



**DENMARK BANCSHARES, INC.**  
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Quarterly Report on Form 10-Q  
For the Quarter Ended June 30, 2012

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**Item 1. Financial Statements*****Denmark Bancshares, Inc. and Subsidiaries  
Consolidated Statements of Financial Condition***

	June 30, 2012 <u>(Unaudited)</u>	December 31, 2011 <u></u>
<b>Assets</b>		
Cash and due from banks	\$16,031,893	\$21,905,812
Federal funds sold	6,394,000	20,187,000
Investment securities available-for-sale, at fair value	78,031,000	67,610,693
Loans	304,594,002	297,832,116
Allowance for loan losses	<u>(6,585,076)</u>	<u>(6,578,087)</u>
Net loans	\$298,008,926	\$291,254,029
Loans held for sale	446,865	485,926
Premises and equipment, net	7,202,209	7,085,783
Other investments, at cost	2,741,480	4,404,811
Accrued interest receivable	1,325,211	1,244,473
Other assets	<u>11,358,733</u>	<u>11,807,370</u>
<b>TOTAL ASSETS</b>	<b><u>\$421,540,317</u></b>	<b><u>\$425,985,897</u></b>
<b>Liabilities</b>		
Deposits		
Noninterest-bearing	\$41,278,673	\$47,469,622
Interest-bearing	<u>283,088,777</u>	<u>280,323,469</u>
Total Deposits	\$324,367,450	\$327,793,091
Short-term borrowings	11,085,931	11,558,861
Accrued interest payable	304,726	334,178
Other liabilities	1,778,831	1,794,808
Long-term debt	<u>27,065,399</u>	<u>28,481,999</u>
<b>Total Liabilities</b>	<b><u>\$364,602,337</u></b>	<b><u>\$369,962,937</u></b>
<b>Stockholders' Equity</b>		
Common stock, no par value, authorized 640,000 shares; outstanding 118,568 shares at 6/30/12 and 118,917 shares at 12/31/11	\$18,173,975	\$18,173,975
Treasury stock shares, at cost (2,962 at 6/30/12 and 2,613 at 12/31/11)	(2,272,445)	(2,125,865)
Paid in capital	469,986	469,986
Retained earnings	40,729,316	39,918,706
Accumulated other comprehensive loss	<u>(162,852)</u>	<u>(413,842)</u>
Total Stockholders' Equity	<u>\$56,937,980</u>	<u>\$56,022,960</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$421,540,317</u></b>	<b><u>\$425,985,897</u></b>

The accompanying notes are an integral part of these financial statements.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
(Unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
<b>Interest Income</b>				
Loans including fees	\$3,847,577	\$3,935,613	\$7,633,587	\$7,924,196
Investment securities:				
Taxable	299,697	302,294	578,127	547,217
Exempt from federal tax	184,435	251,676	378,840	575,871
Interest on federal funds sold	2,487	3,504	7,136	10,973
Other interest income	25,804	19,209	66,894	72,897
	<u>\$4,360,000</u>	<u>\$4,512,296</u>	<u>\$8,664,584</u>	<u>\$9,131,154</u>
<b>Interest Expense</b>				
Deposits	\$589,242	\$769,912	\$1,223,911	\$1,592,260
Short-term borrowings	15,524	27,894	30,378	57,351
Long-term debt	242,115	254,824	488,541	506,010
	<u>\$846,881</u>	<u>\$1,052,630</u>	<u>\$1,742,830</u>	<u>\$2,155,621</u>
Net interest income	\$3,513,119	\$3,459,666	\$6,921,754	\$6,975,533
<b>Provision for Loan Losses</b>				
Net interest income after provision for loan losses	<u>\$3,363,119</u>	<u>\$3,309,666</u>	<u>\$6,621,754</u>	<u>\$6,675,533</u>
<b>Other Income</b>				
Service fees and commissions	\$216,590	\$238,604	\$524,101	\$447,415
Loan sale gains	117,266	39,628	235,070	119,099
Investment security gains	0	31,953	0	31,953
Other	170,895	198,691	341,218	401,215
	<u>\$504,751</u>	<u>\$508,876</u>	<u>\$1,100,389</u>	<u>\$999,682</u>
<b>Other-than-Temporary Impairment Losses, Net</b>				
Total other-than-temporary impairment losses	\$77,620	\$46,536	\$1,742,488	\$963,226
Amount in other comprehensive income, before taxes	(33,310)	33,817	(1,665,303)	(858,399)
	<u>\$44,310</u>	<u>\$80,353</u>	<u>\$77,185</u>	<u>\$104,827</u>
<b>Other Expense</b>				
Salaries and employee benefits	\$1,598,446	\$1,497,646	\$3,178,316	\$3,012,800
Occupancy expenses	222,410	239,011	450,503	484,046
FDIC Insurance	75,000	81,000	149,463	246,000
Data processing expenses	170,586	194,752	413,122	392,954
Professional fees	108,407	87,743	196,057	185,332
Amortization of intangibles	48,098	48,098	96,196	96,196
Loss on sale of other real estate	103,216	11,371	163,200	17,891
Other real estate expenses	2,125	74,615	21,033	154,195
Other operating expenses	248,289	252,276	447,822	449,068
	<u>\$2,576,577</u>	<u>\$2,486,512</u>	<u>\$5,115,712</u>	<u>\$5,038,482</u>
Income before income taxes	\$1,246,983	\$1,251,677	\$2,529,246	\$2,531,906
Income tax expense	425,493	383,481	859,018	750,845
<b>NET INCOME</b>	<u>\$821,490</u>	<u>\$868,196</u>	<u>\$1,670,228</u>	<u>\$1,781,061</u>
<b>Per Share</b>				
Net income	\$6.93	\$7.30	\$14.07	\$14.98
Dividends declared	\$7.25	\$7.25	\$7.25	\$7.25
<b>Weighted average shares outstanding</b>	118,568	118,917	118,733	118,917

The accompanying notes are an integral part of these financial statements.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
(Unaudited)

	For the Six Months Ended	
	June 30, 2012	June 30, 2011
Net income	\$1,670,228	\$1,781,061
Other comprehensive income (loss), net of tax		
Unrealized gains on securities		
Unrealized holding gains arising during period	436,368	232,101
Plus: Reclassification adjustment for losses included in net income	77,185	72,874
Other comprehensive income	513,553	304,975
Income tax (expense) benefit related to items of other comprehensive income	(262,563)	(104,555)
Other comprehensive income (loss), net of tax	\$250,990	\$200,420
Comprehensive income	\$1,921,218	\$1,981,481

**Denmark Bancshares, Inc. and Subsidiaries**  
**Consolidated Statement of Changes in Stockholders' Equity**  
(Unaudited)

	Common Stock		Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance, December 31, 2011	118,917	\$16,048,110	\$469,986	\$39,918,706	(\$413,842)	\$56,022,960
Comprehensive income						
Net income				1,670,228		1,670,228
Other comprehensive income, net of tax						
Change in unrealized loss on securities available-for-sale, net of reclassification adjustment					250,990	250,990
Total comprehensive income						\$1,921,218
Treasury stock acquisitions	(349)	(146,580)				(146,580)
Cash dividends declared, \$7.25 per share				(859,618)		(859,618)
Balance, June 30, 2012	118,568	\$15,901,530	\$469,986	\$40,729,316	(\$162,852)	\$56,937,980

The accompanying notes are an integral part of these financial statements.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(Unaudited)

	For the Six Months Ended June 30,	
	2012	2011
<b><i>Cash Flows from Operating Activities:</i></b>		
Net income	\$1,670,228	\$1,781,061
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	189,564	202,047
Provision for credit losses	300,000	300,000
Amortization of intangibles	96,196	96,196
Gains on sales of loans	(235,070)	(119,099)
Loss on sale of other real estate	163,200	17,891
Gains on sale of securities	0	(31,953)
Loss on investment securities impairment writedowns	77,185	104,827
Amortization of bond premium	375,346	216,675
Accretion of bond discount	(43,608)	(87,181)
Mortgage loans originated for sale	(15,069,875)	(7,127,170)
Proceeds from sale of mortgage loans	15,344,005	10,570,599
Income from bank owned life insurance	(133,752)	(130,070)
Increase in interest receivable	(80,738)	(41,517)
Decrease in interest payable	(29,452)	(26,666)
Other, net	(152,551)	58,705
Net Cash Provided by Operating Activities	\$2,470,678	\$5,784,345
<b><i>Cash Flows from Investing Activities:</i></b>		
Maturities and sales of available-for-sale securities	\$12,713,004	\$15,542,834
Purchases of available-for-sale securities	(23,028,681)	(20,937,094)
Money market mutual funds, net	0	(34,037)
Proceeds from sale of FHLB common stock	1,663,331	0
Federal funds sold, net	13,793,000	5,773,000
Proceeds from sale of foreclosed assets	296,534	652,908
Net (increase) decrease in loans made to customers	(7,151,896)	4,036,446
Capital expenditures	(305,990)	(34,880)
Net Cash Provided by (Used in) Investing Activities	(\$2,020,698)	\$4,999,177
<b><i>Cash Flows from Financing Activities:</i></b>		
Net decrease in deposits	(\$3,425,641)	(\$10,289,256)
Purchase of treasury stock	(146,580)	0
Dividends paid	(862,148)	(862,148)
Debt proceeds	1,777,070	1,795,815
Debt repayments	(3,666,600)	(2,775,000)
Net Cash Used in Financing Activities	(\$6,323,899)	(\$12,130,589)
Net decrease in cash and cash equivalents	(\$5,873,919)	(\$1,347,067)
Cash and cash equivalents, beginning	21,905,812	16,917,728
CASH AND CASH EQUIVALENTS, ENDING	\$16,031,893	\$15,570,661
<b><i>Noncash Investing Activities:</i></b>		
Loans transferred to foreclosed properties	\$97,000	\$805,992
<b><i>Supplemental Cash Flow Disclosures:</i></b>		
Cash paid for interest	\$1,775,042	\$1,621,871
Cash paid for income taxes	717,000	471,980
The accompanying notes are an integral part of these financial statements.		

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

**NOTE 1 – FINANCIAL STATEMENTS**

The consolidated financial statements included herein are unaudited. In the opinion of management, these statements contain all adjustments necessary to present fairly the financial position of Denmark Bancshares, Inc. (“DBI”), its results of operations and cash flows for the periods presented. All adjustments necessary for the fair presentation of the financial statements are of a normal recurring nature. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in DBI’s latest annual report on Form 10-K. DBI’s subsidiaries are Denmark State Bank (“DSB”), Denmark Agricultural Credit Corporation (“DACC”), and DBI Properties, Inc. (“Properties”).

**Reclassifications** – Certain amounts in the prior period financial statements have been reclassified for comparative purposes to conform to the presentation in the current year.

**NOTE 2 – INVESTMENT SECURITIES**

The amortized cost and estimated fair market value of securities available-for-sale were as follows:

	June 30, 2012			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Government-sponsored agencies	\$3,500,000	\$7,500	(\$10,000)	\$3,497,500
U.S. Government-sponsored agency MBS	40,003,709	646,642	(13,119)	40,637,232
State and local governments	27,005,486	1,220,423	(70,213)	28,155,696
Residential mortgage-backed securities	7,793,224	22,261	(2,074,913)	5,740,572
	<u>\$78,302,419</u>	<u>\$1,896,826</u>	<u>(\$2,168,245)</u>	<u>\$78,031,000</u>
	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government-sponsored agencies	\$3,500,000	\$17,050	\$0	\$3,517,050
U.S. Government-sponsored agency MBS	31,729,409	505,292	(8,172)	32,226,529
State and local governments	24,628,519	1,032,038	(192,058)	25,468,499
Residential mortgage-backed securities	8,537,737	26,590	(2,165,712)	6,398,615
	<u>\$68,395,665</u>	<u>\$1,580,970</u>	<u>(\$2,365,942)</u>	<u>\$67,610,693</u>

Proceeds of \$4.2 million from calls and \$3.7 million from normal pay-downs were received during the second quarter of 2012. On a year-to-date basis for 2012, proceeds of \$7.0 million from normal pay-downs, \$5.2 million from calls and \$0.5 million in maturities were received. Purchases for the quarter-ended June 30, 2012 comprised \$4.0 million in agency mortgage-backed securities (“MBS”), \$2.9 million of tax-exempt municipals, \$1.2 million in taxable municipals and \$1.0 million of agencies. For the six-months ended June 30, 2012 purchases of \$15.1 million in agency MBS, \$3.0 million of agencies, \$2.9 million of tax-exempt municipals and \$2.0 million of taxable municipals were made.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

The amortized cost and estimated fair values of securities at June 30, 2012, by maturity were as follows:

Amounts Maturing	Securities Available-for-Sale	
	Amortized Cost	Estimated Fair Value
Within one year	\$5,045,845	\$5,090,937
From one through five years	40,670,020	40,453,753
From five through ten years	20,775,223	20,713,760
After ten years	11,811,331	11,772,550
	<u>\$78,302,419</u>	<u>\$78,031,000</u>

MBS are allocated according to their expected prepayments rather than their contractual maturities. Certain state and local governments' securities are allocated according to their put date. Fair values of securities are estimated based on financial models or prices paid for similar securities. It is possible interest rates could change considerably resulting in a material change in the estimated fair value of the securities.

At June 30, 2012, twenty-four debt securities have unrealized losses with aggregate depreciation of 11.1% from DSB's amortized cost basis. Information pertaining to securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

June 30, 2012	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Securities Available for Sale				
U.S. Government-sponsored agencies	\$10,000	\$990,000	\$0	\$0
U.S. Government-sponsored agency MBS	13,119	4,666,042	0	0
State and local governments	39,832	6,476,056	30,381	380,152
Residential mortgage-backed securities	0	0	2,074,913	4,909,496
Total securities available for sale	<u>\$62,951</u>	<u>\$12,132,098</u>	<u>\$2,105,294</u>	<u>\$5,289,648</u>

December 31, 2011	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Securities Available for Sale				
U.S. Government-sponsored agency MBS	\$8,172	\$2,388,919	\$0	\$0
State and local governments	14,144	817,753	177,914	1,808,504
Residential mortgage-backed securities	0	0	2,165,712	5,359,064
Total securities available for sale	<u>\$22,316</u>	<u>\$3,206,672</u>	<u>\$2,343,626</u>	<u>\$7,167,568</u>

All securities with unrealized losses are assessed to determine if the impairment is other-than-temporary. Factors that are evaluated include the mortgage loan types supporting the securities, delinquency and foreclosure rates, credit support, weighted average loan-to-value, and year of origination, among others.

Currently, a quarterly analysis by a third party is performed on three residential MBS secured by non-traditional loan types in order to determine whether they are other-than-temporarily impaired ("OTTI"). The purpose of the third party evaluation is to determine if the present value of the expected cash flows is less than the amortized costs, thereby resulting in credit loss, in accordance with the authoritative accounting guidance under *FASB ASC Topic 320*. The third party determines an estimated fair value for each security based on discounted cash flow analyses. The estimates are based on the following key valuation assumptions – collateral cash flows, prepayment assumptions, default rates, loss severity, liquidation lag, bond waterfall and internal rate of return. Since there is currently no active secondary market for these types of securities due to the non-traditional loan types supporting the securities, these valuations are considered Level 3 inputs as defined in Note 5 – Fair

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

Value Measurement. Additional securities may be analyzed in the future if deemed necessary to determine whether they are OTTI and if so, if any possible credit loss exists.

Two of the three securities supported by non-traditional loan types were previously found to have credit losses since a portion of the unrealized losses is due to an expected cash flow shortfall. As such, these securities were determined to be OTTI. DBI does not intend to sell the investments and it is not more likely than not that DBI will be required to sell the securities before the anticipated recovery of their remaining amortized cost bases, which may be maturity. The analysis on the third security did not reveal any credit loss nor was the security found to be OTTI. The total credit loss that was recognized in earnings through December 31, 2011 was \$0.6 million. The analysis performed as of June 30, 2012 resulted in an additional \$44,310 of credit loss that was recorded through the income statement during the current period on one of the OTTI securities. This results in a total credit loss for the first six months of 2012 of \$77,185 being recognized. Unrealized losses on the three securities analyzed by the third party were recognized through accumulated other comprehensive loss on the balance sheet as of June 30, 2012, net of tax, in the amount of \$1.2 million.

The unrealized losses on the remainder of the residential MBS are due to the distressed and illiquid markets for collateralized mortgage obligations. The securities are investments in senior tranches with adequate credit support from subordinate tranches, are supported by traditional mortgage loans that originated between 2002 and 2005, have low delinquency and foreclosure rates, and reasonable loan-to-value ratios. DBI does not consider these investments to be OTTI at June 30, 2012.

Changes in credit losses recognized for securities with OTTI were as follows:

	For the Six Months Ended		For the Year
	June 30,		Ended
	2012	2011	December 31, 2011
Credit losses recognized in earnings, beginning of period	(\$637,245)	(\$432,488)	(\$432,488)
Credit losses for OTTI not previously recognized	(77,185)	(104,827)	(204,757)
Credit losses recognized in earnings, end of period	<u>(\$714,430)</u>	<u>(\$537,315)</u>	<u>(\$637,245)</u>

**NOTE 3 – LOANS**

Loans are reported at the principal amount outstanding, net of the allowance for credit losses. Interest on loans is calculated and accrued by using the simple interest method on the daily balance of the principal amount outstanding. Loan origination fees are credited to income when received and the related loan origination costs are expensed as incurred. Capitalization of the fees net of the related costs would not have a material effect on the consolidated financial statements.

DBI's customer information system tracks the past due status of all loans beginning with the first day a payment is late. On a weekly basis, lenders are given a report with all loans past due one day or more to allow them to actively monitor the portfolio and attempt to keep past due levels to a minimum.

All loans are given an internal risk rating when the loan is originated. On a quarterly basis, risk rating reports are distributed to the lenders to ensure that loans are appropriately rated. On an annual basis, all commercial loans over \$100,000 and agricultural loans over \$200,000 are reviewed by the loan officer and/or credit analyst. All loans over \$1 million are independently reviewed annually by the Chief Credit Officer. An independent third party also performs periodic reviews of risk ratings to ensure that loans are accurately graded. The internal risk ratings are defined as:

- *Non-classified loans* are assigned a risk rating of 1 – 4, with a one-rated credit being the highest quality. Non-classified loans have credit quality that ranges from well above average quality to some inherent industry weaknesses that may present higher than average risk due to conditions affecting the borrower, the borrower's industry or economic environment.
- *Special mention loans* are assigned a risk rating of 5. Potential weaknesses exist that deserve management's close attention. If left uncorrected, the potential weaknesses may result in deterioration of repayment prospects or in DSB's credit position at some future date.
- *Substandard loans* are assigned a rating of 6. These loans are inadequately protected by the current worth and borrowing capacity of the borrower. Well-defined weaknesses exist that may jeopardize the liquidation of the debt. There is a possibility of some loss if the deficiencies are not corrected. At this point, the loan may still be performing and accruing.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

- *Doubtful loans* are rated 7 and have all the weaknesses of a substandard credit plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of current facts, conditions and values highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonable specific pending factors, which may work to the advantage of strengthening the asset, its classification as an estimated loss is deferred until its more exact status can be determined.
- *Loss loans* are internally rated as an 8. A loss amount has been determined and this has been charged-off against the allowance for loan losses. All or a portion of the charge-off may be recovered in the future and any such recoveries would also be recorded through the allowance.

DBI's policy is to place into nonaccrual status all loans that are contractually past due 90 days or more, along with other loans as to which reasonable doubt exists to the full and timely collection of principal and/or interest based on management's view of the financial condition of the borrower. When a loan is placed on nonaccrual, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Loan charge-offs for all loans will occur as soon as there is a reasonable probability of loss. When the amount of the loss can be readily calculated, the charge-off will be recorded as soon as practical within the calendar quarter the loss was identified. Loans that are partially charged-off will be placed in nonaccrual status unless the remaining loan is restructured with adequate collateral and payments are assured and current.

A loan is impaired when, based on current information and events, it is probable that not all amounts due will be collected according to the contractual terms of the loan agreement. Interest income is recognized in the same manner described above for nonaccrual loans. Further detail on the analysis of impaired loans can be found in the discussion of the Allowance for Loan Losses, below.

#### **Allowance for Loan Losses**

The allowance for loan losses is an estimate of the losses that have been incurred in the loan portfolio. The allowance is based on two basic accounting principles: (1) *FASB Accounting Standards Codification (ASC) Topic 310-10 "Receivables – Overall,"* (formerly FAS 114), which requires that losses be accrued when it is probable that DBI will not collect all principal and interest payments according to the loan's contractual terms, and (2) *FASB ASC Topic 450, "Contingencies,"* (formerly FAS 5), which requires that losses be accrued when they are probable of occurring and estimable. The FFIEC "Interagency Policy Statement on the Allowance for Loan and Lease Losses" provides additional guidance on the allowance methodology.

On a quarterly basis, management utilizes a systematic methodology to determine an appropriate allowance for loan losses. This methodology includes a loan grading system that requires quarterly reviews; identification of loans to be evaluated on an individual basis for impairment; results of independent reviews of asset quality and the adequacy of the allowance by regulatory agencies; consideration of current trends and volumes of nonperforming, past-due, nonaccrual and potential problem loans; as well as national and local economic trends and industry conditions.

In applying the methodology, all troubled debt restructurings, regardless of size, are considered impaired and will be individually evaluated. All nonaccrual and watchlist commercial real estate, construction and land development, agricultural real estate, multifamily residential real estate, commercial, and agricultural production loans over \$50,000 are evaluated individually to determine if they are impaired. Nonaccrual residential real estate or consumer loans with characteristics that differ from loans that are typical for DBI will also be considered impaired and evaluated individually as there would be no pool of similar loans to evaluate these loans under *ASC Topic 450*. Impaired loans are measured at the estimated fair value of the collateral. If the estimated fair value of the impaired loan is less than the recorded investment in the loan, an impairment is recognized by creating a valuation allowance in conjunction with *ASC Topic 310-10*.

Loans that are not impaired are segmented into groups by type of loan. The following loan types are utilized so each segment of loans will have similar risk factors: (1) residential real estate, (2) agricultural real estate, (3) commercial real estate, (4) construction and land development, (5) commercial, (6) agricultural, (7) consumer, (8) guaranteed loans and (9) other. These loans are further segmented by internal risk ratings of non-classified, special mention, substandard and doubtful, which are defined above.

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

Risk factor percentages are applied to the risk rating segments of the non-impaired loans to calculate an allowance allocation in conjunction with *ASC Topic 450*. The risk factor percentages are based on historical loan loss experience for each loan type and are adjusted for current economic conditions and trends as well as internal loan quality trends. The historical loan loss percentages are applied to the non-classified portion of the portfolio to determine the required allocation to the allowance. The historical loan loss percentages are then multiplied by a factor based on current economic conditions to calculate the allocation for each of the remaining risk rating categories of the non-impaired loans. The current economic conditions take into account items such as vacancy rates for rental properties; property values based on actual sales transactions; income projections based on current prices such as dairy commodities; and other available economic data.

The above steps result in calculations that estimate the loan losses inherent in the portfolio at that time. The calculations are used to confirm the adequacy and appropriateness of the actual balance of the allowance, recognizing that the allowance represents an aggregation of judgments and estimates by management. Such calculations will influence the amount of future provisions for loan losses charged to expense.

The calculation is submitted to DSB's Board of Directors quarterly along with a recommendation for the amount of the monthly provision to the allowance. If the mix and amount of future charge-offs differ significantly from those assumptions used by management in making its determination, the allowance and provision expense could be materially affected.

Major categories of loans included in the loan portfolio are as follows:

	June 30, 2012	December 31, 2011
Real Estate:		
Residential	\$71,534,648	\$72,655,569
Commercial	60,709,030	60,864,761
Agricultural	82,213,621	78,767,692
Construction	10,503,737	11,655,550
	<u>224,961,036</u>	<u>223,943,572</u>
Commercial	40,285,836	35,178,049
Agricultural	28,810,254	27,661,420
Consumer and other	10,536,876	11,049,075
TOTAL	<u>\$304,594,002</u>	<u>\$297,832,116</u>

**Denmark Bancshares, Inc. and Subsidiaries**  
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The following table presents information related to the average recorded investment and interest income recognized on impaired loans for the six months ended June 30, 2012 and June 30, 2011:

<i>\$(000)s</i>	<b>Six months ended June 30, 2012</b>		<b>Six months ended June 30, 2011</b>	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b><i>With no related allowance:</i></b>				
Residential Real Estate	\$1,640	\$10	\$573	\$5
Commercial Real Estate	2,184	15	1,862	11
Construction & Land Dev	440	3	2,344	52
Agricultural Real Estate	0	0	246	2
Commercial	954	7	950	6
Agricultural	0	0	0	0
Consumer	0	0	44	1
<b><i>With a related allowance:</i></b>				
Residential Real Estate	\$1,011	\$11	\$1,282	\$7
Commercial Real Estate	2,434	22	4,122	8
Construction & Land Dev	4,497	26	1,962	45
Agricultural Real Estate	0	0	0	0
Commercial	41	0	42	0
Agricultural	0	0	116	0
Consumer	143	0	149	0
<b><i>Total:</i></b>				
Residential Real Estate	\$2,651	\$21	\$1,855	\$12
Commercial Real Estate	4,618	37	5,984	19
Construction & Land Dev	4,937	29	4,306	97
Agricultural Real Estate	0	0	246	2
Commercial	995	7	992	6
Agricultural	0	0	116	0
Consumer	143	0	193	1
Total	\$13,344	\$94	\$13,692	\$137

**Denmark Bancshares, Inc. and Subsidiaries**  
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The following tables show the investment in impaired loans and the corresponding allowance for those loans as of June 30, 2012 and December 31, 2011:

<b>Impaired Loans</b>			
<i>\$(000)s</i>	Recorded	Unpaid	Related
<b>June 30, 2012</b>	<u>Investment</u>	<u>Principal</u>	<u>Allowance</u>
<b>Unpaid</b>	<b>Investment</b>	<b>Balance</b>	<b>Allowance</b>
<b>With no related allowance:</b>			
Residential Real Estate	\$1,472	\$1,626	\$0
Commercial Real Estate	1,910	2,176	0
Construction & Land Dev	260	260	0
Agricultural Real Estate	0	0	0
Commercial	1,031	1,086	0
Agricultural	0	0	0
Consumer	0	0	0
<b>With a related allowance:</b>			
Residential Real Estate	\$918	\$1,009	\$144
Commercial Real Estate	1,930	2,257	580
Construction & Land Dev	4,459	4,484	926
Agricultural Real Estate	0	0	0
Commercial	37	41	13
Agricultural	0	0	0
Consumer	140	142	127
<b>Total:</b>			
Residential Real Estate	\$2,390	\$2,635	\$144
Commercial Real Estate	3,840	4,433	580
Construction & Land Dev	4,719	4,744	926
Agricultural Real Estate	0	0	0
Commercial	1,068	1,127	13
Agricultural	0	0	0
Consumer	140	142	127
Total	<u>\$12,157</u>	<u>\$13,081</u>	<u>\$1,790</u>

**Denmark Bancshares, Inc. and Subsidiaries**  
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<i>\$(000)s</i>	Recorded	Unpaid	Related
<b>December 31, 2011</b>	Investment	Principal	Allowance
<b>With no related allowance:</b>	<u>          </u>	<u>          </u>	<u>          </u>
Residential Real Estate	\$805	\$841	\$0
Commercial Real Estate	1,433	1,698	0
Construction & Land Dev	2,658	2,658	0
Agricultural Real Estate	0	0	0
Commercial	890	935	0
Agricultural	0	0	0
Consumer	43	43	0
 <b>With a related allowance:</b>			
Residential Real Estate	\$1,190	\$1,392	\$171
Commercial Real Estate	2,482	2,615	721
Construction & Land Dev	2,832	2,832	580
Agricultural Real Estate	0	0	0
Commercial	38	41	14
Agricultural	0	0	0
Consumer	142	144	129
 <b>Total:</b>			
Residential Real Estate	\$1,995	\$2,233	\$171
Commercial Real Estate	3,915	4,313	721
Construction & Land Dev	5,490	5,490	580
Agricultural Real Estate	0	0	0
Commercial	928	976	14
Agricultural	0	0	0
Consumer	185	187	129
Total	<u>\$12,513</u>	<u>\$13,199</u>	<u>\$1,615</u>

**Recorded Investment in Financing Receivables**  
**June 30,**

<i>\$(000)s</i>	<u>2012</u>		<u>2011</u>		<u>December 31, 2011</u>	
	Ending Balance	Ending Balance	Ending Balance	Ending Balance	Ending Balance	Ending Balance
	Individually	Individually	Individually	Individually	Individually	Individually
	Evaluated	Evaluated	Evaluated	Evaluated	Evaluated	Evaluated
	for Impairment	for Impairment	for Impairment	for Impairment	for Impairment	for Impairment
	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>
Residential Real Estate	\$71,535	\$2,390	\$74,372	\$1,610	\$72,656	\$1,995
Commercial Real Estate	60,709	3,840	61,908	4,954	60,865	3,915
Construction & Land Dev	10,504	4,719	11,985	4,300	11,655	5,490
Agricultural Real Estate	82,213	0	71,864	246	78,768	0
Commercial	40,286	1,068	38,623	726	35,178	928
Agricultural	28,810	0	24,859	116	27,661	0
Consumer	10,537	140	10,244	189	11,049	185
<b>Total</b>	<u>\$304,594</u>	<u>\$12,157</u>	<u>\$293,855</u>	<u>\$12,141</u>	<u>\$297,832</u>	<u>\$12,513</u>

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**Allowance for Loan Losses**  
**For the Six Months Ended June 30, 2012 and 2011**

\$(000)s

	Beginning Balance 1/1/2012	Charge-offs	Recoveries	Provision	Ending Balance 6/30/2012	Ending Balance Individually Evaluated for Impairment
<b>2012</b>						
Residential Real Estate	\$1,132	(\$134)	\$9	\$64	\$1,071	\$144
Commercial Real Estate	2,858	(180)	7	88	2,773	580
Construction & Land Dev	1,163	0	0	310	1,473	926
Agricultural Real Estate	198	0	0	1	199	0
Commercial	202	0	10	23	235	13
Agricultural	263	0	0	(15)	248	0
Consumer	150	(10)	5	3	148	127
Unallocated	612	0	0	(174)	438	0
<b>Total</b>	<b>\$6,578</b>	<b>(\$324)</b>	<b>\$31</b>	<b>\$300</b>	<b>\$6,585</b>	<b>\$1,790</b>

\$(000)s

	Beginning Balance 1/1/2011	Charge-offs	Recoveries	Provision	Ending Balance 6/30/2011	Ending Balance Individually Evaluated for Impairment
<b>2011</b>						
Residential Real Estate	\$1,429	(\$32)	\$19	\$68	\$1,484	\$299
Commercial Real Estate	2,849	(431)	3	272	2,693	698
Construction & Land Dev	880	(139)	25	47	813	89
Agricultural Real Estate	204	0	0	1	205	0
Commercial	278	(252)	29	187	242	17
Agricultural	347	0	5	(10)	342	101
Consumer	160	(7)	3	(2)	154	133
Unallocated	718	0	0	(263)	455	0
<b>Total</b>	<b>\$6,865</b>	<b>(\$861)</b>	<b>\$84</b>	<b>\$300</b>	<b>\$6,388</b>	<b>\$1,337</b>

Nonaccrual loans totaled \$7.2 million and \$8.7 million at June 30, 2012 and December 31, 2011, respectively. There were no loans past due ninety days or more and still accruing. A schedule of loans by the number of days past due (including nonaccrual loans) along with a schedule of credit quality indicators follows:

**Age Analysis of Past Due Financing Receivables**

	30-89 Days Past Due	90 Days & Over	Total Past Due	Current	Total Financing Receivables
\$(000)s					
<b>June 30, 2012</b>					
Residential Real Estate	\$423	\$860	\$1,283	\$70,252	\$71,535
Commercial Real Estate	0	815	815	59,894	60,709
Construction & Land Dev	0	728	728	9,776	10,504
Agricultural Real Estate	0	116	116	82,097	82,213
Commercial	28	537	565	39,721	40,286
Agricultural	8	0	8	28,802	28,810
Consumer	11	164	175	10,362	10,537
<b>Total</b>	<b>\$470</b>	<b>\$3,220</b>	<b>\$3,690</b>	<b>\$300,904</b>	<b>\$304,594</b>

**Denmark Bancshares, Inc. and Subsidiaries**  
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<i>\$(000)s</i>	30-89 Days Past Due	90 Days & Over	Total Past Due	Current	Total Financing Receivables
<b><u>December 31, 2011</u></b>					
Residential Real Estate	\$1,319	\$866	\$2,185	\$70,471	\$72,656
Commercial Real Estate	1,103	1,074	2,177	58,688	60,865
Construction & Land Dev	0	1,452	1,452	10,203	11,655
Agricultural Real Estate	0	0	0	78,768	78,768
Commercial	185	200	385	34,793	35,178
Agricultural	0	0	0	27,661	27,661
Consumer	63	81	144	10,905	11,049
<b>Total</b>	<b><u>\$2,670</u></b>	<b><u>\$3,673</u></b>	<b><u>\$6,343</u></b>	<b><u>\$291,489</u></b>	<b><u>\$297,832</u></b>

**Credit Quality Indicators**

<i>\$(000)s</i>	Non- Classified	Special Mention	Substandard	Doubtful	Total
<b><u>June 30, 2012</u></b>					
Residential Real Estate	\$58,611	\$5,373	\$5,429	\$2,122	\$71,535
Commercial Real Estate	48,195	5,575	4,371	2,568	60,709
Construction & Land Dev	4,548	627	2,724	2,605	10,504
Agricultural Real Estate	76,668	5,545	0	0	82,213
Commercial	37,667	933	1,502	184	40,286
Agricultural	26,211	2,599	0	0	28,810
Consumer	10,252	78	44	163	10,537
<b>Total</b>	<b><u>\$262,152</u></b>	<b><u>\$20,730</u></b>	<b><u>\$14,070</u></b>	<b><u>\$7,642</u></b>	<b><u>\$304,594</u></b>

<i>\$(000)s</i>	Non- Classified	Special Mention	Substandard	Doubtful	Total
<b><u>December 31, 2011</u></b>					
Residential Real Estate	\$58,960	\$6,277	\$6,501	\$918	\$72,656
Commercial Real Estate	49,547	3,668	4,787	2,863	60,865
Construction & Land Dev	4,691	898	4,154	1,912	11,655
Agricultural Real Estate	70,412	8,356	0	0	78,768
Commercial	32,600	1,250	1,164	164	35,178
Agricultural	23,779	3,882	0	0	27,661
Consumer	10,678	102	127	142	11,049
<b>Total</b>	<b><u>\$250,667</u></b>	<b><u>\$24,433</u></b>	<b><u>\$16,733</u></b>	<b><u>\$5,999</u></b>	<b><u>\$297,832</u></b>

**Modifications  
As of June 30, 2012**

<i>\$(000)s</i>	Number of Contracts	Pre-Modification Recorded Investment	Post- Modification Recorded Investment	Recorded Investment as of 6/30/2012	Impact to Allowance for Credit Losses
Residential Real Estate	3	\$177	\$177	\$176	\$151

Since December 31, 2011 there were no loans that were modified as troubled debt restructurings that subsequently defaulted.

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**NOTE 4 – NEW ACCOUNTING PRONOUNCEMENTS**

In April 2011, FASB issued ASU No. 2011-03 *Reconsideration of Effective Control for Repurchase Agreements*. This update to *Topic 860, "Transfers and Servicing,"* modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than a sale. The provisions of ASU No. 2011-03 remove from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and the collateral maintenance implementation guidance related to that criterion. This update does not change the other existing criteria used in the assessment of effective control. ASU No. 2011-03 is effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. These amendments did not have any impact on DBI's financial statements.

In May 2011, FASB issued ASU No. 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. These amendments to *Topic 820, "Fair Value Measurement,"* result in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS"). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows; (a) the concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets; (b) U.S. GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices in active markets, however ASU No. 2011-04 extends that prohibition to all fair value measurements; (c) an exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity's net exposure to either of those risks which allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (d) aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities; and (e) disclosure requirements have been enhanced for recurring Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to describe the sensitivity of fair value measurements to changes in unobservable inputs and interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The provisions of ASU No. 2011-04 are effective for interim reporting periods beginning on or after December 15, 2011. See Note 5 for the impact that the adoption of ASU No. 2011-04 had on DBI's financial statements.

In June 2011, FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. This update to *Topic 220, "Comprehensive Income,"* allows an entity the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive must be reclassified to net income. ASU No. 2011-05 is effective for interim reporting periods beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 changed the presentation of DBI's income statement and the addition of a statement of other comprehensive income. The adoption did not have any impact on DBI's statement of financial condition.

In September 2011, FASB issued ASU No. 2011-08, *Testing Goodwill for Impairment*. This update to *Topic 350, "Intangibles – Goodwill and Other,"* permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment on at least an annual basis by comparing the fair value of a reporting unit with its carrying amount (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments of this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. If after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. An entity has the option under this update to bypass the qualitative assessment for any

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reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption was permitted. The adoption of ASU No. 2011-08 had no impact on DBI's financial statements.

**NOTE 5 – FAIR VALUE MEASUREMENT**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in a transaction between market participants on the measurement date. Some assets and liabilities are measured on a recurring basis while others are measured on a non-recurring basis, as required by U.S. GAAP, which also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. The three levels of inputs defined in the standard that may be used to measure fair value are as follows:

- *Level 1:* Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- *Level 2:* Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
- *Level 3:* Significant unobservable inputs that are supported by little, if any, market activity. These unobservable inputs reflect estimates that market participants would use in pricing the assets or liability.

DBI used the following methods and significant assumptions to estimate fair value:

**Cash, Cash Equivalents, and Federal Funds Sold:** For cash, cash equivalents and federal funds sold, the carrying amount is a reasonable estimate of fair value.

**Investment Securities:** Investment securities available-for-sale (“AFS”) are recorded at fair value on a recurring basis. The fair value measurement of most of DBI's AFS securities is currently determined by an independent provider using Level 2 inputs (except as noted below). The measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speed and default rates. Two of DBI's AFS MBS that are secured by non-traditional mortgage loans and one AFS MBS secured by traditional mortgage loans that was previously downgraded were analyzed by a third party in order to determine an estimated fair value. The estimated fair values were based on discounted cash flow analyses and are considered Level 3 inputs.

Refer to Note 2 – Investment Securities for additional detail on the assumptions used in determining the estimated fair values, the valuation techniques and significant unobservable inputs for Level 3 assets as well as additional disclosures regarding DBI's investment securities. For other securities held as investments, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

**Loans Receivable, net:** The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar characteristics and for the same remaining maturities.

**Loans Held for Sale:** Mortgage loans held for sale are recorded at the lower of cost or market value. The fair value is based on a market commitment for the sale of the loan in the secondary market. These loans are typically sold within one week of funding. DBI classifies mortgage loans held for sale as nonrecurring Level 2 assets.

**Impaired Loans:** As defined below in the *Glossary of Loan Terms* section, a loan is considered impaired when, based on current information or events, it is probable that not all amounts due will be collected according to the contractual terms of the loan agreement. Impairment is measured based on the fair value of the underlying collateral. The collateral value is determined based on appraisals and other market valuations for similar assets. Under *FASB ASC Topic 820, “Fair Value Measurements and Disclosures,”* the fair value of impaired loans is reported before selling costs of the related collateral, while *FASB ASC Topic 310, “Receivables,”* requires that impaired loans be reported on the balance sheet net of estimated selling costs. Therefore, significant estimated selling costs would result in the reported fair value of impaired loans being greater than the measurement value of impaired loans as maintained on the balance sheet. In most instances, selling costs

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were estimated for real estate-secured collateral and included broker commissions, legal and title transfer fees and closing costs. Given the valuation technique and significant unobservable inputs utilized to determine the fair value, impaired loans are classified as nonrecurring Level 3 assets.

**Other Investments:** For other investments, the carrying amount is a reasonable estimate of fair value.

**Other Real Estate Owned:** Real estate that DBI has taken control of in partial or full satisfaction of debt is valued at the lower of book value or fair value. The fair value is determined by analyzing the collateral value of the real estate using appraisals and other market valuations for similar assets less any estimated selling costs. The value carried on the balance sheet for other real estate owned is estimated fair value of the properties. Other real estate owned is classified as a nonrecurring Level 2 asset.

**Bank Owned Life Insurance:** The carrying amount of bank owned life insurance approximates fair value.

**Deposit Liabilities:** The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is the estimate of discounted cash flows using the rates currently offered for deposits of similar remaining maturities.

**Borrowings:** Rates currently available to DSB for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

**Commitments to Extend Credit, Standby Letters of Credit and Financial Guarantees Written:** The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of guarantees and letters of credit is not material.

**Assets Recorded at Fair Value on a Recurring Basis**

Assets measured at fair value on a recurring basis, are summarized in the table below:

June 30, 2012				
<u>Description</u>	Fair Value Measurements Using			<u>Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
U.S. Government-sponsored agencies	\$0	\$3,497,500	\$0	\$3,497,500
U.S. Government-sponsored agency MBS	0	40,637,232	0	40,637,232
State and local governments	0	28,155,696	0	28,155,696
Residential mortgage-backed securities	0	2,120,204	3,620,368	5,740,572
Total securities available for sale	<u>\$0</u>	<u>\$74,410,632</u>	<u>\$3,620,368</u>	<u>\$78,031,000</u>

December 31, 2011				
<u>Description</u>	Fair Value Measurements Using			<u>Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
U.S. Government-sponsored agencies	\$0	\$3,517,050	\$0	\$3,517,050
U.S. Government-sponsored agency MBS	0	32,226,529	0	32,226,529
State and local governments	0	25,468,499	0	25,468,499
Residential mortgage-backed securities	0	2,355,680	4,042,935	6,398,615
Total securities available for sale	<u>\$0</u>	<u>\$63,567,758</u>	<u>\$4,042,935</u>	<u>\$67,610,693</u>

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The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable (Level 3) for the six months ended June 30, 2012.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	Available- for-Sale Securities
Beginning balance, January 1, 2012	\$4,042,935
Total realized and unrealized gains/(losses):	
Included in earnings	(77,185)
Included in other comprehensive income	25,766
Purchases, issuances, sales and settlements	
Purchases	0
Issuances	0
Sales	0
Settlements	(371,148)
Transfers into Level 3	0
Transfers out of Level 3	0
Ending balance, June 30, 2012	\$3,620,368

**Assets Recorded at Fair Value on a Nonrecurring Basis**

Assets measured at fair value on a nonrecurring basis, are summarized in the following table:

June 30, 2012

<u>Description</u>	Fair Value Measurements Using			<u>Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Loans held for sale	\$0	\$446,865	\$0	\$446,865
Other real estate owned	0	438,955	0	438,955
Impaired loans	0	0	11,544,977	11,544,977
<b>Total Assets</b>	<b>\$0</b>	<b>\$885,820</b>	<b>\$11,544,977</b>	<b>\$12,430,797</b>

December 31, 2011

<u>Description</u>	Fair Value Measurements Using			<u>Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Loans held for sale	\$0	\$485,926	\$0	\$485,926
Other real estate owned	0	801,689	0	801,689
Impaired loans	0	0	13,260,619	13,260,619
<b>Total Assets</b>	<b>\$0</b>	<b>\$1,287,615</b>	<b>\$13,260,619</b>	<b>\$14,548,234</b>

**Denmark Bancshares, Inc. and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
(Unaudited)

The tables below summarize fair value of financial assets and liabilities at June 30, 2012 and December 31, 2011.

	June 30, 2012				
	Carrying Amount	Fair Value	Fair Value Hierarchy Level		
			Level 1	Level 2	Level 3
<i>(In thousands)</i>					
<b>Financial Assets</b>					
Cash and federal funds sold	\$22,426	\$22,426	\$22,426	\$0	\$0
Investment securities	78,031	78,031	0	74,411	3,620
Loans, net of allowance for loan losses	298,009	296,549	0	0	296,549
Loans held for sale	447	447	0	447	0
Bank owned life insurance	7,217	7,217	0	7,217	0
Other investments, at cost	2,741	2,741	0	0	2,741
<b>TOTAL</b>	<b>\$408,871</b>	<b>\$407,411</b>	<b>\$22,426</b>	<b>\$82,075</b>	<b>\$302,910</b>
<b>Financial Liabilities</b>					
Deposits	\$324,367	\$325,732	\$0	\$0	\$325,732
Borrowings	38,151	40,255	0	0	40,255
<b>TOTAL</b>	<b>\$362,518</b>	<b>\$365,987</b>	<b>\$0</b>	<b>\$0</b>	<b>\$365,987</b>
December 31, 2011					
	Carrying Amount	Fair Value	Fair Value Hierarchy Level		
			Level 1	Level 2	Level 3
<i>(In thousands)</i>					
<b>Financial Assets</b>					
Cash and federal funds sold	\$42,093	\$42,093	\$42,093	\$0	\$0
Investment securities	67,611	67,611	0	63,568	4,043
Loans, net of allowance for loan losses	291,254	291,427	0	0	291,427
Loans held for sale	486	486	0	486	0
Bank owned life insurance	7,083	7,083	0	7,083	0
Other investments, at cost	4,405	4,405	0	0	4,405
<b>TOTAL</b>	<b>\$412,932</b>	<b>\$413,105</b>	<b>\$42,093</b>	<b>\$71,137</b>	<b>\$299,875</b>
<b>Financial Liabilities</b>					
Deposits	\$327,793	\$328,864	\$0	\$0	\$328,864
Borrowings	40,041	41,935	0	0	41,935
<b>TOTAL</b>	<b>\$367,834</b>	<b>\$370,799</b>	<b>\$0</b>	<b>\$0</b>	<b>\$370,799</b>

## *Management's Discussion and Analysis*

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

#### *Denmark Bancshares, Inc. and Subsidiaries*

##### *Selected Quarterly Financial Data*

(Unaudited)

<b>Financial Highlights</b>	2nd Qtr	1st Qtr	4th Qtr	3rd Qtr	2nd Qtr
(In thousands, except per share data)	2012	2012	2011	2011	2011
<b>Operating Results</b>					
Interest income	\$4,360	\$4,305	\$4,340	\$4,406	\$4,512
Interest expense	847	896	946	1,003	1,052
Net interest income	3,513	3,409	3,394	3,403	3,460
Provision for credit losses	150	150	150	150	150
Noninterest income	505	596	539	484	509
Noninterest expense	2,621	2,572	2,328	2,514	2,567
Net income	821	849	982	848	868
<b>Per Share Data</b>					
Net income per share	\$6.93	\$7.14	\$8.26	\$7.13	\$7.30
Book value per share	\$480.21	\$479.09	\$471.11	\$470.88	\$462.89
<b>Financial Condition (1)</b>					
Total Loans	\$304,594	\$301,606	\$297,832	\$295,511	\$293,855
Allowance for loan losses	6,585	6,603	6,578	6,518	6,388
Investment securities	78,031	76,787	67,611	65,757	68,547
Assets	421,540	422,731	425,986	412,560	410,023
Deposits	324,367	324,922	327,793	315,232	310,210
Other borrowed funds	38,151	39,683	40,041	39,759	42,609
Stockholders' equity	56,938	56,804	56,023	55,996	55,045
<b>Financial Ratios</b>					
Return on average equity	5.77%	5.99%	7.14%	6.20%	6.41%
Return on average assets	0.79%	0.80%	0.96%	0.83%	0.85%
Interest rate spread	3.33%	3.17%	3.37%	3.29%	3.33%
Average equity to average assets	13.60%	13.39%	13.23%	13.37%	13.22%
Allowance for loan losses to total loans (1)	2.16%	2.19%	2.21%	2.21%	2.17%
Non-performing loans to allowance for loan losses (1)	109%	137%	132%	125%	112%

(1) As of the period ending.

#### **Forward Looking Statements**

This report may contain certain forward-looking statements, including without limitation, statements regarding results of operations, the appropriateness of the allowance for loan losses, the amounts of charge-offs and recoveries, capital to asset ratios, capacity for paying dividends and liquidity. These statements speak of DBI's plans, goals, beliefs or expectations, and refer to estimates or use of similar terms. Forward-looking statements can generally be identified because they contain words and phrases such as "may," "project," "are confident," "should," "predict," "believe," "plan," "expect," "estimate," "anticipate," and similar expressions. These forward-looking statements are inherently uncertain and actual results may differ from DBI's expectations. The factors that, among others, could impact current and future performance include but are not limited to: (i) adverse changes in asset quality and resulting credit risk-related losses and expenses; (ii) adverse changes in the local economy; (iii) fluctuations in market rates and prices which can negatively affect net interest margin, asset valuations and expense expectations; (iv) changes in regulatory requirements of federal and state agencies applicable to banks

## *Management's Discussion and Analysis*

and bank holding companies; and (v) the factors set forth in Item 1A of DBI's Annual Report on Form 10-K for the year ended December 31, 2011 (the "2011 Annual Report"), which item is incorporated herein by reference, as well as other risks identified in this Report. When reviewing forward-looking statements to make decisions with respect to DBI, investors and others are cautioned to consider these and other risks and uncertainties. All forward-looking statements contained in this report are based upon information presently available and DBI assumes no obligation to update any forward-looking statements.

### **The Dodd-Frank Wall Street Reform and Consumer Protection Act**

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") into law. This legislation makes extensive changes to the laws regulating financial services firms and requires significant rulemaking. In addition, the legislation mandates multiple studies, which could result in additional legislative or regulatory action. While the full effects of the legislation on DBI and DSB cannot yet be determined, this legislation is generally perceived as negatively impacting the banking industry. This legislation may result in higher compliance and other costs, reduced revenues and higher capital and liquidity requirements, among other things, which could adversely affect DBI's and DSB's business.

### **Critical Accounting Policies**

The accounting and reporting policies of DBI are in accordance with accounting principles generally accepted in the United States of America and conform to general practices in the banking industry. The preparation of financial statements in conformity with these principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on information available at the date of the financial statements. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Management believes that DBI's critical accounting policies are those relating to the allowance for loan losses, the valuation of investment securities and intangible assets.

#### *Allowance for Loan Losses*

The allowance for loan losses ("ALL") is an estimate of the losses that may be sustained in the loan portfolio. Please refer to the Allowance for Loan Losses section of Note 3 – Loans for detail on the allowance methodology. Management believes the ALL is appropriate as of June 30, 2012.

#### *Valuation of Investment Securities*

Investment securities are classified as available-for-sale and are valued at their fair market value. Please refer to Note 2 – Investment Securities and Note 5 – Fair Value Measurement for additional details on the valuation of investment securities.

#### *Other Real Estate Owned*

Real estate that DBI has taken control of in partial or full satisfaction of debt is valued at the lower of book value or market value. Please refer to Note 5 – Fair Value Measurement for additional information on the accounting policies related to the valuation of other real estate owned.

### **Glossary of Loan Terms**

**Impaired Loan** – A loan is impaired when, based on current information and events, it is probable that not all amounts due will be collected according to the contractual terms of the loan agreement. Impaired loans are measured at the estimated fair value of the collateral. If the estimated fair value of the impaired loan is less than the recorded investment in the loan, an impairment is recognized by creating a valuation allowance.

**Nonaccrual Loan** – DSB's policy is to place in nonaccrual status all loans which are contractually past due 90 days or more as to any payment of principal or interest and all other loans for which reasonable doubt exists as to the full, timely collection of interest or principal based on management's view of the financial condition of the borrower. When a loan is placed on nonaccrual, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

## *Management's Discussion and Analysis*

**Non-Performing Assets** – Non-performing assets include nonaccrual loans as defined above and real and personal properties acquired in satisfaction of debts previously owed.

**Past Due Accruing Loans** – A loan on which all or part of a scheduled payment is delinquent by more than 30 days but less than 90 days, except loans that are considered nonaccrual.

**Potential Problem Loans** – Potential problem loans are accruing loans in which there exists doubt as to the ability of the borrower to comply with present loan repayment terms. Management's decision to place loans in this category does not necessarily mean that DBI expects losses to occur on these loans, but that management recognizes that a higher degree of risk is associated with these accruing loans and they deserve closer scrutiny.

**Restructured Loans** – Restructured loans involve the granting of some concession to the borrower involving the modification of terms of the loan, such as changes in the payment schedule, the amortization term, the interest rate, or a combination of these.

**Risk Rating** – Risk rating, which is also sometimes referred to as loan grade, is the credit quality grade assigned to each loan. Loans are assigned a risk rating upon origination. Lenders and credit review analysts conduct periodic reviews and evaluations and make adjustments to the assigned grades when appropriate. The range of categories from the best quality to the worst is as follows: highest quality, solid quality, some weakness, inherent industry weakness, special mention, substandard, doubtful and loss. Impaired loans are generally rated a substandard or lower risk rating.

**Special Mention Loans** – Loans classified "special mention" are one step above substandard loans as described below. These loans contain some weaknesses, which if not corrected or improved upon could lead to further deterioration and a lower rating.

**Substandard** – A "substandard" loan is a loan that is inadequately protected by the current net worth and paying capacity of the borrower or the value of the collateral. Loans classified "substandard" have well-defined weaknesses that jeopardize prospects for liquidation and are characterized by the distinct possibility that some loss will be sustained if the deficiencies are not corrected.

### **Results of Operations**

Net income for the quarter ended June 30, 2012, was \$0.8 million, a decline of \$0.1 million or 5.4% from \$0.9 million for the corresponding period in 2011. This decrease was primarily the result of a \$0.1 million increase in salaries and employee benefits from the same period during 2011.

Year-to-date net income for the first six months of 2012 was \$1.7 million, a decline of \$0.1 million or 6.2% from \$1.8 million for the comparable period in 2011. An increase in salaries and employee benefits of \$0.2 million, partially offset by an increase of \$0.1 million in gain on sale of loans were the primary factors in the decline for the first half of 2012 compared to the same period in 2011.

Net interest income for the quarter ended June 30, 2012 was relatively stable at \$3.5 million for the quarters ended June 30, 2012 and 2011. Net interest income for the first six months of 2012 was \$6.9 million, a \$0.1 million or 0.8% decline from \$7.0 million recognized during the same period in 2011. The following tables set forth a summary of the changes in average balances of interest-earning assets and interest-bearing liabilities as well as the amount of interest earned and interest paid with the resulting average yield or rate for both the current quarter and year-to-date:

**Management's Discussion and Analysis**

(\$000s)	Three Months Ended June 30,					
	2012			2011		
	Average Daily Balance	Income and Expense	Average Yield or Rate	Average Daily Balance	Income and Expense	Average Yield or Rate
<b>ASSETS</b>						
<b>Interest-earning assets:</b>						
Loans (1) (2)	\$302,162	\$3,851	5.10%	\$297,894	\$3,940	5.29%
Investment securities: (3)						
Taxable securities	62,150	300	1.93%	46,775	302	2.59%
Nontaxable securities (2)	15,193	279	7.36%	21,082	381	7.23%
Federal funds sold	6,913	3	0.14%	9,787	4	0.14%
Other investments	10,777	26	0.96%	8,966	19	0.86%
Total earning assets	\$397,195	\$4,459	4.49%	\$384,504	\$4,646	4.83%
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$21,215	\$10	0.19%	\$19,597	\$9	0.19%
Savings accounts	22,776	17	0.30%	21,098	16	0.30%
Money market accounts	133,466	185	0.55%	119,334	225	0.75%
Time deposits	104,038	377	1.45%	115,722	520	1.80%
Other borrowed funds	39,111	257	2.63%	44,008	283	2.57%
Total interest-bearing liabilities	\$320,606	\$846	1.06%	\$319,759	\$1,053	1.32%
Net interest income and rate spread		\$3,613	3.43%		\$3,593	3.51%
Net yield on interest earning assets			3.64%			3.74%

## Management's Discussion and Analysis

(\$000s)	Six Months Ended June 30,					
	2012			2011		
	Average Daily Balance	Income and Expense	Average Yield or Rate	Average Daily Balance	Income and Expense	Average Yield or Rate
<b>ASSETS</b>						
<b>Interest-earning assets:</b>						
Loans (1) (2)	\$301,029	\$7,641	5.08%	\$298,294	\$7,932	5.32%
Investment securities: (3)						
Taxable securities	59,476	578	1.94%	42,859	547	2.55%
Nontaxable securities (2)	15,363	574	7.47%	23,154	873	7.54%
Federal funds sold	10,270	7	0.14%	13,025	11	0.17%
Other investments	14,453	67	0.93%	10,789	73	1.35%
Total earning assets	\$400,591	\$8,867	4.43%	\$388,121	\$9,436	4.86%
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$21,878	\$20	0.18%	\$21,018	\$20	0.19%
Savings accounts	22,048	33	0.30%	20,576	34	0.33%
Money market accounts	135,691	397	0.59%	119,032	465	0.78%
Time deposits	104,587	774	1.48%	116,988	1,074	1.84%
Other borrowed funds	39,392	519	2.63%	44,007	563	2.56%
Total interest-bearing liabilities	\$323,596	\$1,743	1.08%	\$321,621	\$2,156	1.34%
Net interest income and rate spread		\$7,124	3.35%		\$7,280	3.52%
Net yield on interest earning assets			3.56%			3.75%

(1) Nonaccrual loans are included in the average daily balance figure, but interest income associated with these loans is recognized under the cash basis method of accounting.

(2) The yield on tax-exempt loans and securities is computed on a fully taxable equivalent basis assuming a tax rate of 34%.

(3) Securities are shown at amortized cost.

The decline in net interest income for the quarter-ended June 30, 2012 was primarily due to a 66 basis point decline in the yield on taxable securities along with a \$5.9 million decline in the average balance of tax-exempt municipal securities. The net interest rate spread on a tax equivalent basis declined 8 basis points during this period from 3.51% for the quarter ended June 30, 2011 to 3.43% for the most recent quarter. DBI's yield on earning assets declined 34 basis points from 4.83% for the quarter ended June 30, 2011 to 4.49% as of the quarter ended June 30, 2012. The reduction in the yield on earning assets was partially offset by a decline in the cost of funds of 26 basis points from 1.32% for the quarter ended June 30, 2011 to 1.06% during the second quarter of 2012. This reduction in the cost of funds was primarily impacted by a 35 basis point reduction in the rate and \$11.7 million decline in average balances on certificates of deposits.

During the first six months of 2012, net interest income declined due in large part to a 61 basis point reduction in the yield on taxable securities along with a \$7.8 million decrease in the average balance of tax-exempt municipal securities. The net interest rate spread on a tax equivalent basis fell 17 basis points compared to the first six months of the prior year from 3.52% at June 30, 2011 to 3.35% at June 30, 2012. The yield on earning assets fell 43 basis points during this period from 4.86% in 2011 to 4.43% in 2012 due in large part to a 24 basis point decline in the yield on loans during this same period. This decline in the yield on earning assets was partially offset by a decrease in the cost of funds of 26 basis points from 1.34% year-to-date 2011 to 1.08% for the same period in 2012. The reduction in the cost of funds was primarily impacted by a 36 basis point reduction in the rate and a \$12.4 million decline in the average balances on certificates of deposits.

For each of the second quarters of 2012 and 2011, DBI's provision for credit losses was \$0.2 million. Net charge-offs of \$0.2 million were recognized in the second quarter of 2012 compared to net charge-offs of \$0.5 million during the corresponding period in 2011. For each of the six months ended June 30, 2012 and 2011, DBI's provision for loan losses totaled \$0.3

## *Management's Discussion and Analysis*

million. Net charge-offs for the current six-month period totaled \$0.3 million versus \$0.8 million for the comparable period in 2011.

Noninterest income for the three months ended June 30, 2012 was stable at \$0.5 million compared to the corresponding period in 2011. During the second quarter of 2012, gains on the sale of loans to the secondary market were \$0.1 million higher than the same period for 2011. This is due to an increase in the volume of loans sold of \$4.4 million to \$7.5 million. This improvement was offset by declines in the other noninterest income categories. Noninterest income for the six months ended June 30, 2012 was \$1.1 million an increase of \$0.1 million or 10.1% versus \$1.0 million recorded during the six months ended June 30, 2011. This was primarily due to increases of \$0.1 million in both service fees and commissions and gains on the sale of loans during the first half of 2012 compared to the first half of 2011. The increase in service fees and commissions is the result of a bonus insurance commission payment of \$0.1 million from DSB's credit-life insurance carrier that was paid during March 2012. The bonus was paid as compensation for insurance policy sales levels realized in recent years and it will not be a recurring payment.

Noninterest expense increased \$0.1 million or 3.6% to \$2.6 million for the quarter ended June 30, 2012 compared to \$2.5 million for the second quarter of 2011. An increase in salaries and employee benefits of \$0.1 million when comparing the current quarter with the same period of 2011 is the primary reason for this increase. Higher health insurance costs along with additional staffing led to this increase. For the six months ended June 30, 2012, noninterest expense increased \$0.1 million or 1.5% to \$5.1 million compared to \$5.0 million for the six months ended June 30, 2011. Salaries and employee benefits were \$0.2 million higher during the first half of 2012 when compared to the same period for 2011. In addition to higher health insurance costs and staffing, there was an accrual adjustment made during the first quarter of 2011 to correct an over-accrual for 2010 bonuses. This adjustment was not repeated during 2012. A decline of \$0.1 million in FDIC insurance premiums for the first six months of 2012 compared to the same period of 2011 partially offset the increase in salaries and employee benefit costs. The lower FDIC insurance premiums resulted from a new premium structure implemented by the FDIC effective April 1, 2011.

Additional OTTI credit loss was recognized during the most recent quarter on the two securities previously determined to be other-than-temporarily-impaired. The credit loss recognized through the income statement was \$44,310 during the three months ended June 30, 2012 compared to \$80,353 recognized during the second quarter of 2011 on one of the two securities. For both the six months ended June 30, 2012 and 2011, OTTI credit losses recognized on two securities previously determined to be other-than-temporarily-impaired totaled \$0.1 million.

For both the three months ended June 30, 2012 and 2011, DBI recorded combined federal and state income tax expense of \$0.4 million. These provisions reflect effective income tax rates of 34% for the second quarter of 2012 and 31% for the second quarter of 2011. DBI's combined statutory tax rate is 39%. The lower effective income tax rates are primarily due to certain federally tax exempt interest earned on state and local government investment securities. The effective tax rates for the six months ended June 30, 2012 and 2011 were 34% and 30%, respectively.

### **Financial Condition**

Total assets decreased by \$4.4 million between December 31, 2011 and June 30, 2012. Cash, cash equivalents and fed funds sold decreased by \$19.7 million since December 31, 2011, while other investments declined \$1.7 million during the same period. Increases in investment securities of \$10.4 million and loans of \$6.8 million during the first half of 2012 partially offset these declines.

## *Management's Discussion and Analysis*

The following table sets forth major types of loans, excluding loans held for sale, by primary collateral and the percentage of total loans for each type:

\$(000)s	June 30, 2012		December 31, 2011	
	Amount	%	Amount	%
<b>Real Estate:</b>				
Residential	\$71,535	23.5%	\$72,656	24.4%
Commercial	60,709	19.9%	60,865	20.4%
Agricultural	82,213	27.0%	78,768	26.5%
Construction	10,504	3.4%	11,655	3.9%
	<u>\$224,961</u>	<u>73.8%</u>	<u>\$223,944</u>	<u>75.2%</u>
Commercial	40,286	13.2%	35,178	11.8%
Agricultural	28,810	9.5%	27,661	9.3%
Consumer and other	10,537	3.5%	11,049	3.7%
<b>TOTAL</b>	<u>\$304,594</u>	<u>100.0%</u>	<u>\$297,832</u>	<u>100.0%</u>

During 2011, management made the decision to purchase government guaranteed loans given the lack of quality loan growth potential currently available within DSB's lending market. As of June 30, 2012 there were approximately \$13.9 million of government guaranteed loans recorded, of which \$10.2 million are secured by agricultural real estate and \$3.7 million by commercial real estate. The average maturity of the loans purchased is approximately 10 years. The premiums on the loans are being amortized over a three year period. Management will continue to evaluate DSB's loan portfolio and may make additional purchases as deemed appropriate. Management is authorized to invest up to \$15 million in government guaranteed loan purchases.

The allowance for loan losses remained stable during the first half of 2012 at \$6.6 million. Provisions of \$0.3 million were added to the allowance in the first six months of 2012 and were partially offset by net charge-offs of approximately \$0.3 million during the period. The allowance equals 2.16% of total loans as of June 30, 2012 compared to 2.21% at December 31, 2011. Nonaccrual loans totaled \$7.2 million at June 30, 2012, a decrease of approximately \$1.5 million compared to nonaccrual loans of \$8.7 million at December 31, 2011.

The following table sets forth nonaccrual loans by major category:

\$(000)s	June 30, 2012	December 31, 2011
<b>Secured By Real Estate:</b>		
Residential	\$1,591	\$2,195
Agricultural	116	0
Commercial	2,079	2,299
Construction	2,605	3,364
Subtotal Real Estate Loans	<u>6,391</u>	<u>7,858</u>
Secured by commercial assets	574	563
Secured by agricultural assets	0	0
Secured by other assets	203	235
<b>TOTAL</b>	<u>\$7,168</u>	<u>\$8,656</u>

DBI's ratio of loans more than 30 days past due (including nonaccrual loans) to total loans was 2.51% at June 30, 2012, compared to 3.58% at year-end 2011. As of June 30, 2012, management had identified \$35.3 million of potential problem loans compared to \$38.2 million at year-end 2011. Loan quality continues to be a concern and improving the portfolio is the primary focus for management. DBI has no accruing loans that are past due 90 days or more.

DBI's investment in other real estate (property acquired through foreclosure or in satisfaction of loans) decreased \$0.4 million in the first six months of 2012. At June 30, 2012 the \$0.4 million balance in other real estate comprised three

## *Management's Discussion and Analysis*

construction/land development properties totaling \$0.2 million, one property secured by agricultural-related real estate with an estimated value of \$0.2 million and two residential real estate properties with an estimated value of \$36,000. This compares to the seven parcels held at year-end 2011 consisting of \$0.3 million in construction/land development properties, \$0.2 million in commercial real estate, \$0.2 million in agricultural-related real estate and \$0.1 million in residential real estate.

The following table sets forth certain data concerning nonaccrual loans, past due accruing loans, restructured loans and other real estate:

<i>\$(000)s</i>	June 30, 2012		December 31, 2011	
	Amount	% of Total Loans	Amount	% of Total Loans
Nonaccrual Loans (1)	\$7,168	2.4%	\$8,656	2.9%
Restructured Accruing Loans	5,438	1.8%	4,449	1.4%
Accruing Loans Past Due				
90 Days or More	0	0.0%	0	0.0%
Total	\$12,606	4.1%	\$13,105	4.3%
Other Real Estate	\$439		\$802	

(1) Includes restructured loans of \$2.8 million as of June 30, 2012 and \$4.3 million as of December 31, 2011.

Total deposits declined \$3.4 million at June 30, 2012 compared to balances at December 31, 2011. Noninterest-bearing deposits decreased by \$6.2 million, or 13.0%, during the first half of 2012. Interest-bearing deposits increased \$2.8 million or 1.0% between December 31, 2011 and June 30, 2012. Money market accounts increased \$4.1 million or 3.1% during the first six months of 2012 and savings accounts increased \$2.4 million or 11.2% during the same period. The trend in money market balances continues to increase given the current rate environment and depositors reluctance to commit to long-term rates. NOW account balances decreased \$1.2 million or 5.4% since year-end 2011, while certificates of deposit also fell \$2.5 million, or 2.4%, during the first half of 2012. Given the current interest rate environment, there has been a shift away from certificates of deposit into money market accounts as customers are reluctant to lock into a rate at this time. DBI's money market rates are comparable to its rates for short-term certificates of deposit.

Interest-bearing deposits consisted of the following:

<i>\$(000)s</i>	6/30/2012	12/31/2011
NOW accounts	\$21,073	\$22,278
Savings accounts	23,488	21,129
Money market accounts	135,061	130,959
Certificates of deposit	103,467	105,957
TOTAL	\$283,089	\$280,323

Short-term borrowings decreased \$0.5 million or 4.1% as of June 30, 2012 compared to December 31, 2011. Loan volume for DACC was relatively stable during the first quarter of 2012 thereby eliminating the need to advance funds against the line of credit at Agribank, FCB. Long-term borrowings declined \$1.4 million or 5.0% since year-end 2011 due to maturities of FHLB advances.

### **Capital Resources**

Stockholders' equity increased by \$0.9 million to \$56.9 million as of June 30, 2012 from \$56.0 million at December 31, 2011 due primarily to earnings for the period of \$1.7 million and a decrease in other comprehensive loss of \$0.3 million that were partially offset by the dividend payable of \$0.9 million and purchase of treasury stock of \$0.1 million. As of June 30, 2012 DBI's leverage ratio was 13.7%, its risk-based core capital ratio was 18.3% and its risk-based total capital ratio was 19.5%. As of June 30, 2012, DSB's leverage ratio was 10.7% and its risk-based total capital ratio was 16.0%. DBI and DSB continue

## *Management's Discussion and Analysis*

to maintain capital levels well above regulatory minimum levels established for "well-capitalized" institutions. DBI believes its and DSB's capital positions as June 30, 2012 are adequate under current economic conditions.

### **Liquidity**

Liquidity refers to the ability of DBI to generate adequate amounts of cash to meet its needs. DBI maintains liquid assets and established lines of credit to meet its liquidity needs. DBI's Board of Directors annually approves a Consolidated Contingent Liquidity Plan, which reviews the sources and uses of liquidity for DBI, DSB and DACC. Cash, cash equivalents and federal funds sold decreased \$19.7 million or 46.7% to \$22.4 million during the first six months of 2012 primarily due to the increases in investment securities of \$10.4 million and loans of \$6.8 million during this period. The major sources and uses of cash are detailed in the accompanying Consolidated Statements of Cash Flows.

In addition to on-balance sheet sources of funds, DBI also has off-balance sheet sources available to meet liquidity needs. Specifically, DBI has unused lines of credit of \$50.0 million as of June 30, 2012. This includes a \$20.0 million line of credit with the Federal Reserve Bank of Chicago that was established in 1999. DSB has not borrowed on this line. DBI also has \$78.0 million of eligible loans and securities that could be pledged to increase its available credit. Management believes DBI's and DSB's liquidity positions as of June 30, 2012 are adequate under current economic conditions.

### **Off-Balance Sheet Arrangements**

DBI and its subsidiaries are parties to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and stand-by letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial condition. The contract or notional amounts of those instruments reflect the extent of involvement DBI and its subsidiaries have in particular classes of financial instruments.

The exposure of DBI and its subsidiaries to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of these instruments. DBI and its subsidiaries use the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. DBI and its subsidiaries require collateral or other security to support financial instruments with credit risk. The following table sets forth DBI's commitments to extend credit and standby letters of credit:

<i>(In thousands)</i>	Contract or Notional Amount June 30, 2012	Secured Portion
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$43,661	\$39,543
Standby letters of credit and financial guarantees written	1,403	1,403

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. DBI and its subsidiaries evaluate each customer's creditworthiness on a case-by-case basis. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by DSB to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support commercial business transactions. When a customer fails to perform according to the terms of the agreement, DSB honors drafts drawn by the third party in amounts up to the contract amount. A majority of the letters of credit expire within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties and residential properties. All letters of credit are fully collateralized.

## *Management's Discussion and Analysis*

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

DBI's primary market risk position has not materially changed from that disclosed in DBI's 2011 Annual Report.

### **Item 4. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended, DBI's management, under the supervision and with the participation of DBI's principal executive officer and principal financial officer, has evaluated DBI's disclosure controls and procedures as of the end of the period covered by this Report. Based on that evaluation, DBI's principal executive officer and principal financial officer believe that DBI's disclosure controls and procedures are effective as of the end of the period covered by this Report.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

There were no significant changes in DBI's internal controls over financial reporting or in other factors that have significantly affected those controls during the fiscal quarter covered by this Report, including any correction actions with regard to significant deficiencies and material weaknesses.

## **Part II. Other Information**

### **Item 1A. Risk Factors**

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Item 1A – Risk Factors of DBI's 2011 Annual Report, which could materially affect DBI's business, financial condition or future results. There have been no material changes in risk factors as described in such Report.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended June 30, 2012, DBI did not sell any equity securities which were not registered under the Securities Act of 1933, as amended, or repurchase any of its equity securities.

The Federal Reserve Board (“the Board”) has adopted regulations that deal with the measure of capitalization for bank holding companies. The Board has also issued a policy statement on the payment of cash dividends by bank holding companies, wherein the Board has stated that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or which could only be funded in ways that weaken the bank holding company’s financial health, such as by borrowing.

The ability of DBI to pay dividends on its common stock is largely dependent upon the ability of DSB to pay dividends on its stock held by DBI. DSB’s ability to pay dividends is restricted by both state and federal laws and regulations. DSB is subject to policies and regulations issued by the FDIC and the Division of Banking of the Wisconsin Department of Financial Institutions (“the Division”), which, in part, establish minimum acceptable capital requirements for banks, thereby limiting the ability of such banks to pay dividends. In addition, Wisconsin law provides that state chartered banks may declare and pay dividends out of undivided profits but only after provision has been made for all expenses, losses, required reserves, taxes and interest accrued or due from the bank. Payments of dividends in some circumstances may require the written consent of the Division.

## Item 6. Exhibits

(a) Exhibits:

31.1 Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Statements of Financial Condition, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders’ Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements tagged as blocks of text. \*

\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DENMARK BANCSHARES, INC.

Date: August 8, 2012

/s/ John P. Olsen  
John P. Olsen  
President and CEO

Date: August 8, 2012

/s/ Dennis J. Heim  
Dennis J. Heim  
Vice President, CFO and Treasurer