

Peoples Bancorp

Accountants' Report and Consolidated Financial Statements

September 30, 2008 and 2007

Peoples Bancorp
September 30, 2008 and 2007

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Independent Accountants' Report

Audit Committee, Board of Directors
and Stockholders
Peoples Bancorp
Auburn, Indiana

We have audited the accompanying consolidated balance sheets of Peoples Bancorp as of September 30, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Peoples Bancorp as of September 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
November 25, 2008

Peoples Bancorp
Consolidated Balance Sheets
September 30, 2008 and 2007

Assets

	<u>2008</u>	<u>2007</u>
Cash and cash equivalents	\$ 6,789,106	\$ 12,311,371
Interest-bearing time deposits	-	2,567,908
Investment securities		
Available for sale	103,624,296	86,599,820
Held to maturity (fair value of \$337,566 and \$424,745)	334,271	423,173
Total investment securities	<u>103,958,567</u>	<u>87,022,993</u>
Mortgage loans held for sale	288,000	255,500
Loans, net of allowance for loan losses of \$1,871,970 and \$1,833,682	316,461,983	348,229,797
Premises and equipment	6,401,220	5,555,341
Federal Home Loan Bank of Indianapolis stock, at cost	4,403,900	4,403,900
Core deposit intangible	-	57,436
Goodwill	2,330,198	2,330,198
Cash surrender value of life insurance	8,014,986	774,075
Other assets	<u>6,453,971</u>	<u>5,684,518</u>
Total assets	<u>\$ 455,101,931</u>	<u>\$ 469,193,037</u>

Liabilities

NOW and savings deposits	\$ 145,577,620	\$ 135,474,910
Certificates of deposit	<u>173,668,093</u>	<u>213,816,272</u>
Total deposits	319,245,713	349,291,182
Short-term borrowings	191,180	1,000,511
Federal Home Loan Bank advances	75,350,000	53,480,000
Other liabilities	<u>2,783,797</u>	<u>3,388,380</u>
Total liabilities	<u>397,570,690</u>	<u>407,160,073</u>

Commitments and Contingencies

Stockholders' Equity

Preferred stock, \$1 par value		
Authorized and unissued - 5,000,000 shares		
Common stock, \$1 par value		
Authorized - 7,000,000 shares		
Issued and outstanding - 2,801,007 and 3,106,134 shares	2,801,007	3,106,134
Additional paid-in capital	-	679,457
Retained earnings	55,626,060	58,570,157
Accumulated other comprehensive loss	<u>(895,826)</u>	<u>(322,784)</u>
Total stockholders' equity	<u>57,531,241</u>	<u>62,032,964</u>
Total liabilities and stockholders' equity	<u>\$ 455,101,931</u>	<u>\$ 469,193,037</u>

Peoples Bancorp
Consolidated Statements of Income
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Interest Income		
Loans	\$ 21,868,814	\$ 24,076,195
Investment securities	3,858,149	3,795,752
Other interest and dividend income	503,706	788,043
	<u>26,230,669</u>	<u>28,659,990</u>
Interest Expense		
Deposits		
NOW and savings deposits	1,361,705	1,854,558
Certificates of deposit	7,171,924	9,561,365
Short-term borrowings	13,678	16,262
Federal Home Loan Bank advances	3,115,383	3,127,113
	<u>11,662,690</u>	<u>14,559,298</u>
Net Interest Income	14,567,979	14,100,692
Provision for loan losses	522,448	76,972
Net Interest Income After Provision for Loan Losses	<u>14,045,531</u>	<u>14,023,720</u>
Non-Interest Income		
Fiduciary activities	433,150	357,221
Fees and service charges	1,300,455	1,320,528
Net realized gains on available-for-sale securities	264,216	5,104
Gain on sale of loans	194,126	161,554
Other income	492,511	260,376
Total other income	<u>2,684,458</u>	<u>2,104,783</u>
Non-Interest Expenses		
Salaries and employee benefits	6,937,564	6,991,906
Net occupancy expense	1,046,620	944,335
Equipment expense	702,136	557,283
Data processing expense	881,614	1,140,519
Deposit insurance expense	57,737	44,553
Other expenses	2,456,047	2,421,031
Total other expenses	<u>12,081,718</u>	<u>12,099,627</u>
Income Before Income Tax	4,648,271	4,028,876
Income tax expense	1,325,791	1,227,460
Net Income	<u>\$ 3,322,480</u>	<u>\$ 2,801,416</u>
Basic Earnings Per Share	\$ 1.12	\$ 0.89
Diluted Earnings Per Share	\$ 1.12	\$ 0.89
Weighted-Average Shares Outstanding - Basic	2,966,957	3,161,939
Weighted-Average Shares Outstanding - Diluted	2,967,378	3,164,080

Peoples Bancorp

Consolidated Statements of Stockholders' Equity

Years Ended September 30, 2008 and 2007

	Common Stock		Additional Paid-in Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Outstanding	Amount					
Balances, September 30, 2006	3,206,969	\$ 3,206,969	\$ 2,567,131		\$ 58,152,876	\$ (1,151,760)	\$ 62,775,216
Comprehensive income							
Net income				\$ 2,801,416	2,801,416		2,801,416
Other comprehensive income, net of tax							
Unrealized gains on securities, net of reclassification adjustment				828,976		828,976	828,976
Comprehensive income				<u>\$ 3,630,392</u>			
Cash dividends (\$.76 per share)					(2,384,135)		(2,384,135)
Stock options exercised	7,722	7,722	96,519				104,241
Repurchase of common stock	<u>(108,557)</u>	<u>(108,557)</u>	<u>(1,984,193)</u>				<u>(2,092,750)</u>
Balances, September 30, 2007	3,106,134	3,106,134	679,457		58,570,157	(322,784)	62,032,964
Comprehensive income							
Net income				\$ 3,322,480	3,322,480		3,322,480
Other comprehensive income, net of tax							
Unrealized losses on securities, net of reclassification adjustment				(573,042)		(573,042)	(573,042)
Comprehensive income				<u>\$ 2,749,438</u>			
Cash dividends (\$.76 per share)					(2,249,173)		(2,249,173)
Stock options exercised	594	594	7,158				7,752
Repurchase of common stock	<u>(305,721)</u>	<u>(305,721)</u>	<u>(686,615)</u>		<u>(4,017,404)</u>		<u>(5,009,740)</u>
Balances, September 30, 2008	<u>2,801,007</u>	<u>\$ 2,801,007</u>	<u>\$ -</u>		<u>\$ 55,626,060</u>	<u>\$ (895,826)</u>	<u>\$ 57,531,241</u>

Peoples Bancorp

Consolidated Statements of Cash Flows

Years Ended September 30, 2008 and 2007

	2008	2007
Operating Activities		
Net income	\$ 3,322,480	\$ 2,801,416
Items not requiring (providing) cash		
Provision for loan losses	522,448	76,972
Depreciation and amortization	780,743	637,111
Investment securities amortization, net	(162,772)	(33,393)
(Gain) loss from sale of property, plant and equipment	(4,148)	4,708
Gain on sale of loans	(194,126)	(161,554)
Amortization of deferred loan fees	(321,449)	(353,785)
Net realized gains on available-for-sale securities	(264,216)	(5,104)
Increase in cash surrender value of life insurance	(240,911)	(51,641)
Deferred income tax	26,515	(199,101)
Change in		
Loans held for sale	(32,500)	131,455
Interest receivable	209,475	(30,684)
Interest payable	(1,043,014)	715,042
Other adjustments	391,901	483,315
Net cash provided by operating activities	2,990,426	4,014,757
Investing Activities		
Net change in interest-bearing deposits	2,567,908	2,479,975
Purchases of securities available for sale	(85,963,312)	(14,020,286)
Proceeds from maturities and paydowns of securities held to maturity	99,161	154,789
Proceeds from maturities and paydowns of securities available for sale	51,147,279	17,824,291
Proceeds from sales of securities available for sale	17,314,215	4,501,896
Proceeds from the sale of FHLB stock	-	163,700
Net change in loans	30,639,368	22,143,467
Purchase of cash surrender value life insurance	(7,000,000)	-
Purchases of premises and equipment	(1,622,474)	(493,238)
Proceeds from sale of foreclosed real estate	599,099	934,373
Net cash provided by investing activities	7,781,244	33,688,967
Financing Activities		
Net change in		
NOW and savings deposits	10,102,710	(11,287,168)
Certificates of deposit	(40,148,179)	(15,270,379)
Short-term borrowings	(809,331)	482,720
Proceeds from Federal Home Loan Bank advances	50,850,000	78,785,000
Repayment of Federal Home Loan Bank advances	(28,980,000)	(84,460,000)
Cash dividends	(2,307,147)	(2,410,710)
Stock options exercised	7,752	104,241
Repurchase of common stock	(5,009,740)	(2,092,750)
Net cash used in financing activities	(16,293,935)	(36,149,046)
Net Change in Cash and Cash Equivalents	(5,522,265)	1,554,678
Cash and Cash Equivalents, Beginning of Year	12,311,371	10,756,693
Cash and Cash Equivalents, End of Year	\$ 6,789,106	\$ 12,311,371
Additional Cash Flows Information		
Interest paid	\$ 13,228,617	\$ 13,844,257
Income tax paid	1,415,216	991,230
Transfer to other real estate from loans	1,121,573	1,268,828

Peoples Bancorp

Notes to Consolidated Financial Statements

September 30, 2008 and 2007

Note 1: Nature of Operations and Summary of Significant Accounting Policies

The accounting and reporting policies of Peoples Bancorp (Company), its wholly-owned subsidiary, Peoples Federal Savings Bank of DeKalb County (Bank), the Bank's wholly-owned subsidiaries, Peoples Financial Services, Inc. (Peoples Financial), PFDC Investments, Inc. and Alpha Financial, Inc. (Alpha) conform to accounting principles generally accepted in the United States of America and reporting practices followed by the thrift industry. The more significant of the policies are described below. As of October 1, 2007, First Savings Bank, a wholly-owned subsidiary of the Company was merged into Peoples Federal Savings Bank of DeKalb County.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company is a thrift holding company whose principal activity is the ownership and management of the Bank. The Bank operates under a federal thrift charter and provides full banking services, including trust services. As a federally-chartered thrift, the Bank is subject to the regulation of the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation.

The Bank generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in north central and north eastern Indiana and south central Michigan. The Bank's loans are generally secured by specific items of collateral including real property and consumer assets.

Consolidation - The consolidated financial statements include the accounts of the Company, the Bank, Alpha, PFDC Investments, Inc. and Peoples Financial after elimination of all material intercompany transactions.

Cash Equivalents - Cash and cash equivalents include amounts due from banks and overnight investments with the Federal Home Loan Bank (FHLB). Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and repurchase agreements.

Investment Securities - Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost. Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported separately, net of tax, in accumulated other comprehensive income. The Company holds no securities for trading.

Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

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Notes to Consolidated Financial Statements
September 30, 2008 and 2007

Mortgage loans held for sale are carried at the lower of cost or fair value, determined using an aggregate basis. Write-downs to fair value are recognized as a charge to earnings at the time the decline in value occurs. Forward commitments to sell mortgage loans are acquired to reduce market risk on mortgage loans in the process of origination and mortgage loans held for sale. Gains and losses resulting from sales of mortgage loans are recognized when the respective loans are sold to investors. Gains and losses are determined by the difference between the selling price and the carrying amount of the loans sold, net of discounts collected or paid and considering a normal servicing rate.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of deferred loan fees and costs and the allowance for loan losses. Interest income is accrued on the principal balances of loans. Generally, loans are placed on non-accrual status at ninety days past due. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed when considered uncollectible. Interest income is subsequently recognized only to the extent cash payments are received. Certain loan fees and direct costs are being deferred and amortized as an adjustment of yield on the loans.

Allowance for loan losses is maintained at a level believed by management to absorb probable incurred losses in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans, actual loss experience, current economic events in specific industries and geographical areas, and other pertinent factors including general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience and consideration of economic trends, all of which may be susceptible to significant change. Allocations of the allowance may be made for specific loans, however, the entire allowance is available for any loan that, in management's judgment, should be charged off. A loan is impaired when full payment under the loan terms is not expected.

Loan losses are charged off against the allowance when, in management's estimation, it is unlikely that the loan will be collected, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors in order to maintain the allowance for loan losses at the level deemed adequate by management. The determination of whether a loan is considered past due or delinquent is based on the contractual payment terms. Management believes that, as of September 30, 2008, the allowance for loan losses is adequate based on information currently available. A worsening or protracted economic decline in the area within which the Company operates would increase the likelihood of additional losses due to credit and market risks and could create the need for additional loss provisions.

Peoples Bancorp
Notes to Consolidated Financial Statements
September 30, 2008 and 2007

Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using either a straight-line or accelerated method with useful lives ranging from 5 to 39 years. Furniture, fixtures and equipment are depreciated using a straight-line or accelerated method with useful lives ranging from 3 to 10 years. Land is carried at cost. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Federal Home Loan Bank stock is a required investment for institutions that are members of the Federal Home Loan Bank system. The required investment in the common stock is based on a predetermined formula.

Foreclosed assets are carried at the lower of cost or fair value less estimated selling costs. When foreclosed assets are acquired, any required adjustment is charged to the allowance for loan losses. All subsequent activity is included in current operations.

Goodwill is annually tested for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

Core deposit intangible was being amortized over eight years using an accelerated method switching to straight-line amortization when it exceeded the accelerated method, and was periodically evaluated as to the recoverability of its carrying value.

Cash surrender value of life insurance - The Bank has purchased life insurance policies on certain key executives. The insurance is recorded at its cash surrender value, or the amount that can be realized.

Investments in limited partnerships are included in other assets. The Company utilizes the equity method of accounting for these investments. At September 30, 2008 and 2007, these investments totaled \$215,000 and \$221,000, respectively.

Pension plan costs are based on actuarial computations and charged to current operations. The funding policy is to pay at least the minimum amounts required by ERISA. The Company froze the Company's defined benefit plan effective August 1, 2007.

Stock Options - At September 30, 2008, the Company has a stock-based employee compensation plan, which is described more fully in Note 17. The Company adopted SFAS 123R, *Share-Based Payment*, (SFAS 123R) in 2006. All stock options were previously vested and no stock options or restricted shares were granted in 2006; therefore, there was no impact from adopting SFAS 123R.

Income tax in the consolidated statements of income includes deferred income tax provisions or benefits for all significant temporary differences in recognizing income and expenses for financial reporting and income tax purposes. The Company files consolidated income tax returns with its subsidiaries.

Earnings per share have been computed based upon the weighted-average common shares outstanding during each year.

Reclassifications - Reclassifications have been made to the 2007 financial statements to conform to the 2008 financial statement presentation. These reclassifications had no effect on net income.

Peoples Bancorp
Notes to Consolidated Financial Statements
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Mortgage Servicing Rights - Mortgage servicing rights on originated loans that have been sold are initially recorded at fair value. Capitalized servicing rights are amortized in proportion to and over the period of estimated servicing revenues. Impairment of mortgage-servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. For purposes of measuring impairment, the rights are stratified based on the predominant risk characteristics of the underlying loans. The predominant characteristic currently used for stratification is type of loan. The amount of impairment recognized is the amount by which the capitalized mortgage servicing rights for a stratum exceed their fair value.

Note 2: Concentration of Funds and Restriction on Cash and Cash Equivalents

As of September 30, 2008 and 2007, respectively, there were no balances with other financial institutions in excess of the balance insured by the Federal Deposit Insurance Corporation. Additionally, the Company had \$1,567,000 and \$5,699,000 on deposit with the Federal Home Loan Bank of Indianapolis, and \$125,000 and \$126,000 on deposit with the Federal Reserve Bank of Chicago as of September 30, 2008 and 2007, respectively.

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve funds required at September 30, 2008 totaled \$3,216,000.

Note 3: Investment Securities

	2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available for sale				
Federal agencies	\$ 24,303,099	\$ 218,815	\$ 271,519	\$ 24,250,395
State and municipal obligations	33,414,940	24,677	1,076,221	32,363,396
Mortgage-backed securities	47,302,403	80,797	372,695	47,010,505
Total available for sale	<u>105,020,442</u>	<u>324,289</u>	<u>1,720,435</u>	<u>103,624,296</u>
Held to maturity				
Mortgage-backed securities	<u>334,271</u>	<u>9,126</u>	<u>5,831</u>	<u>337,566</u>
Total investment securities	<u>\$ 105,354,713</u>	<u>\$ 333,415</u>	<u>\$ 1,726,266</u>	<u>\$ 103,961,862</u>

Peoples Bancorp
Notes to Consolidated Financial Statements
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	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
Federal agencies	\$ 72,103,912	\$ 175,834	\$ 454,100	\$ 71,825,646
State and municipal obligations	10,560,571	14,710	156,570	10,418,711
Mortgage-backed securities	4,437,411	14,879	96,827	4,355,463
Total available for sale	<u>87,101,894</u>	<u>205,423</u>	<u>707,497</u>	<u>86,599,820</u>
Held to maturity				
Mortgage-backed securities	<u>423,173</u>	<u>9,906</u>	<u>8,334</u>	<u>424,745</u>
Total investment securities	<u>\$ 87,525,067</u>	<u>\$ 215,329</u>	<u>\$ 715,831</u>	<u>\$ 87,024,565</u>

The amortized cost and fair value of securities held to maturity and available for sale at September 30, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Maturity Distributions at September 30	2008			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 4,433,372	\$ 4,443,546	\$ -	\$ -
One to five years	16,910,314	16,761,780	-	-
Five to ten years	20,443,311	20,264,767	-	-
After ten years	<u>15,931,042</u>	<u>15,143,698</u>	-	-
Mortgage-backed securities	<u>57,718,039</u>	<u>56,613,791</u>	-	-
	<u>47,302,403</u>	<u>47,010,505</u>	<u>334,271</u>	<u>337,566</u>
	<u>\$ 105,020,442</u>	<u>\$ 103,624,296</u>	<u>\$ 334,271</u>	<u>\$ 337,566</u>

Securities with a carrying value of \$897,000 and \$1,050,000 were pledged at September 30, 2008 and 2007 to secure repurchase agreements. Securities with a carrying value of \$3,504,000 and \$4,350,000 were pledged at September 30, 2008 and 2007 to secure certain deposits.

Proceeds from sales of securities available for sale during 2008 and 2007 were \$17,314,000 and \$4,502,000, respectively. Gross gains of \$307,000 and \$20,000 were realized on investment transactions during 2008 and 2007, respectively. Gross losses of \$43,000 and \$15,000 were realized on investment transactions during 2008 and 2007, respectively.

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Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at September 30, 2008 and 2007 was \$62,972,000 and \$63,076,000, which is approximately 61% and 72% of the Company's available-for-sale and held-to-maturity investment portfolio. These declines primarily resulted from fluctuations in market interest rates after the purchase.

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other – than-temporary impairment is identified.

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2008:

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal agencies	\$ 3,548,507	\$ 22,359	\$ 250,840	\$ 249,160	\$ 3,799,347	\$ 271,519
State and municipal obligations	24,933,474	899,665	2,632,065	176,556	27,565,539	1,076,221
Mortgage-backed securities	29,475,913	345,434	2,131,189	33,092	31,607,102	378,526
Total temporarily impaired securities	<u>\$ 57,957,894</u>	<u>\$ 1,267,458</u>	<u>\$ 5,014,094</u>	<u>\$ 458,808</u>	<u>\$ 62,971,988</u>	<u>\$ 1,726,266</u>

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2007:

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal agencies	\$ -	\$ -	\$ 50,204,415	\$ 454,100	\$ 50,204,415	\$ 454,100
State and municipal obligations	1,987,331	40,618	7,159,366	115,952	9,146,697	156,570
Mortgage-backed securities	8,680	20	3,716,549	105,141	3,725,229	105,161
Total temporarily impaired securities	<u>\$ 1,996,011</u>	<u>\$ 40,638</u>	<u>\$ 61,080,330</u>	<u>\$ 675,193</u>	<u>\$ 63,076,341</u>	<u>\$ 715,831</u>

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Notes to Consolidated Financial Statements
September 30, 2008 and 2007

Note 4: Loans and Allowance

	<u>2008</u>	<u>2007</u>
Commercial and commercial mortgage loans	\$ 33,615,442	\$ 31,444,707
Real estate loans	278,577,145	307,292,018
Construction loans	1,150,324	3,295,699
Individuals' loans for household and other personal expenditures	5,933,113	10,491,307
	<u>319,276,024</u>	<u>352,523,731</u>
Less:		
Undisbursed portion of loans	203,658	1,574,144
Deferred loan fees and discounts	738,413	886,108
Allowance for loan losses	1,871,970	1,833,682
	<u>2,814,041</u>	<u>4,293,934</u>
Total loans	<u>\$ 316,461,983</u>	<u>\$ 348,229,797</u>

	<u>2008</u>	<u>2007</u>
Allowance for loan losses		
Balances, October 1	\$ 1,833,682	\$ 1,898,257
Provision for losses	522,448	76,972
Recoveries on loans	41,000	7,513
Loans charged off	(525,160)	(149,060)
	<u>\$ 1,871,970</u>	<u>\$ 1,833,682</u>
Balances, September 30		

Impaired loans were as follows:

	<u>2008</u>	<u>2007</u>
Year-end loans with no allocated allowance for loan losses	\$ 308,007	\$ -
Year-end loans with allocated allowance for loan losses	1,497,586	500,868
	<u>\$ 1,805,593</u>	<u>\$ 500,868</u>
Amount of the allowance for loan losses allocated	\$ 477,535	\$ 40,000

	<u>2008</u>	<u>2007</u>
Average balance of impaired loans during the year	\$ 1,507,296	\$ 262,505
Interest income recognized during impairment	63,548	-
Cash-basis interest income recognized	60,775	1,372

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The Company considers its investment in one-to-four family residential loans and consumer loans to be homogeneous and therefore excluded from separate identification for evaluation of impairment.

At September 30, 2008 and 2007, non-accruing loans were \$3,125,000 and \$1,003,000, respectively. There are no loans delinquent 90 days or more and still accruing as of September 30, 2008 and 2007, respectively.

Note 5: Premises and Equipment

	2008	2007
Land	\$ 1,369,541	\$ 1,344,098
Buildings	9,178,278	9,154,093
Equipment	7,876,947	6,286,248
Total cost	<u>18,424,766</u>	<u>16,784,439</u>
Accumulated depreciation	<u>(12,023,546)</u>	<u>(11,229,098)</u>
Net	<u><u>\$ 6,401,220</u></u>	<u><u>\$ 5,555,341</u></u>

Depreciation and amortization expense for 2008 and 2007 was \$781,000 and \$637,000, respectively.

Note 6: Deposits

	2008	2007
Noninterest-bearing demand deposits	\$ 15,570,530	\$ 15,654,934
Interest-bearing demand deposits	78,388,245	75,501,731
Savings deposits	51,618,845	44,318,245
Certificates and other time deposits of \$100,000 or more	31,867,199	43,419,375
Other certificates and time deposits	<u>141,800,894</u>	<u>170,396,897</u>
	<u><u>\$ 319,245,713</u></u>	<u><u>\$ 349,291,182</u></u>

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Certificates and other time deposits maturing in years ending September 30:

2009	\$ 90,016,312
2010	29,196,641
2011	37,444,824
2012	10,454,356
2013	<u>6,555,960</u>
	<u>\$ 173,668,093</u>

Note 7: Short-Term Borrowings

	<u>2008</u>	<u>2007</u>
Securities sold under agreements to repurchase	\$ 191,180	\$ 1,000,511

At September 30, 2008 and 2007, the securities sold under agreements to repurchase obligations were secured by investment securities and such collateral is held by a safekeeping agent. The maximum amount of outstanding agreements at any month-end during 2008 and 2007 totaled \$1,225,000 and \$1,092,000 and the average of such agreements for the years ended September 30, 2008 and 2007 totaled \$555,000 and \$631,000, respectively.

Note 8: Federal Home Loan Bank Advances

Federal Home Loan Bank advances at September 30, 2008 and 2007 totaled \$75,350,000 and \$53,480,000 and were at various rates ranging from 2.00% to 7.21% maturing at various dates through July 2018. The Federal Home Loan Bank advances are secured by first mortgage loans totaling \$242,657,000. Advances are subject to restrictions or penalties in the event of prepayment.

<u>Maturities in years ending September 30</u>	<u>Amount</u>	<u>Weighted-Average Rate</u>
2009	\$ 15,900,000	4.49%
2010	13,700,000	5.77%
2011	8,250,000	4.76%
2012	15,000,000	4.75%
2013	15,500,000	3.56%
Thereafter	<u>7,000,000</u>	4.29%
	<u>\$ 75,350,000</u>	

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Amounts advanced totaling \$20,500,000 are subject to an option for the FHLB to convert the entire advance to a periodic adjustable rate five years after the date of the advance. The adjustable rate would be for the remaining term at the predetermined rate of three-month LIBOR or three-month LIBOR plus .0002 (.02 basis points), varying by advance. If the FHLB exercises its option to convert the advance to an adjustable rate, the advance will be pre-payable at the Banks' option, at par without a penalty fee.

Note 9: Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgage loans serviced for others was \$57,643,000 and \$51,067,000 at September 30, 2008 and 2007, respectively.

	2008	2007
Mortgage servicing rights		
Balance, beginning of year	\$ 166,487	\$ 191,751
Servicing rights capitalized	110,227	71,999
Amortization of servicing rights	(90,143)	(97,263)
Balance, end of year	\$ 186,571	\$ 166,487

The fair value of servicing rights subsequently measured using the amortization method was as follows:

Fair value, beginning of period	\$ 166
Fair value, end of period	187

Note 10: Core Deposit Intangible

The carrying basis and accumulated amortization of recognized core deposit intangibles at September 30, 2008 and 2007, were:

	2008	2007
Gross carrying amount	\$ 1,154,000	\$ 1,154,000
Accumulated amortization	(1,154,000)	(1,096,564)
	\$ -	\$ 57,436

Amortization expense for the years ended September 30, 2008 and 2007 was approximately \$57,000 and \$138,000, respectively.

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Note 11: Income Tax

	<u>2008</u>	<u>2007</u>
Income tax expense		
Currently payable		
Federal	\$ 1,228,123	\$ 1,298,666
State	71,153	127,895
Deferred		
Federal	23,068	(167,006)
State	3,447	(32,095)
	<u> </u>	<u> </u>
Total income tax expense	<u>\$ 1,325,791</u>	<u>\$ 1,227,460</u>
Reconciliation of federal statutory to actual tax expense		
Federal statutory income tax at 34%	\$ 1,580,409	\$ 1,369,818
Tax exempt interest	(213,120)	(110,700)
Nondeductible expenses	1,845	1,349
Effect of state income taxes	49,236	63,228
Cash surrender value	(82,278)	(19,445)
Effect of low income housing credits	(57,499)	(98,569)
Other	47,198	21,779
	<u> </u>	<u> </u>
Actual tax expense	<u>\$ 1,325,791</u>	<u>\$ 1,227,460</u>

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	<u>2008</u>	<u>2007</u>
Assets		
Allowance for loan losses	\$ 772,586	\$ 753,515
Loan fees	297,028	226,336
Net unrealized losses on securities available for sale	498,840	178,346
Capital loss carry-forward	78,129	225,579
Other	202,362	190,135
	<u> </u>	<u> </u>
Total assets	<u>1,848,945</u>	<u>1,573,911</u>
Liabilities		
Depreciation	71,756	82,166
State income tax	42,232	39,003
FHLB of Indianapolis stock dividend	249,079	247,293
Prepaid expenses	79,755	76,622
Other	281,253	297,936
	<u> </u>	<u> </u>
Total liabilities	<u>724,075</u>	<u>743,020</u>
	<u> </u>	<u> </u>
	<u>\$ 1,124,870</u>	<u>\$ 830,891</u>

Management believes no valuation allowance is necessary at September 30, 2008 and 2007.

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Note 13: Commitments and Contingent Liabilities

In the normal course of business there are outstanding commitments and contingent liabilities, such as commitments to extend credit, which are not included in the accompanying consolidated financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheets.

Financial instruments whose contract amount represents credit risk at September 30, 2008 and 2007 consisted of commitments to extend credit totaling \$53,044,000 and \$40,816,000.

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. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include residential real estate, income-producing commercial properties, or other assets of the borrower.

The Company has employment agreements with two officers which include provisions for payment to them of three and two years' salary, respectively, in the event of their termination in connection with any change in ownership or control of the Company, other than by agreement. The agreements have terms of three and two years, respectively, which may be extended annually for successive periods of one year.

The Company and subsidiaries are also subject to possible claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate determination of such possible claims or lawsuits will not have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company.

Note 14: Dividends and Capital Restrictions

Without prior approval, current regulations allow the Bank to pay dividends to the Company not exceeding net profits (as defined) for the current calendar year to date plus those for the previous two years. The Bank normally restricts dividends to a lesser amount because of the need to maintain an adequate capital structure.

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Note 15: Regulatory Capital

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. The assigned capital category is largely determined by ratios that are calculated according to the regulations. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. At September 30, 2008, the Bank was categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since September 30, 2008 that management believes have changed the Bank's classification.

Peoples' actual and required capital amounts and ratios are as follows:

	Actual		2008 Required for Adequate Capital ¹		To Be Well Capitalized ¹	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital ¹ (to risk-weighted assets)	\$ 54,382,000	22.97%	\$ 18,937,000	8.00%	\$ 23,672,000	10.00%
Tier 1 risk-based capital ¹ (to risk-weighted assets)	52,525,000	22.19%	9,469,000	4.00%	14,203,000	6.00%
Core capital ¹ (to adjusted total assets)	52,525,000	11.58%	18,142,000	4.00%	22,677,000	5.00%
Core capital ¹ (to adjusted tangible assets)	52,525,000	11.58%	9,071,000	2.00%	NA	NA
Tangible capital ¹ (to adjusted total assets)	52,525,000	11.58%	6,803,000	1.50%	NA	NA

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	Actual		2007 Required for Adequate Capital ¹		To Be Well Capitalized ¹	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital ¹ (to risk-weighted assets)	\$ 44,474,000	24.20%	\$ 14,672,000	8.00%	\$ 18,340,000	10.00%
Tier 1 risk-based capital ¹ (to risk-weighted assets)	43,171,000	23.50%	7,336,000	4.00%	11,004,000	6.00%
Core capital ¹ (to adjusted total assets)	43,171,000	11.70%	14,803,000	4.00%	18,504,000	5.00%
Core capital ¹ (to adjusted tangible assets)	43,171,000	11.70%	7,401,000	2.00%	NA	NA
Tangible capital ¹ (to adjusted total assets)	43,171,000	11.70%	5,551,000	1.50%	NA	NA

First Savings' actual and required capital amounts and ratios are as follows:

	Actual		2007 Required for Adequate Capital ¹		To Be Well Capitalized ¹	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital ¹ (to risk-weighted assets)	\$ 14,806,000	29.30%	\$ 4,037,000	8.00%	\$ 5,047,000	10.00%
Tier 1 risk-based capital ¹ (to risk-weighted assets)	14,291,000	28.30%	2,019,000	4.00%	3,028,000	6.00%
Core capital ¹ (to adjusted total assets)	14,291,000	14.70%	3,879,000	4.00%	4,848,000	5.00%
Core capital ¹ (to adjusted tangible assets)	14,291,000	14.70%	1,939,000	2.00%	NA	NA
Tangible capital ¹ (to adjusted total assets)	14,291,000	14.70%	1,454,000	1.50%	NA	NA

¹As defined by Regulatory Agencies

Note 16: Employee Benefit Plans

The Bank is a participant in a pension fund known as the Financial Institutions Retirement Fund (FIRF). This plan is a multi-employer plan; separate actuarial valuations are not made with respect to each participating employer. This plan provides pension benefits for substantially all of the Company's employees. Pension expense was approximately \$562,000 and \$1,181,000 for 2008 and 2007. The benefits of this plan were frozen on August 1, 2007.

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A profit-sharing plan is maintained for the benefit of substantially all of the Company's employees and allows for both employee and Company contributions. The Company contribution consists of a matching contribution of 50 percent of employee contributions, up to 6 percent of eligible employee compensation. The Company may also contribute an additional discretionary amount to each employee, regardless of participation in the matching program. The Company's contribution to the plan, for the matching program was approximately \$101,000 and \$109,000 for 2008 and 2007. The Company's contribution for the discretionary program was \$146,000 and \$28,000 for 2008 and 2007.

Note 17: Stock Option Plan

Under the Company's incentive stock option plan approved in 1998, which is accounted for in accordance with SFAS No. 123R, the Company grants selected executives and other key employees stock option awards which vest and become fully exercisable at the end of five years of continued employment. During 1999, the Company authorized the grant of options for up to 200,000 shares of the Company's common stock. The exercise price of each option, which has a ten-year life, was equal to or greater than the market price of the Company's stock on the date of grant. The Company has not granted any options during the two year period ended September 30, 2008.

The following is a summary of the status of the Company's stock option plan and changes in that plan as of and for the years ended September 30, 2008 and 2007.

Options	Shares	2008 Weighted- Average Exercise Price	Weighted- Average Remaining Contractual
Outstanding, beginning of year	21,643	\$ 19.30	
Exercised	(594)	13.05	
Forfeited or expired	<u>(16,000)</u>	21.50	
Outstanding, end of year	<u>5,049</u>	\$ 13.05	<u>0.1</u>
Exercisable, end of year	<u>5,049</u>	\$ 13.05	<u>0.1</u>

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Options	Shares	2007 Weighted- Average Exercise Price	Weighted- Average Remaining Contractual
Outstanding, beginning of year	38,741	\$ 18.16	
Exercised	(7,722)	13.50	
Forfeited or expired	<u>(9,376)</u>	19.36	
Outstanding, end of year	<u>21,643</u>	\$ 19.30	<u>1.0</u>
Exercisable, end of year	<u>21,643</u>	\$ 19.30	<u>1.0</u>

The total intrinsic value of options exercised during the years ended September 30, 2008 and 2007 was \$2,000 and \$44,000, respectively.

As of September 30, 2008 and 2007, there was no unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan.

Note 18: Earnings Per Share

For the year ended September 30, 2008, 15,000 options to purchase shares of common stock at an exercise price of \$21.50 were outstanding, but were not included in the computation of diluted earnings per share because the options were anti-dilutive. Earnings per share (EPS) were computed as follows:

	Income	2008 Weighted- Average Shares	Per-Share Amount
Basic Earnings Per Share			
Net income available to common stockholders	\$ 3,322,480	2,966,957	\$ 1.12
Effect of Dilutive Securities			
Stock options	<u>-</u>	<u>421</u>	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	<u>\$ 3,322,480</u>	<u>2,967,378</u>	\$ 1.12

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	Income	2007 Weighted- Average Shares	Per-Share Amount
Basic Earnings Per Share			
Net income available to common stockholders	\$ 2,801,416	3,161,939	\$ 0.89
Effect of Dilutive Securities			
Stock options	-	2,141	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	\$ 2,801,416	3,164,080	\$ 0.89

Note 19: Fair Values of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Cash Equivalents - The fair value of cash and cash equivalents approximates carrying value.

Interest-Bearing Time Deposits - The fair values of interest-bearing time deposits are determined on a discounted cash flow basis.

Investment Securities - Fair values are based on quoted market prices.

Loans and Loans Held for Sale - For both short-term loans and variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for other loans is estimated using discounted cash flow analyses using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Interest Receivable/Payable - The fair values of interest receivable/payable approximate carrying values.

FHLB Stock - Fair value of FHLB stock is based on the price at which it may be resold to the FHLB.

Deposits - The fair values of noninterest-bearing, interest-bearing demand and savings accounts are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on such time deposits.

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Short-Term Borrowings - The fair value of short-term borrowings approximates carrying value.

Federal Home Loan Bank Advances - The fair value of these borrowings is estimated using a discounted cash flow calculation, based on current rates for similar advances.

The estimated fair values of the Company's financial instruments are as follows:

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and cash equivalents	\$ 6,789,106	\$ 6,789,106	\$12,311,371	\$12,311,371
Interest-bearing time deposits	-	-	2,567,908	2,574,000
Investment securities available for sale	103,624,296	103,624,296	86,599,820	86,599,820
Investment securities held to maturity	334,271	337,566	423,173	424,745
Loans, including loans held for sale	316,749,983	317,742,000	348,485,297	346,543,000
Stock in FHLB	4,403,900	4,403,900	4,403,900	4,403,900
Interest receivable	2,742,358	2,742,358	2,951,833	2,951,833
Liabilities				
Deposits	319,245,713	319,497,000	349,291,182	349,237,000
Short-term borrowings	191,180	191,180	1,000,511	1,000,511
Federal Home Loan Bank advances	75,350,000	77,484,000	53,480,000	54,054,000
Interest payable	324,071	324,071	1,889,998	1,889,998

Note 20: Significant Estimates and Concentrations

Current Economic Conditions

The current economic environment presents financial institutions with unprecedented circumstances and challenges which in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The financial statements have been prepared using values and information currently available to the Bank.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses, capital that could negatively impact the Bank's ability to meet regulatory capital requirements and maintain sufficient liquidity.

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Note 21: Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to financial position, results of operations and cash flows of the Company.

Condensed Balance Sheets

	2008	2007
Assets		
Cash	\$ 4,061,135	\$ 2,986,285
Investment in subsidiaries	53,983,794	59,553,403
Securities available for sale	-	69,340
Other assets	21,500	14,801
Total assets	\$ 58,066,429	\$ 62,623,829
Liabilities		
Dividends payable on common stock	\$ 532,191	\$ 590,165
Other	2,997	700
Total liabilities	535,188	590,865
Stockholders' Equity		
Common stock	2,801,007	3,106,134
Additional paid-in capital	-	679,457
Retained earnings	55,626,060	58,570,157
Accumulated other comprehensive loss	(895,826)	(322,784)
Total liabilities and stockholders' equity	\$ 58,066,429	\$ 62,623,829

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Condensed Statements of Income

	2008	2007
Income		
Dividends from subsidiaries	\$ 8,450,000	\$ 2,225,000
Interest on investments securities	848	6,774
	8,450,848	2,231,774
Expenses	208,127	163,665
Income before equity in undistributed income of subsidiaries and income tax expense	8,242,721	2,068,109
Equity in undistributed income of subsidiaries	(4,998,241)	673,307
Income before income tax	3,244,480	2,741,416
Income tax expense (benefit)	(78,000)	(60,000)
Net income	\$ 3,322,480	\$ 2,801,416

Condensed Statements of Cash Flows

	2008	2007
Net cash provided by operating activities	\$ 8,314,645	\$ 2,615,590
Cash flows from investing activities - proceeds from maturities and calls of securities available for sale	69,340	-
Cash flows from financing activities		
Stock repurchased	(5,009,740)	(2,092,750)
Stock options exercised	7,752	104,241
Cash dividends	(2,307,147)	(2,410,710)
Net cash used in financing activities	(7,309,135)	(4,399,219)
Net change in cash	1,074,850	(1,783,629)
Cash at beginning of year	2,986,285	4,769,914
Cash at end of year	\$ 4,061,135	\$ 2,986,285