. WAINWRIGHT  
President

JULIE A. HUBER  
Vice President

# Recognizing our Board Retirees and New Directors



James C. Fabiano

We would like to recognize two retirements from our Board in 2012: Mr. James C. Fabiano and Mr. Dale D. Weburg. On behalf of the Isabella Bank Corporation and Isabella Bank Boards, we would like to express our sincere appreciation to these individuals for their dedication and service to our Bank. Both Mr. Fabiano's and Mr. Weburg's strong leadership qualities, astute business sense and passion for our local communities have been tremendous assets to our Bank. We wish them the very best in their retirement as they devote more time to their own businesses.



Dale D. Weburg

Mr. Fabiano had been a director of Isabella Bank since 1979 and the Corporation since 1988. He served as the Corporation's Chairman from 2004 to 2010. Most recently, he served on the Loan, Nominating and Corporate Governance and Compensation and Human Resource Committees.

Mr. Weburg had served as a director of the Breckenridge Division of the Bank since 1987 and the Bank and Corporation Boards since 2000. Most recently, he served as chairman of our technology subsidiary, Financial Group Information Services as well as served on the Board's Compensation and Human Resource Committee.



Sarah R. Opperman

In 2012, we welcomed two highly respected members of our communities to our Board, Ms. Sarah Opperman and Mr. Wilson Lauer.

Ms. Opperman owns her own company, which provides public affairs counsel for corporate clients. Previously, she was employed by The Dow Chemical Company for 28 years, where she held leadership roles in public and government affairs. A life-long resident of mid-Michigan, Ms. Opperman is active in the community, serving on the Central Michigan University Board of Trustees and CMU Research Corporation Board of Directors. She also is a member of the MidMichigan Health Corporate Board, the Midland United Way and First United Methodist Church. She and her husband, Dan, reside in Midland.



Wilson C. Lauer

Mr. Lauer has served as a director for the Isabella Bank Breckenridge Division Board since 1997 and he is the owner of Lauer Farms LLC, a 2,500 acre cash crop business. Over the years, Mr. Lauer has served several different community organizations including the Ithaca School District Board, the Gratiot Economic Development Board, and Farm Bureau's County and State Policy Development Committees. He is currently on the board of directors for Resurrection Life Church and Victory Christian Outreach. He and his wife, Connie, reside in Ithaca.

## Isabella Bank Employee Retirements

**KEN HOWELL** - 40 years  
Vice President, Consumer Loans  
Breckenridge

**PAT OMAN** - 29 years  
Assistant Vice President, Loan Officer  
Farwell

**KAY BLACKMAN** - 23 years  
New Accounts Representative  
Breckenridge

**DIANE COURTER** - 21 years  
Customer Service Representative, Bookkeeping  
Mt. Pleasant

**PAM COVEY** - 15 years  
Customer Service Representative  
& New Accounts  
Mt. Pleasant

**PAT GIBSON** - 9 years  
Teller  
Big Rapids

**SUE STRAHOTA** - 4 years  
Loan Officer  
Clare

## Shareholder Services

For Information, Contact Debra Campbell  
(989) 779-6237 | 401 N. Main St., Mt. Pleasant, MI 48558  
or visit [www.isabellabank.com](http://www.isabellabank.com) ► Investors

## Stock Information

Isabella Bank Corporation common stock is traded in the over the counter market. The common stock is quoted on the OTCQB tier of the OTC Markets Group, Inc.'s electronic quotation system ([www.otcm Markets.com](http://www.otcm Markets.com)) under the symbol "ISBA". Other trades in the common stock occur in privately negotiated transactions from time to time of which the Corporation may have little or no information. Current stock price and availability can be obtained by contacting a licensed broker or through the Investment and Trust Services Department at Isabella Bank. To learn more about Isabella Bank Corporation, visit the Investors tab at [www.isabellabank.com](http://www.isabellabank.com) or contact Shareholder Services.

## Investing in Our Future

Our employees and directors have a vested interest in the success of our organization. As of December 31, 2012, our employees, directors and their families owned approximately 15% of our outstanding shares.

## Investors Tab - [www.isabellabank.com](http://www.isabellabank.com)

- Stock Price Information
- Email Alerts on Closing Stock Price
- Direct Stock Repurchase Plan
- Dividend Reinvestment
- Current News



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