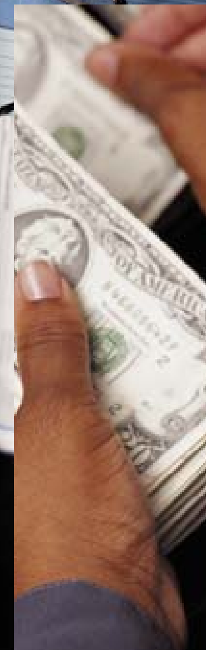
mbc

Middlefield Banc Corp.

2005 annual report

"we're putting banking
to work
in our communities"



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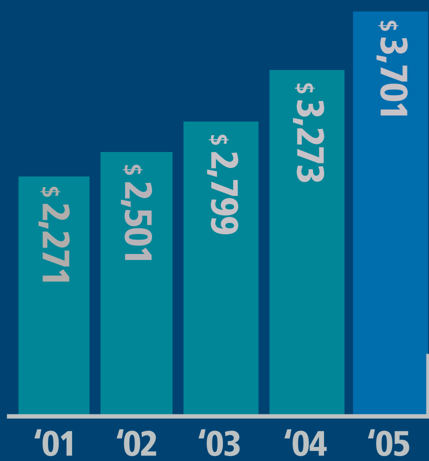
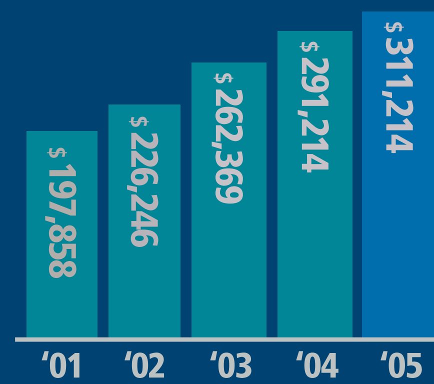
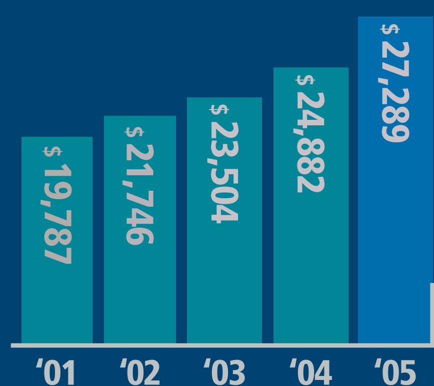
mbc statistical summary



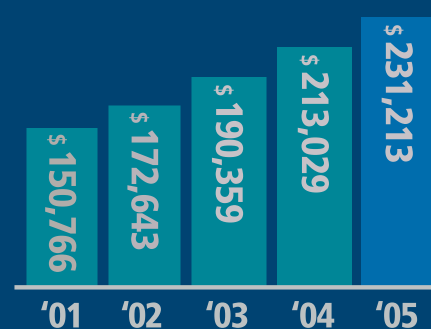
net income
(in thousands)



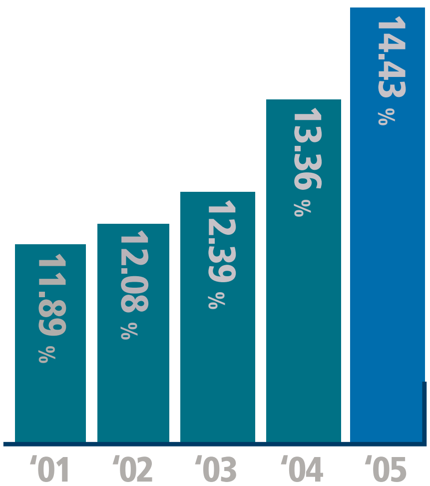
total assets
(in thousands)



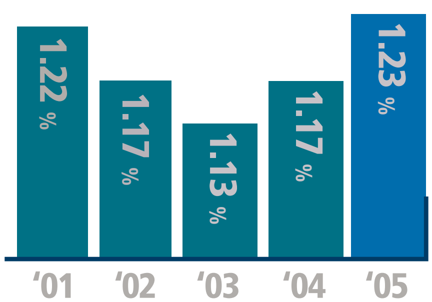
equity capital
(in thousands)



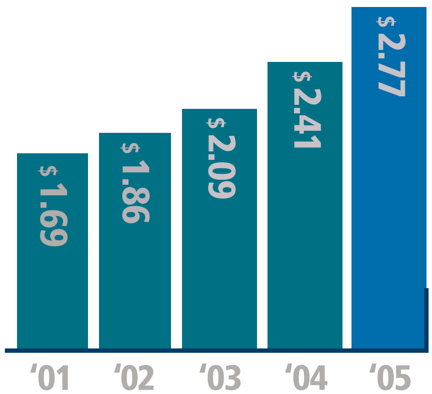
net loans outstanding
(in thousands)



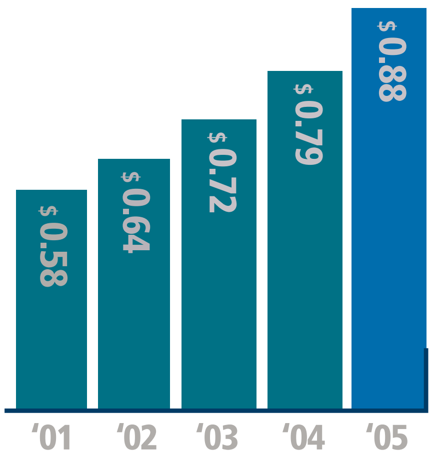
return on average equity



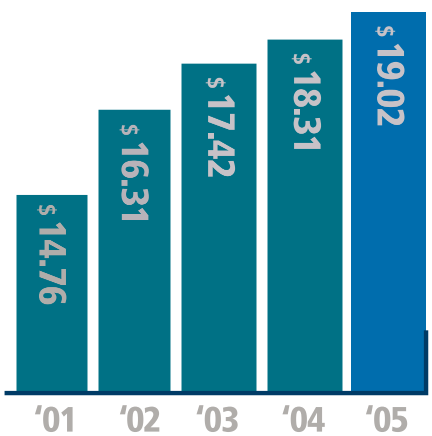
return on average assets



basic earnings per share



dividends per share



book value per share

mbc decade of progress

	1996	1997	1998
Interest Income	$10,375,117	$10,599,777	$10,901,445
Interest Expense	$4,985,064	$5,083,713	$5,084,615
Net interest Income	**$5,390,053**	**$5,516,064**	**$5,816,830**
Provision for loan losses	$351,000	$200,000	$270,000
Net interest Income After Provision for loan losses	**$5,039,053**	**$5,316,064**	**$5,546,830**
Noninterest Income, Including Security Gains/Losses	$586,328	$546,103	$598,771
Noninterest Expense	$3,245,926	$3,493,280	$3,824,819
Income Before Income Taxes	**$2,379,455**	**$2,368,887**	**$2,320,782**
Income Taxes	$657,000	$624,243	$630,337
Net Income	**$1,722,455**	**$1,744,644**	**$1,690,445**
Total Assets	$133,867,396	$142,276,167	$155,557,609
Deposits	$119,254,240	$121,482,038	$128,827,889
Equity Capital	$14,135,561	$15,465,255	$16,656,797
Loans Outstanding, Net	$83,946,960	$88,320,047	$102,728,454
Allowance For Loan Losses	$1,138,919	$1,334,800	$1,538,726
Net Charge-Offs (Recoveries)	$280,037	$4,119	$66,074
Full Time Employees (Average Equivalents)	53	56	59
Number of Offices	3	3	4
Basic Earnings Per Share	1.24	1.25	1.21
Dividends Per Share	0.28	0.31	0.36
Book Value Per Share	10.12	11.08	11.93
Dividends Pay-out Ratio	22.61%	24.98%	29.53%
Cash Dividends Paid	$389,365	$435,747	$499,215
Return on Average Assets	1.29%	1.23%	1.15%
Return on Average Equity	12.21%	11.67%	10.43%

Notes

The above per share amounts have been restated to reflect the five for one stock split effected in 1995, the 10% stock dividend paid in 1997 and 1998, the two for one stock split effected in 2000 and the 5% stock dividend paid in 2002, 2003, 2004, and 2005.

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1999	2000	2001	2002	2003	2004	2005
$11,448,619	$12,770,170	$13,706,569	$14,119,963	$14,647,163	$15,732,536	$17,378,504
$5,048,276	$5,909,884	$6,747,922	$6,148,086	$5,724,907	$5,768,898	$6,654,614
$6,400,343	**$6,860,286**	**$6,958,647**	**$7,971,877**	**$8,922,256**	**$9,963,638**	**$10,723,890**
$296,000	$275,000	$170,000	$300,000	$315,000	$174,000	$302,000
$6,104,343	**$6,585,286**	**$6,788,647**	**$7,671,877**	**$8,607,256**	**$9,789,638**	**$10,421,890**
$804,358	$982,663	$1,194,193	$1,143,217	$1,428,144	$1,779,231	$2,119,237
$4,254,374	$4,408,617	$4,741,374	$5,206,339	$6,105,450	$6,965,706	$7,424,640
$2,654,327	**$3,159,332**	**$3,241,466**	**$3,608,755**	**$3,929,950**	**$4,603,163**	**$5,116,487**
$735,318	$992,661	$970,859	$1,107,806	$1,131,330	$1,330,000	$1,415,156
$1,919,009	**$2,166,671**	**$2,270,607**	**$2,500,949**	**$2,798,620**	**$3,273,163**	**$3,701,331**
$165,512,453	$176,488,813	$197,857,964	$226,245,533	$262,369,448	$291,213,986	$311,214,191
$135,094,459	$147,166,046	$167,382,728	$187,384,494	$219,839,910	$239,885,451	$249,449,640
$17,689,055	$18,243,362	$19,786,807	$21,746,408	$23,504,314	$24,822,024	$27,289,365
$119,471,741	$133,266,893	$150,766,103	$172,642,646	$190,358,883	$213,029,852	$231,213,699
$1,756,137	$2,037,322	$2,062,252	$2,300,485	$2,521,270	$2,623,431	$2,841,098
$78,589	-$6,185	$145,070	$61,767	$94,215	$71,839	$84,333
61	57	64	66	72	73	75
4	4	5	5	6	6	6
1.38	1.66	1.69	1.86	2.09	2.41	2.77
0.41	0.44	0.58	0.64	0.72	0.79	0.88
12.74	13.61	14.76	16.31	17.42	18.31	19.02
29.82%	27.47%	34.00%	34.30%	34.37%	32.72%	32.10%
$572,343	$595,255	$772,068	$857,751	$961,901	$1,070,833	$1,188,145
1.21%	1.31%	1.22%	1.17%	1.13%	1.17%	1.23%
11.17%	12.83%	11.89%	12.08%	12.39%	13.36%	14.43%

letter to our shareholders

Thomas G. Caldwell

Donald D. Hunter

To Our Shareholders and Friends:

Record Profits. Constricted Growth. Change. Challenge. These all come to mind when we consider the performance of your company in 2005.

The year was marked by a record level of net income. The $3,701,322 that we achieved in 2005 was 13% higher than the figure that we produced in 2004. Our earnings per diluted share were $2.73, up from $2.39 in 2004. Our return on average equity for 2005 was 14.43%, which compares favorably to 13.36% for the prior year. The respective returns on average assets were 1.23% for 2005 and 1.17% for 2004.

Growth of our balance sheet was not to the levels that we had planned. Contributing to this were the policy of measured increases in interest rates by the Federal Open Market Committee, the strong performance of the stock market, and the resulting highly competitive nature of our primary market area. In the face of these factors, we were still able to achieve an increase in assets of just over $20 million. For the first time in our history, we ended the year with assets of over $311 million. Taking an historical perspective, we note that from the founding of the bank in 1901, assets did not surpass the $100 million mark until 1992. We grew another $100 million by 2002, and have now achieved the next milestone in three years. This is testament to the efforts of our employees, officers, and directors, as well as the continuing support of our shareholders.

Change has been and will continue to be dominated by the economy from a national and international perspective. The aforementioned policy of measured increases in interest rates was capped off by the retirement of the Chairman of the Board of Governors of the Federal Reserve System. A new Chairman is now in place, with the expectation that a similar approach to economic policy will be continued. Employment is strong, housing continues near record pace, and tax-based initiatives have stimulated a pattern of consistent investment. All of these require that we more closely examine our business practices so that we are able to achieve the maximum return for your benefit.

These changes have also produced severe challenges for us. Our net interest margin, as well as those of our competitors, is undergoing significant compression factors. The interest rate curve has become inverted and has served to make pricing difficult, at the very least. Recently, the Treasury re-introduced the 30-year bond. As an example of the complexities of the market, this “long” bond has produced a yield well below that of the 1-year Treasury instrument.

On more positive notes, we are pleased to report that all six of our banking offices achieved profitable performance in 2005. We believe that our commitment to our Core Values, which guides our approach to banking services, has been a factor in this achievement. As further evidence of our strong community oriented approach, we are proud to report that we received a rating of Outstanding under our Community Reinvestment Act examination by the FDIC during 2005.

We have continued our efforts to stay near the forefront of technological changes within the industry. In February of 2005, we introduced an image-based proof of deposit system. This has permitted more efficient backroom operations and the ability to deliver deposit account images over the Internet, as well as in statements and on compact disc. Late in the third quarter, we also initiated statement delivery via e-mail. In December, we began to deliver our outgoing cash letter to the Federal Reserve in an electronic format, and expect to begin receiving the same in February of 2006.

Our venture with UVEST Financial Services® continues in a positive trend. Assets under management now top $14.5 million. Efforts will continue to advance this opportunity to provide a diverse offering of investment and savings options.

EasyLink, our Internet banking solution continues to receive positive reviews and expanded usage. Available to both individual consumers as well as businesses, this banking alternative permits full account access, including bill payment and check images, all within the comfort of your home or office. Additionally, our commercial customers may also take advantage of ACH and employee direct deposit capability.

In December, Middlefield Banc Corp. paid a 5% stock dividend. This reflects a practice that we have adopted for the benefit of our shareholders, along with paying a strong cash dividend. For perspective, a shareholder owning 100 shares in January of 1995 would today hold 1,541 shares. We were also pleased to increase the cash portion of our dividend in 2005 by 11.1% from the level of 2004.

At our annual meeting in 2006, Director George F. Hasman will be retiring. Having spent his career in banking, Mr. Hasman has provided positive insights and strong guidance in the growth of Middlefield Banc Corp. since he joined the board in 1989. His counsel will be missed, but we wish him only the best in the coming years.

As we look back over the past year, we recognize that the cornerstone to our success has been the dedication of many who have worked diligently for the growth of your company. Our sincere thanks go to our Directors, Management Team, and Employees, who, by working together, have made Middlefield Banc Corp. into a stronger, more efficient company poised for the future.

Sincerely,

Thomas Caldwell

Thomas G. Caldwell
President and Chief Executive Officer

Donald D. Hunter

Donald D. Hunter
Chairman, Board of Directors

we're putting banking to work

The Middlefield Banking Company has been proud to serve the communities of Middlefield, Chardon, Garrettsville, Mantua and Orwell and their surrounding territories for more than one hundred years. Our remarkable history tells story after story of people helping people through home loans, savings for life's milestones, business development loans, and more. We saw integrity in the eyes of our customers then and we see it today. Our success as a community bank was built by the honest, hard-working people we have served.

What do these communities look like in terms of growth, development, job opportunity and family life? What potential do the local counties hold for our future? How is The Middlefield Banking Company poised to meet the needs of Geauga, Portage and Ashtabula Counties in Ohio?

While Ohio saw a population increase of 4.6%, Geauga County's population has grown by 16.6% since 1990, to 94,602. Fastest growing areas in the county were Auburn and Troy, followed by Chardon, Hambden, Montville, Thompson and Parkman. Portage County's population is currently 154,764 marking an increase of 8.5%, and Ashtabula grew 3.3% during this period to a total population of 103,152. Each of these areas is projected to continue their growth pattern, so that by 2020 each will grow by 15.3%, 6.3% and 3.3% respectively.

The chart below shows the promise of the future held within the counties we serve, and the potential offered to The Middlefield Banking Company.

	Geauga	**Portage**	**Ashtabula**
Per Capita Income 2004	**$38,403**	**$27,735**	**$23,965**
Avg Household Income	**60,200**	**44,347**	**35,607**
National Avg Income — $40,956			
Avg Home Price	**$182,400**	**$123,000**	**$ 85,300**
% Increase since 1970	**33.2%**	**39.9%**	**47.4%**
Median Age	**38.7**	**34.4**	**37.6**
Unemployment Rate	**4.7%**	**5.8%**	**7.3%**
Active Businesses	**2119**	**2804**	**2067**

As The Middlefield Banking Company moves forward, we see a continued vision of improving lives in Geauga, Portage and Ashtabula Counties. We will continue the tradition of putting banking to work in our communities.

in our communities

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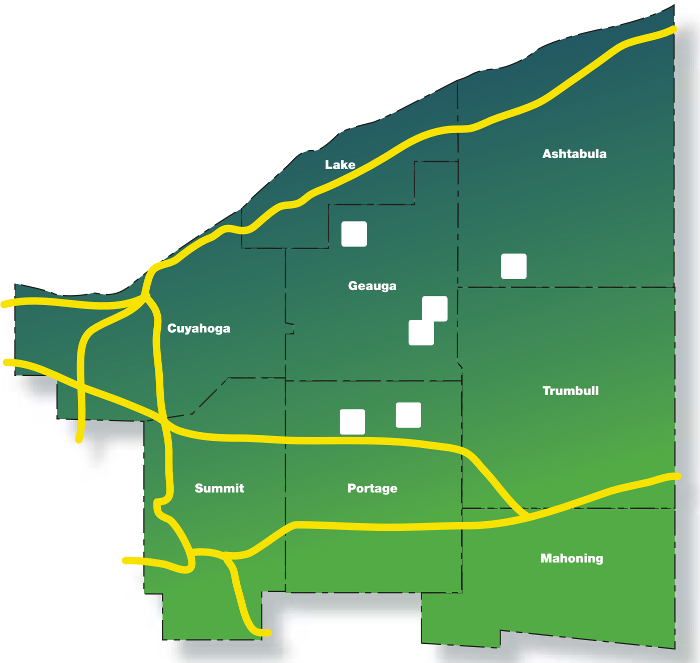

Additional ATM Location –

Hiram College, Kennedy Center, Main Entrance,
11730 Garfield Avenue, Hiram, Ohio 44234

Garrettsville
(Drive Up ATM)
8058 State Street
Garrettsville, Ohio 44231
888-801-2121 • 330-527-2121
Fax 330-527-4210

Mantua
(Walk Up ATM)
10519 Main Street
P.O. Box 648
Mantua, Ohio 44255
877-274-0881 • 330-274-0881
Fax 330-274-0883

Chardon
(Drive Up ATM)
348 Center Street
P.O. Box 1078
Chardon, Ohio 44024
888-801-1666 • 440-286-1222
Fax 440-286-1111

Orwell
(Drive Up ATM)
30 South Maple Avenue
P.O. Box 66
Orwell, Ohio 44076
888-801-1666 • 440-437-7200
Fax 440-437-1111

Middlefield – Main Office
(Walk Up ATM)
15985 East High Street
P.O. Box 35
Middlefield, Ohio 44062
888-801-1666 • 440-632-1666
Fax 440-632-1700

Middlefield – West Branch
(Drive Up ATM)
15545 West High Street
P.O. Box 35
Middlefield, Ohio 44062
888-801-1666 • 440-632-1666
Fax 440-632-9781

branch locations

consolidated statements

consolidated balance sheet

Year Ended December 31,	2005	2004
ASSETS		
Cash and due from banks	$ 5,294,641	$ 5,311,776
Interest-bearing deposits in other institutions	526,523	614,506
Investment securities available for sale	57,887,130	57,240,965
Investment securities held to maturity (estimated market value of $232,967 and $243,810)	221,453	221,412
Loans	234,054,797	215,653,283
Less allowance for loan losses	2,841,098	2,623,431
Net loans	231,213,699	213,029,852
Premises and equipment	6,624,776	6,617,594
Bank-owned life insurance	5,632,982	5,424,304
Accrued interest and other assets	3,812,987	2,753,577
TOTAL ASSETS	$ 311,214,191	$ 291,213,986
LIABILITIES		
Deposits:		
Non-interest-bearing demand	$ 39,782,375	$ 36,331,809
Interest-bearing demand	9,362,399	8,817,873
Money market	13,078,829	15,666,730
Savings	66,495,057	75,280,343
Time	120,730,980	103,788,696
Total deposits	249,449,640	239,885,451
Short-term borrowings	6,710,914	1,871,763
Other borrowings	26,578,211	23,683,324
Accrued interest and other liabilities	1,186,061	951,424
TOTAL LIABILITIES	283,924,826	266,391,962
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 1,434,987 and 1,355,488 shares issued	15,976,335	12,815,927
Retained earnings	14,959,891	15,004,552
Accumulated other comprehensive income (loss)	(677,088)	(28,682)
Treasury stock, at cost (89,333 shares)	(2,969,773)	(2,969,773)
TOTAL STOCKHOLDERS' EQUITY	27,289,365	24,822,024
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 311,214,191	$ 291,213,986

See accompanying notes to consolidated financial statements.

Year Ended December 31,	2005	2004	2003
INTEREST AND DIVIDEND INCOME			
Interest and fees on loans	$15,040,518	$13,617,560	$12,846,525
Interest-bearing deposits in other institutions	15,500	5,641	17,188
Federal funds sold	35,173	50,608	48,947
Investment securities:			
Taxable	1,353,035	1,400,063	1,196,221
Tax-exempt	864,745	604,399	486,485
Otherr dividend income	69,533	54,265	51,797
Total interest and dividend income	17,378,504	15,732,536	14,647,163
INTEREST EXPENSE			
Deposits	5,520,206	4,905,899	4,905,826
Short-term borrowings	103,836	2,180	4,048
Other borrowings	1,030,572	860,819	815,033
Total interest expense	6,654,614	5,768,898	5,724,907
NET INTEREST INCOME	10,723,890	9,963,638	8,922,256
Provision for loan losses	302,000	174,000	315,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,421,890	9,789,638	8,607,256
NONINTEREST INCOME			
Service charges on deposit accounts	1,579,121	1,402,027	1,033,928
Investment securities gains (losses), net	—	(98,375)	542
Earnings on bank-owned life insurance	208,677	221,919	202,385
Other income	331,439	253,660	191,289
Total noninterest income	2,119,237	1,779,231	1,428,144
NONINTEREST EXPENSE			
Salaries and employee benefits	3,568,603	3,442,262	3,085,451
Occupancy	495,982	494,759	403,591
Equipment	432,635	356,346	333,163
Data processing costs	625,856	538,349	470,393
Professional fees	293,138	252,731	218,838
Ohio state franchise tax	284,950	285,050	265,050
Advertising	302,679	253,858	168,849
Postage and freight	189,970	178,717	161,632
Other expense	1,230,826	1,163,634	998,483
Total noninterest expense	7,424,639	6,965,706	6,105,450
Income before income taxes	5,116,488	4,603,163	3,929,950
Income taxes	1,415,156	1,330,000	1,131,330
NET INCOME	$ 3,701,332	$ 3,273,163	$ 2,798,620
EARNINGS PER SHARE			
Basic	$2.77	$2.41	$ 2.09
Diluted	2.73	2.39	2.08

See accompanying notes to consolidated financial statements.

consolidated statement of income

mbc consolidated statements

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity	Comprehensive Income
Balance, December 31, 2002	1,209,123	7,883,155	15,051,110	475,428	(1,663,285)	21,746,408	
Net income			2,798,620			2,798,620	$ 2,798,620
Other comprehensive income:							
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of tax benefit of $180,421				(350,229)		(350,229)	(350,229)
Comprehensive income							$ 2,448,391
Exercise of stock options	847	19,916				19,916	
Common stock issued	5,612	170,513				170,513	
Purchase of treasury stock					(81,624)	(81,624)	
Five percent stock dividend (including cash paid for fractional shares)	57,972	1,797,165	(1,801,961)			(4,796)	
Dividend reinvestment plan	5,574	167,407				167,407	
Cash dividends ($.72 per share)			(961,901)			(961,901)	
Balance, December 31, 2003	1,279,128	$ 10,038,156	$ 15,085,868	$ 125,199	$ (1,744,909)	$ 23,504,314	
Net income			3,273,163			3,273,163	$ 3,273,163
Other comprehensive income:							
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of tax benefit of $79,272				(153,881)		(153,881)	(153,881)
Comprehensive income							$ 3,119,282
Exercise of stock options	521	14,198				14,198	
Common stock issued	8,154	277,171				277,171	
Purchase of treasury stock					(1,224,864)	(1,224,864)	
Five percent stock dividend (including cash paid for fractional shares)	61,387	2,271,282	(2,283,646)			(12,364)	
Dividend reinvestment plan	6,298	215,120				215,120	
Cash dividends ($.79 per share)			(1,070,833)			(1,070,833)	
Balance, December 31, 2004	1,355,488	$ 12,815,927	$ 15,004,552	$ (28,682)	$ (2,969,773)	$ 24,822,023	
Net income			3,701,332			3,701,332	$ 3,701,332
Other comprehensive income:							
Unrealized gain on available-for-sale securities, net of tax benefit of $334,027				(648,406)		(648,406)	(648,406)
Comprehensive income							$ 3,052,926
Exercise of stock options	2,583	71,386				71,386	
Common stock issued	7,158	285,669				285,669	
Purchase of treasury stock							
Five percent stock dividend (including cash paid for fractional shares)	63,549	2,557,847	(2,572,949)			(15,102)	
Dividend reinvestment plan	6,209	245,506				245,506	
Cash dividends ($.88 per share)			(1,173,044)			(1,173,044)	
Balance, December 31, 2005	1,434,987	$ 15,976,335	$ 14,959,891	$ (677,088)	$ (2,969,773)	$ 27,289,364	

Components of comprehensive income:	2005	2004	2003
Change in net unrealized loss on investments available-for-sale	$ (648,406)	$ (218,808)	$ (349,871)
Realized losses (gains) included in net income, net of taxes of $0, $33,448, and ($184)	—	64,927	(358)
Total	$ (648,406)	$ (153,881)	$ (350,229)

See accompanying notes to consolidated financial statements.

consolidated statement of changes in stockholders' equity

Year Ended December 31,	2005	2004	2003
OPERATING ACTIVITIES			
Net income	$ 3,701,332	$ 3,273,163	$ 2,798,620
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	302,000	174,000	315,000
Depreciation and amortization	448,386	403,916	377,547
Amortization of premium and discount on investment securities	289,111	260,198	259,890
Amortization of net deferred loan fees	(139,722)	(134,758)	(117,524)
Investment securities (gains) losses, net	—	98,375	(542)
Earnings on bank-owned life insurance	(208,677)	(221,919)	(202,385)
Deferred income taxes	(85,339)	(33,704)	(69,934)
Increase in accrued interest receivable	(217,022)	(75,303)	(11,796)
Increase (decrease) in accrued interest payable	155,449	(25,617)	(77,862)
Other, net	(285,535)	299,533	184,433
Net cash provided by operating activities	3,964,985	4,017,884	3,455,447
INVESTING ACTIVITIES			
Decrease (increase) in interest-bearing deposits in other institutions, net	614,506	(75,359)	32,822
Investment securities available for sale:			
Proceeds from repayments and maturities	11,361,937	14,857,656	16,167,324
Purchases	(13,279,687)	(27,638,162)	(32,985,572)
Proceeds from sales	—	4,912,619	1,991,917
Investment securities held to maturity:			
Proceeds from repayments and maturities	—	1,639,200	4,370,070
Increase in loans, net	(18,346,125)	(22,710,211)	(17,913,713)
Purchase of Federal Home Loan Bank stock	(63,300)	(53,300)	(52,000)
Purchase of bank-owned life insurance	—	—	(5,000,000)
Purchase of premises and equipment	(455,568)	(213,580)	(704,746)
Net cash used for investing activities	(20,168,240)	(29,281,137)	(34,093,898)
FINANCING ACTIVITIES			
Net increase in deposits	9,564,189	20,045,541	32,455,416
Increase (decrease) in short-term borrowings, net	4,839,151	1,426,944	(340,959)
Proceeds from other borrowings	7,000,000	9,000,000	5,000,000
Repayment of other borrowings	(4,105,113)	(2,982,337)	(3,024,392)
Purchase of treasury stock	—	(1,224,864)	(81,624)
Exercise of stock options	71,386	14,198	19,916
Common stock issued	285,669	277,171	170,513
Proceeds from dividend reinvestment plan	245,506	215,120	167,407
Cash dividends	(1,188,146)	(1,083,197)	(966,697)
Net cash provided by financing activities	16,712,642	25,688,576	33,399,580
Increase in cash and cash equivalents	509,388	425,323	2,761,129
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	5,311,776	4,886,453	2,125,324
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 5,821,164	$ 5,311,776	$ 4,886,453
SUPPLEMENTAL INFORMATION			
Cash paid during the year for:			
Interest on deposits and borrowings	$ 6,499,165	$ 5,794,515	$ 5,802,769
Income taxes	1,540,000	1,280,000	1,295,000

See accompanying notes to consolidated financial statements.

consolidated statement of cash flows

MIDDLEFIELD BANC CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Nature of Operations and Basis of Presentation

Middlefield Banc Corp. (the "Company") is an Ohio corporation organized to become the holding company of The Middlefield Banking Company (the "Bank"). The Bank is a state-chartered bank located in Ohio. The Company and its subsidiary derive substantially all of their income from banking and bank-related services, which includes interest earnings on residential real estate, commercial mortgage, commercial and consumer financings as well as interest earnings on investment securities and deposit services to its customers through five locations. The Company is supervised by the Board of Governors of the Federal Reserve System, while the Bank is subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Ohio Division of Financial Institutions.

The consolidated financial statements of the Company include its wholly owned subsidiary, the Bank. Significant intercompany items have been eliminated in preparing the consolidated financial statements.

The financial statements have been prepared in conformity with U.S. generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Investment Securities

Investment securities are classified at the time of purchase, based on management's intention and ability, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to hold to maturity are stated at cost adjusted for amortization of premium and accretion of discount, which are computed using a level yield method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available-for-sale securities are reported as a separate component of stockholders' equity, net of tax, until realized. Realized security gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Common stock of the Federal Home Loan Bank ("FHLB") represents ownership in an institution that is wholly owned by other financial institutions. This equity security is accounted for at cost and classified with other assets.

Loans

Loans are reported at their principal amount net of the allowance for loan losses. Interest income is recognized as income when earned on the accrual method. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Interest received on nonaccrual loans is recorded as income against principal according to management's judgment as to the collectibility of such principal.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (Continued)

Loan origination fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. Management is amortizing these amounts over the contractual life of the related loans.

Allowance for Loan Losses

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable loan losses inherent in its loan portfolio. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses which is charged to operations. The provision is based on management's periodic evaluation of the adequacy of the allowance for loan losses, which encompasses the overall risk characteristics of the various portfolio segments, past experience with losses, the impact of economic conditions on borrowers, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to significant change in the near term.

A loan is considered impaired when it is probable the borrower will not repay the loan according to the original contractual terms of the loan agreement. Management has determined that first mortgage loans on one-to-four family properties and all consumer loans represent large groups of smaller-balance homogeneous loans that are to be collectively evaluated. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. A loan is not impaired during a period of delay in payment if the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of delay. All loans identified as impaired are evaluated independently by management. The Company estimates credit losses on impaired loans based on the present value of expected cash flows or the fair value of the underlying collateral if the loan repayment is expected to come from the sale or operation of such collateral. Impaired loans, or portions thereof, are charged off when it is determined a realized loss has occurred. Until such time, an allowance for loan losses is maintained for estimated losses. Cash receipts on impaired loans are applied first to accrued interest receivable unless otherwise required by the loan terms, except when an impaired loan is also a nonaccrual loan, in which case the portion of the payment related to interest is recognized as income.

Mortgage loans secured by one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis, taking into consideration all circumstances concerning the loan, the creditworthiness and payment history of the borrower, the length of the payment delay, and the amount of shortfall in relation to the principal and interest owed.

Premises and Equipment

Premises and equipment are stated at cost net of accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years for furniture, fixtures, and equipment and 3 to 40 years for buildings and leasehold improvements. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance (BOLI)

The Company purchased life insurance policies on certain key employees. BOLI is recorded at its cash surrender value or the amount that can be realized.

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share are calculated utilizing net income as reported in the numerator and average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options, warrants, and convertible securities are adjusted in the denominator.

Stock Options

The Company maintains a stock option plan for key officers, employees, and nonemployee directors. Had compensation expense for the stock option plans been recognized in accordance with the fair value accounting provisions of FAS No. 123, *Accounting for Stock-Based Compensation,* net income applicable to common stock and basic and diluted net income per common share for the year ended December 31 would have been as follows:

	2005	2004	2003
Net income as reported:	$ 3,701,332	$ 3,273,163	$ 2,798,620
Less pro forma expense related to option	60,259	57,308	52,459
Pro forma net income	$ 3,641,073	$ 3,215,855	$ 2,746,161
Basic net income per common share:			
As reported	$ 2.77	$ 2.41	$ 2.09
Pro forma	2.72	2.37	2.04
Diluted net income per common share:			
As reported	$ 2.73	$ 2.39	$ 2.08
Pro forma	2.68	2.35	2.03

For purposes of computing pro forma results, the Company estimated the fair values of stock options using the Black-Scholes option-pricing model. The model requires the use of subjective assumptions that can materially affect fair value estimates. Therefore, the pro forma results are estimates of results of operations as if compensation expense had been recognized for the stock option plans. The fair value of each stock option granted was estimated using the following weighted-average assumptions:

Grant Year	Expected Dividend Yield	Risk-Free Interest Rate	Expected Volatility	Expected Life (in years)
2002	2.72 %	4.19 %	27.04 %	9.94
2003	2.72	4.25	14.00	9.94
2004	2.39	4.00	8.79	9.94
2005	2.35	4.49	18.05	9.94

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the Consolidated Balance Sheet captions and "Cash and due from banks and interest-bearing deposits in other institutions."

Advertising Costs

Advertising costs are expensed as the costs are incurred. Advertising expenses amounted to $302,679, $253,858, and $168,849, for 2005, 2004, and 2003, respectively.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS No. 123R). FAS No. 123R revised FAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. FAS No. 123R will require compensation costs related to share-based payment transactions to be recognized in the financial statement (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award.

In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for FAS No. 123R. The statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. FAS No. 123R covers a wide range of share-based compensation arrangements, including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company will adopt FAS No. 123R on January 1, 2006, management has determined that unless additional options are granted, there will be no impact to future earnings.

In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), *Share-Based Payment*, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of FAS No. 123R, and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of FAS No. 123R on January 1, 2006.

In December 2004, the FASB issued FAS No. 153, *Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29*. The guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that opinion, however, included certain exceptions to that principle. FAS No. 153 amends Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of FAS No. 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Early application is permitted and companies must apply the standard prospectively. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In June 2005, the FASB issued FAS No. 154, *Accounting Changes and Errors Corrections, a replacement of APB Opinion No. 20 and FAS No. 3*. The statement applies to all voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle. FAS No. 154

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impractical. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS No. 154 improves the financial reporting because its requirements enhance the consistency of financial reporting between periods. The provisions of FAS No. 154 are effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

2. EARNINGS PER SHARE

There are no convertible securities that would affect the numerator in calculating basic and diluted earnings per share; therefore, net income as presented on the Consolidated Statement of Income will be used as the numerator. The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	2005	2004	2003
Weighted-average common shares outstanding	1,425,649	1,413,806	1,402,047
Average treasury stock shares	(89,333)	(55,588)	(54,833)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	1,336,316	1,358,218	1,347,214
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	20,159	12,321	3,696
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	1,356,475	1,370,539	1,350,910

There were no options to purchase shares of common stock that were anti-dilutive.

3. STOCK DIVIDEND

The Board of Directors approved a 5 percent stock dividend to stockholders of record as of December 1, 2005, payable December 14, 2005. As a result of the dividend, 63,549 additional shares of the Company's common stock were issued, common stock was increased by $2,557,847, and retained earnings decreased by $2,572,949.

The Board of Directors approved a 5 percent stock dividend to stockholders of record as of December 1, 2004, payable December 15, 2004. As a result of the dividend, 61,387 additional shares of the Company's common stock were issued, common stock was increased by $2,271,282, and retained earnings decreased by $2,283,646.

The Board of Directors approved a 5 percent stock dividend to stockholders of record as of December 3, 2003, payable December 12, 2003. As a result of the dividend, 57,972 additional shares of the Company's common stock were issued, common stock was increased by $1,797,165, and retained earnings decreased by $1,801,961.

Fractional shares paid were paid in cash. All average shares outstanding and all per share amounts included in the financial statements are based on the increased number of shares after giving retroactive effects to the stock dividend.

4. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated market values of securities available for sale are as follows:

	2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. government agency securities	$ 7,260,666	$ 10,229	$ (111,690)	$ 7,159,205
Obligations of states and political subdivisions:				
Taxable	748,530	-	(23,178)	725,352
Tax-exempt	28,231,048	97,897	(330,847)	27,998,098
Mortgage-backed securities	22,228,515	15,432	(639,968)	21,603,979
Total debt securities	58,468,759	123,558	(1,105,683)	57,486,634
Equity securities	444,264	1,050	(44,818)	400,496
Total	$ 58,913,023	$ 124,608	$ (1,150,501)	$ 57,887,130

	2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. government agency securities	$ 5,273,091	$ 70,704	$ (17,637)	$ 5,326,158
Obligations of states and political subdivisions:				
Taxable	748,196	-	(11,129)	737,067
Tax-exempt	21,239,335	303,433	(65,776)	21,476,992
Mortgage-backed securities	29,625,481	80,530	(403,583)	29,302,428
Total debt securities	56,886,103	454,667	(498,125)	56,842,645
Equity securities	398,320	-	-	398,320
Total	$ 57,284,423	$ 454,667	$ (498,125)	$ 57,240,965

The amortized cost and estimated market value of debt securities at December 31, 2005, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Market Value
Due in one year or less	$ 6,529,300	$ 6,495,757
Due after one year through five years	11,192,145	11,095,900
Due after five years through ten years	11,233,086	11,069,894
Due after ten years	29,514,228	28,825,083
Total	$ 58,468,759	$ 57,486,634

Investment securities with an approximate carrying value of $22,867,265 and $21,669,555 at December 31, 2005 and 2004, respectively, were pledged to secure deposits and other purposes as required by law.

4. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

The following is a summary of proceeds received, gross gains, and gross losses realized on the sale of investment securities available for sale for the years ended December 31, 2005, 2004, and 2003.

	2005	2004	2003
Proceeds from sales	$ -	$ 4,912,619	$ 1,991,917
Gross gains	-	-	6,350
Gross losses	-	98,375	5,808

5. INVESTMENT SECURITIES HELD TO MATURITY

The amortized cost and estimated market values of investment securities held to maturity are as follows:

2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of states and political subdivisions:				
Tax-exempt	$ 221,453	$ 11,514	$ -	$ 232,967

2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Obligations of states and political subdivisions:				
Tax-exempt	$ 221,412	$ 22,398	$ -	$ 243,810

The amortized cost and estimated market value of debt securities at December 31, 2005, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Market Value
Due in one year or less	$ 89,956	$ 90,857
Due after one year through five years	31,497	33,368
Due after five years through ten years	100,000	108,742
Due after ten years	-	-
Total	$ 221,453	$ 232,967

Investment securities held to maturity with carrying values of approximately $89,957 and $89,915 and estimated market values of approximately $90,857 and $89,915 at December 31, 2005 and 2004, respectively, were pledged to secure public deposits and other purposes required by law.

6. UNREALIZED LOSSES ON SECURITIES

The following table shows the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2005 and 2004.

	2005					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses
U.S. government agency securities	$ 3,576,063	$ (43,743)	$ 2,421,251	$ (67,947)	$ 5,997,314	$ (111,690)
Obligations of states and political subdivisions	16,016,108	(236,088)	4,576,188	(117,937)	20,592,296	(354,025)
Mortgage-backed securities	6,205,491	(119,155)	14,511,847	(520,813)	20,717,338	(639,968)
Equity securities	353,495	(44,818)	-	-	353,495	(44,818)
Total	$ 26,151,157	$ (443,804)	$ 21,509,286	$ (706,697)	$ 47,660,443	$ (1,150,501)

	2004					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses
U.S. government agency securities	$ 1,488,594	$ (7,817)	$ 981,563	$ (9,820)	$ 2,470,157	$ (17,637)
Obligations of states and political subdivisions	5,227,264	(33,724)	1,673,533	(43,181)	6,900,797	(76,905)
Mortgage-backed securities	7,922,125	(76,319)	11,860,073	(327,264)	19,782,198	(403,583)
Total	$ 14,637,983	$ (117,860)	$ 14,515,169	$ (380,265)	$ 29,153,152	$ (498,125)

The policy of the Company is to recognize an other-than-temporary impairment on equity securities where the fair value has been significantly below cost for three consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where the Company has the positive intent and ability to hold the investment for a period of time sufficient to allow a market recovery, declines in value below cost are not assumed to be other than temporary. There are 129 securities that are considered temporarily impaired at December 31, 2005. The Company reviews its position quarterly and has asserted that at December 31, 2005, the declines outlined in the above table represent temporary declines and the Company does have the intent and ability either to hold those securities to maturity or to allow a market recovery.

The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes, sector credit rating changes, or Company-specific rating changes that are not expected to result in the noncollection of principal and interest during the period.

7. LOANS

Major classifications of loans are summarized as follows:

	2005	2004
Commercial and industrial	$ 65,161,490	$ 52,148,055
Real estate - construction	2,724,958	3,143,706
Real estate - mortgage:		
Residential	151,981,388	147,425,466
Commercial	8,208,572	7,026,582
Consumer installment	5,978,389	5,909,474
	234,054,797	215,653,283
Less allowance for loan losses	2,841,098	2,623,431
Net loans	$ 231,213,699	$ 213,029,852

The Company's primary business activity is with customers located within its local trade area, eastern Geauga County, and contiguous counties to the north, east, and south. Commercial, residential, consumer, and agricultural loans are granted. Although the Company has a diversified loan portfolio at December 31, 2005 and 2004, loans outstanding to individuals and businesses are dependent upon the local economic conditions in its immediate trade area.

Nonperforming loans consist of commercial, mortgage and consumer loans which are on a nonaccrual basis and loans contractually past due 90 days or more but are not on nonaccrual status because they are well secured or in the process of collection.

Information regarding nonperforming loans at December 31 is as follows:

	2005	2004
90 days or more past due and accruing interest	$ 326,633	$ 1,191,242
Nonaccrual loans	1,487,446	279,319
Total nonperforming loans	$ 1,814,079	$ 1,470,561

At December 31, 2005, the total investment in impaired loans, all of which had allowances amounting to $1,106,221. The average recorded investment in impaired loans amounted to $764,396. The allowance for loan losses related to impaired loans amounted to $224,155. Interest income on impaired loans of $23,152 was recognized for cash payments received in 2005. There were no impaired loans at December 31, 2004.

8. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the years ended December 31 are as follows:

	2005	2004	2003
Balance, January 1	$ 2,623,431	$ 2,521,270	$ 2,300,485
Add:			
Provisions charged to operations	302,000	174,000	315,000
Recoveries	95,077	46,643	49,942
Less loans charged off	179,410	118,482	144,157
Balance, December 31	$ 2,841,098	$ 2,623,431	$ 2,521,270

9. PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	2005	2004
Land and land improvements	$ 1,295,938	$ 1,295,938
Building and leasehold improvements	6,999,015	6,859,242
Furniture, fixtures, and equipment	3,142,025	2,826,230
	11,436,978	10,981,410
Less accumulated depreciation and amortization	4,812,202	4,363,816
Total	$ 6,624,776	$ 6,617,594

Depreciation and amortization charged to operations was $448,386 in 2005, $403,916 in 2004, and $377,547 in 2003.

10. OTHER ASSETS

The components of other assets are as follows:

	2005	2004
FHLB stock	$ 1,414,300	$ 1,351,000
Accrued interest on investment securities	347,580	274,740
Accrued interest on loans	675,268	531,086
Deferred tax asset, net	680,191	450,449
Other	695,649	146,302
Total	$ 3,812,988	$ 2,753,577

11. DEPOSITS

Time deposits at December 31, 2005, mature $64,220,054, $22,763,280, $19,076,099, $8,564,183, and $6,107,364 during 2006, 2007, 2008, 2009, and 2010, respectively.

Time deposits include certificates of deposit in denominations of $100,000 or more. Such deposits aggregated $27,398,766 and $21,920,929 at December 31, 2005 and 2004, respectively.

Maturities on time deposits of $100,000 or more at December 31, 2005, are as follows:

Within three months	$	3,860,127
Beyond three but within six months		3,442,934
Beyond six but within twelve months		6,231,038
Beyond one year		13,864,667
Total	$	27,398,766

12. SHORT-TERM BORROWINGS

The outstanding balances and related information of short-term borrowings, which includes securities sold under agreements to repurchase and federal funds purchased, are summarized as follows:

		2005			2004	
Balance at year-end	$	6,710,914		$	1,871,763	
Average balance outstanding		1,844,018			298,500	
Maximum month-end balance		6,710,914			2,057,054	
Weighted-average rate at year-end		4.38	%		3.80	%
Weighted-average rate during the year		5.63			0.73	

Average balances outstanding during the year represent daily average balances, and average interest rates represent interest expense divided by the related average balance.

The Company maintains a $4,000,000 line of credit at an adjustable rate, currently 7.0 percent, from Lorain National Bank. At December 31, 2005, there were no outstanding balances of this line. At December 31, 2004, the Company had outstanding borrowings of $1,200,000.

13. OTHER BORROWINGS

Other borrowings consist of advances from the FHLB as follows:

Description	Maturity range from	Maturity range to	Weighted-average interest rate	Stated interest rate range from	Stated interest rate range to	2005	2004
Fixed rate	08/09/06	09/13/07	3.91 %	3.37 %	4.27 %	$ 5,510,000	$ 3,035,000
Fixed rate amortizing	07/01/07	06/01/25	3.73	2.70	6.40	13,068,211	12,648,324
Convertible	09/04/08	07/28/10	5.43	4.53	6.45	8,000,000	8,000,000
						$ 26,578,211	$ 23,683,324

The scheduled maturities of advances outstanding are as follows:

Year Ending December 31,	2005 Amount	2005 Weighted-average Rate
2006	$ 4,091,765	3.78 %
2007	7,671,543	3.85
2008	7,970,667	4.74
2009	1,472,896	3.69
2010	3,092,373	5.48
Beyond 2010	2,278,967	3.76
	$ 26,578,211	4.28 %

The Bank entered into a ten-year "Convertible Select" fixed commitment advance arrangement with the FHLB. Rates may be reset at the FHLB's discretion on a quarterly basis based on the three-month LIBOR rate. At each rate change the Bank may exercise a put option and satisfy the obligation without penalty.

Advances from the FHLB maturing July 1, 2007, February 1, 2012, June 4, 2012, February 2, 2013, February 26, 2014, July 28, 2014, September 13, 2014, June 1, 2015, June 4, 2017, February 1, 2018, February 26, 2019, February 1, 2023, and June 1, 2025, require monthly principal and interest payments and an annual 20 percent paydown of outstanding principal. Monthly principal and interest payments are adjusted after each 20 percent paydown. Under terms of a blanket agreement, collateral for the FHLB borrowings are secured by certain qualifying assets of the Bank, which consist principally of first mortgage loans. Under this credit arrangement, the Bank has a remaining borrowing capacity of approximately $120 million at December 31, 2005.

14. OTHER LIABILITIES

The components of other liabilities are as follows:

	2005	2004
Accrued interest payable	$ 537,916	$ 382,467
Other	648,145	568,957
Total	$ 1,186,061	$ 951,424

15. INCOME TAXES

The provision for federal income taxes consists of:

	2005	2004	2003
Current payable	$ 1,500,495	$ 1,363,704	$ 1,201,264
Deferred	(85,339)	(33,704)	(69,934)
Total provision	$ 1,415,156	$ 1,330,000	$ 1,131,330

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	2005	2004
Deferred tax assets:		
Allowance for loan losses	$ 897,040	$ 823,034
Net unrealized loss on securities	348,804	14,776
Supplemental retirement plan	68,716	50,764
Gross deferred tax assets	1,314,560	888,574
Deferred tax liabilities:		
Deferred origination fees, net	136,037	118,061
Premises and equipment	145,392	181,273
Other	163,315	138,791
Gross deferred tax liabilities	444,744	438,125
Net deferred tax assets	$ 869,816	$ 450,449

No valuation allowance was established at December 31, 2005 and 2004, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential.

The reconciliation between the federal statutory rate and the Company's effective consolidated income tax rate is as follows:

	2005		2004		2003	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	$ 1,739,606	34.0 %	$ 1,565,076	34.0 %	$ 1,336,030	34.0 %
Tax-free income	(295,146)	(5.8)	(208,593)	(6.1)	(236,760)	(6.1)
Nondeductible interest expense	38,639	0.8	26,485	0.6	22,789	0.6
Other	(67,923)	(1.4)	(52,968)	0.4	9,271	0.3
Actual tax expense and effective rate	$ 1,415,176	27.6 %	$ 1,330,000	28.9 %	$ 1,131,330	28.8 %

16. EMPLOYEE BENEFITS

Retirement Plan

The Bank maintains a section 401(k) employee savings and investment plan for all full-time employees and officers of the Bank with more than one year of service. The Bank's contribution to the plan is based on 50 percent matching of voluntary contributions up to 6 percent of compensation. An eligible employee can contribute up to 15 percent of salary. Employee contributions are vested at all times, and the Bank contributions are fully vested after six years beginning at the second year in 20 percent increments. Contributions for 2005, 2004, and 2003 to this plan amounted to $62,755, $63,083, and $56,731, and respectively.

Supplemental Retirement Plan

The Bank maintains a Directors Retirement Plan to provide postretirement payments over a ten-year period to members of the Board of Directors who have completed five or more years of service. The Plan requires payment of 25 percent of the final average annual board fees paid to a director in the three years preceding the director's retirement.

The following table illustrates the components of the net periodic pension cost for the Directors retirement plans for the years ended:

	Directors' Retirement Plan		
	2005	2004	2003
Components of net periodic pension cost			
Service cost	$ 12,756	$ 25,684	$ 36,089
Interest cost	9,948	8,380	7,804
Net periodic pension cost	$ 22,704	$ 34,064	$ 43,893

Stock Option and Restricted Stock Plan

The Company maintains a stock option and restricted stock plan ("the Plan") for granting incentive stock options, nonqualified stock options, and restricted stock for key officers and employees and nonemployee directors of the Company. A total of 139,621 shares of authorized and unissued or issued common stock are reserved for issuance under the Plan, which expires ten years from the date of stockholder ratification. The per share exercise price of an option granted will not be less than the fair value of a share of common stock on the date the option is granted. No option shall become exercisable earlier than one year from the date the Plan was approved by the stockholders.

The following table presents share data related to the outstanding options:

	2005	Weighted-average Exercise Price	2004	Weighted-average Exercise Price
Outstanding, January 1	68,646	$ 26.43	54,398	$ 24.62
Granted	8,800	40.50	14,820	33.01
Exercised	(2,729)	26.32	(572)	24.71
Forfeited	(412)	21.42	-	-
Outstanding, December 31	74,305	$ 28.13	68,646	$ 26.43
Exercisable at year-end	74,305	28.13	53,826	24.61

16. EMPLOYEE BENEFITS (Continued)

Stock Option and Restricted Stock Plan (Continued)

The following table summarizes the characteristics of stock options at December 31, 2005:

		Outstanding			Exercisable	
Grant Date	Exercise Price	Shares	Remaining Average Life	Average Exercise Price	Shares	Average Exercise Price
June 14, 1999	$ 26.12	6,280	3.45	$26.12	6,280	$ 26.12
November 23, 1999	25.50	2,908	3.90	25.50	2,908	25.50
December 11, 2000	19.74	11,362	4.95	19.74	11,362	19.74
December 9, 2002	24.62	10,629	6.94	24.62	10,629	24.62
December 8, 2003	26.77	20,138	7.94	26.77	20,138	26.77
May 12, 2004	30.16	1,798	8.33	30.16	1,798	30.16
December 13, 2004	33.57	12,390	8.95	33.57	12,390	33.57
December 14, 2005	40.50	8,800	9.95	40.50	8,800	40.50
		74,305			74,305	

For the years ended December 31, 2005, 2004, and 2003, the Company granted 80 shares, 884 shares, and 110 shares, respectively, of common stock under the restricted stock plan. The Company recognizes compensation expense in the amount of fair value of the common stock at the grant date and as an addition to stockholders' equity. The Company recognized compensation expense of $4,035, $31,080, and $3,410, for the years ended December 31, 2005, 2004, and 2003, respectively.

17. COMMITMENTS

In the normal course of business, there are various outstanding commitments and certain contingent liabilities which are not reflected in the accompanying consolidated financial statements. These commitments and contingent liabilities represent financial instruments with off-balance sheet risk. The contract or notional amounts of those instruments reflect the extent of involvement in particular types of financial instruments which were composed of the following:

	2005	2004
Commitments to extend credit	$ 45,678,316	$ 33,925,423
Standby letters of credit	125,000	222,675
Total	$ 45,803,316	$ 34,148,098

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The Company's exposure to credit loss, in the event of nonperformance by the other parties to the financial instruments, is represented by the contractual amounts as disclosed. The Company minimizes its exposure to credit loss under these commitments by subjecting them to credit approval and review procedures and collateral requirements as deemed necessary. Commitments generally have fixed expiration dates within one year of their origination.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Performance letters of credit represent conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid or performance-related contracts. The coverage period for these instruments is typically a one-year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments or customer business assets.

18. REGULATORY RESTRICTIONS

Loans

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific obligations. Further, such secured loans are limited in amount of 10 percent of the Bank's common stock and capital surplus.

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by an Ohio state-chartered bank. Under the Ohio Banking Code, cash dividends may not exceed net profits as defined for that year combined with retained net profits for the two preceding years less any required transfers to surplus. Under this formula, the amount available for payment of dividends for 2006 approximates $4,136,000 plus 2006 profits retained up to the date of the dividend declaration.

19. REGULATORY CAPITAL

Federal regulations require the Company and the Bank to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2005 and 2004, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier 1 risk-based, and Tier 1 Leverage capital ratios must be at least 10 percent, 6 percent, and 5 percent, respectively.

The Company's actual capital ratios are presented in the following table that shows the Company met all regulatory capital requirements. The capital position of the Bank does not differ significantly from the Company's.

	2005		2004	
	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-weighted Assets)				
Actual	$ 30,593,729	14.41 %	$ 27,231,794	14.28 %
For Capital Adequacy Purposes	16,997,337	8.00	15,251,438	8.00
To Be Well Capitalized	21,246,671	10.00	19,064,298	10.00
Tier I Capital (to Risk-weighted Assets)				
Actual	$ 27,937,566	13.16 %	$ 24,850,706	13.04 %
For Capital Adequacy Purposes	8,500,442	4.00	7,625,719	4.00
To Be Well Capitalized	12,750,662	6.00	11,438,579	6.00
Tier I Capital (to Average Assets)				
Actual	$ 27,937,566	9.10 %	$ 24,850,706	8.51 %
For Capital Adequacy Purposes	12,273,560	4.00	11,678,293	4.00
To Be Well Capitalized	15,341,950	5.00	14,597,866	5.00

20. FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments at December 31 are as follows:

	2005		2004	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and due from banks	$ 5,294,641	$ 5,294,641	$ 5,311,776	$ 5,311,776
Interest-bearing deposits in other institutions	526,523	526,523	614,506	614,506
Investment securities:				
Available for sale	57,887,130	57,887,130	57,240,965	57,240,965
Held to maturity	221,453	232,967	221,412	243,810
Net loans	231,213,699	233,988,263	213,029,852	219,485,000
Bank-owned life insurance	5,632,982	5,632,982	5,424,304	5,424,304
Federal Home Loan Bank stock	1,414,300	1,414,300	1,351,000	1,351,000
Accrued interest receivable	1,022,848	1,022,848	805,826	805,826
Financial liabilities:				
Deposits	$ 249,449,640	$ 248,814,640	$ 239,885,451	$ 241,129,000
Short-term borrowings	6,710,914	6,710,914	1,871,763	1,871,763
Other borrowings	26,578,211	26,102,461	23,683,324	22,160,000
Accrued interest payable	537,916	537,916	382,467	382,467

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. Since many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

20. FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS (Continued)

Cash and Due From Banks, Interest-Bearing Deposits in Other Institutions, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings

The fair value is equal to the current carrying value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

Investment Securities

The fair value of investment securities available for sale and held to maturity is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans, Deposits, and Other Borrowings

The fair value of loans, certificates of deposit, and other borrowings is estimated by discounting the future cash flows using a simulation model which estimates future cash flows and constructs discount rates that consider reinvestment opportunities, operating expenses, noninterest income, credit quality, and prepayment risk. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 17.

21. PARENT COMPANY

Following are condensed financial statements for the Company.

CONDENSED BALANCE SHEET

	December 31, 2005	December 31, 2004
ASSETS		
Cash and due from banks	$ 349,385	$ 229,399
Interest-bearing deposits in other institutions	526,522	614,506
Investment securities available for sale	400,495	398,319
Other assets	14,882	-
Investment in subsidiary bank	25,998,081	24,779,800
TOTAL ASSETS	$ 27,289,365	$ 26,022,024
LIABILITIES		
Other borrowings	$ -	$ 1,200,000
STOCKHOLDERS' EQUITY	27,289,365	24,822,024
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 27,289,365	$ 26,022,024

CONDENSED STATEMENT OF INCOME

	Year Ended December 31, 2005	2004	2003
INCOME			
Dividends from subsidiary bank	$ 1,999,052	$ 1,092,122	$ 1,044,637
Interest income	12,017	5,369	5,179
Total income	2,011,069	1,097,491	1,049,816
EXPENSES			
Interest expense	54,107	-	-
Other	163,275	168,524	99,473
Total expense	217,382	168,524	99,473
Income before income tax benefit	1,793,687	928,967	950,343
Income tax benefit	(69,844)	(46,000)	(32,056)
Income before equity in undistributed net income of subsidiary	1,863,531	974,967	982,399
Equity in undistributed net income of subsidiary	1,837,801	2,298,196	1,816,221
NET INCOME	$ 3,701,332	$ 3,273,163	$ 2,798,620

21. PARENT COMPANY (Continued)

CONDENSED STATEMENT OF CASH FLOWS

	Year Ended December 31, 2005	2004	2003
OPERATING ACTIVITIES			
Net income	$ 3,701,332	$ 3,273,163	$ 2,798,620
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiary	(1,837,801)	(2,298,196)	(1,816,221)
Other	-	-	-
Net cash provided by operating activities	1,863,531	974,967	982,399
INVESTING ACTIVITIES			
Decrease (increase) in interest-bearing deposits in other institutions	614,506	(75,359)	(255,178)
Purchase of investment securities	(45,944)	(398,320)	-
Net cash provided by (used for) investing activities	568,562	(473,679)	(255,178)
FINANCING ACTIVITIES			
Net increase (decrease) in short term borrowing	(1,200,000)	1,200,000	-
Purchase of treasury stock	-	(1,224,864)	(81,624)
Exercise of stock options	71,386	14,198	19,916
Common stock issued	285,669	277,171	170,513
Proceeds from dividend reinvestment plan	245,506	215,120	167,407
Cash dividends	(1,188,146)	(1,083,197)	(966,697)
Net cash used for financing activities	(1,785,585)	(601,572)	(690,485)
Increase (decrease) in cash	646,508	(100,284)	36,736
CASH AT BEGINNING OF YEAR	229,399	329,683	292,947
CASH AT END OF YEAR	$ 875,907	$ 229,399	$ 329,683

22. SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Three Months Ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
Total interest income	$ 4,115,912	$ 4,274,683	$ 4,427,392	$ 4,560,517
Total interest expense	1,547,711	1,628,943	1,663,422	1,814,538
Net interest income	2,568,201	2,645,740	2,763,970	2,745,979
Provision for loan losses	60,000	60,000	75,000	107,000
Net interest income after provision for loan losses	2,508,201	2,585,740	2,688,970	2,638,979
Total noninterest income	481,104	526,515	559,275	552,343
Total noninterest expense	2,013,215	1,846,301	1,882,004	1,683,119
Income before income taxes	976,090	1,265,954	1,366,241	1,508,203
Income taxes	262,000	349,000	390,000	414,156
Net income	$ 714,090	$ 916,954	$ 976,241	$ 1,094,047
Per share data:				
Net income				
Basic	$ 0.54	$ 0.69	$ 0.73	$ 0.82
Diluted	0.53	0.68	0.72	0.80
Average shares outstanding				
Basic	1,329,800	1,335,145	1,338,314	1,342,105
Diluted	1,336,957	1,356,819	1,359,988	1,362,500

22. SELECTED QUARTERLY FINANCIAL DATA (Unaudited) (Continued)

	Three Months Ended			
	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
Total interest income	$ 3,798,928	$ 3,889,197	$ 3,978,576	$ 4,065,835
Total interest expense	1,383,071	1,411,961	1,456,471	1,517,395
Net interest income	2,415,857	2,477,236	2,522,105	2,548,440
Provision for loan losses	30,000	30,000	51,000	63,000
Net interest income after provision for loan losses	2,385,857	2,447,236	2,471,105	2,485,440
Total noninterest income	396,719	485,889	484,244	412,379
Total noninterest expense	1,781,318	1,682,607	1,803,558	1,698,223
Income before income taxes	1,001,258	1,250,518	1,151,791	1,199,596
Income taxes	316,000	342,000	330,000	342,000
Net income	$ 685,258	$ 908,518	$ 821,791	$ 857,596
Per share data:				
Net income				
Basic	$ 0.51	$ 0.67	$ 0.60	$ 0.63
Diluted	0.51	0.67	0.60	0.62
Average shares outstanding				
Basic	1,349,225	1,356,816	1,364,001	1,362,456
Diluted	1,356,722	1,365,406	1,372,590	1,377,315

SNODGRASS
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

Board of Directors and Stockholders
Middlefield Banc Corp.

We have audited the accompanying consolidated balance sheet of Middlefield Banc Corp. and subsidiary as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 Middlefield Banc Corp. and subsidiary as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ending December 31, 2005, in conformity with U.S. generally accepted accounting principles.

S.R. Snodgrass, A.C.

Wexford, PA
February 10, 2006

S.R. Snodgrass, A.C.
1000 Stonewood Drive, Suite 200 Wexford, PA 15090-8399 Phone: 724-934-0344 Facsimile: 724-934-0345

Overview

The consolidated review and analysis of Middlefield Banc Corp. ("Middlefield" or "Company") is intended to assist the reader in evaluating the performance of Middlefield for the years ended December 31, 2005, 2004 and 2003. This information should be read in conjunction with the consolidated financial statements and accompanying notes to the financial statements.

Middlefield is an Ohio corporation organized to become the holding company of The Middlefield Banking Company ("Bank"). The Bank is a state-chartered bank located in Middlefield, Ohio. Middlefield and its subsidiary bank derive substantially all of their income from banking and bank-related services, including interest earnings on residential real estate, commercial mortgage, commercial, and consumer financings as well as interest earnings on investment securities and deposit services to its customers through six locations.

The Bank is subject to examination and comprehensive regulation by the FDIC and the Ohio Department of Banking. The Bank is a member of the Federal Home Loan Bank (FHLB) of Cincinnati, which is one of the twelve regional banks comprising the FHLB System.

This Management Discussion and Analysis section of the Annual Report contains certain forward-looking statements. Forward-looking statements are based upon a variety of estimates and assumptions. The estimates and assumptions involve judgments about a number of things, including future economic, competitive, and financial market conditions and future business decisions. These matters are inherently subject to significant business, economic, and competitive uncertainties, all of which are difficult to predict and many of which are beyond Middlefield's control. Although Middlefield believes its estimates and assumptions are reasonable, actual results could vary materially from those shown. Inclusion of forward-looking information does not constitute a representation by Middlefield or any other person that the indicated results will be achieved. Investors are cautioned not to place undue reliance on forward-looking information.

These forward-looking statements may involve significant risks and uncertainties. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results in these forward-looking statements.

Significant Financial Events in 2005

Middlefield's board of directors declared a 5 percent share dividend for shareholders of record on December 1, 2005, and a quarterly cash dividend of $0.235 per common share. On December 15, 2005, shareholders of record received additional stock shares equal to 5% of their holdings. Payment of the fourth quarter cash dividend in the amount of $0.235 per share was on the total holdings including the share dividend. The fourth quarter cash dividend, after adjustment for the stock dividend, is 11.9% higher than the fourth quarter 2004 cash payout. All share and related price and dividend amounts discussed herein have been adjusted to reflect this stock dividend where applicable.

Critical Accounting Policies

Allowance for loan losses

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company's allowance for loan losses provides for probable losses based upon evaluations of known, and inherent risks in the loan portfolio.

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment, which is affected by changing economic conditions and various external factors and which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company's methodology of assessing the adequacy of the reserve for loan losses, refer to Note 1 of "Notes to Consolidated Financial Statements" commencing on the following pages of this Annual Report.

The allowance for loan losses at December 31, 2005 totaled $2.8 million, compared to $2.6 million at December 31, 2004. The variance in the allowance from 2004 to 2005 is primarily the result of the growth of the loan portfolio of 8.5% for the year.

Changes in Financial Condition

General. The Company's total assets increased $20.0 million or 7% to $311.2 million at December 31, 2005 from $291.2 million at December 31, 2004. This increase was composed of a net increase in securities of $646,000, net loans receivable of $18.2 million and Bank-owned life insurance of $209,000.

The increase in the Company's total assets reflects a corresponding increase in total liabilities of $17.5 million or 6.6% to $283.9 million at December 31, 2005 from $266.4 million at December 31, 2004 and a increase in total stockholders' equity of $2.4 million or 9.9% to $27.3 million at December 31, 2005 from $24.8 million at December 31, 2004. The increase in total liabilities was primarily due to increases in deposits, short-term borrowings and other borrowing of $9.6, $4.8 and $2.9 million respectively. The net increase in total stockholders' equity can be attributed to an increase in common stock and net income offset by an increase in accumulated other comprehensive loss of $648,000.

Cash on hand and Interest-earning deposits. Cash on hand and interest-earning deposits both decreased for the year by $17,000 and $88,000 respectively. Deposits from customers into savings and checking accounts, loan and security repayments and proceeds from borrowed funds typically increase these accounts. Decreases result from customer withdrawals, new loan originations, security purchases and repayments of borrowed funds. The net decrease in 2005 can be attributed principally to increases in loans.

Securities. The Company's loan and securities portfolios represent its two largest balance sheet asset classifications, respectively. The Company's securities portfolio increased slightly a net $646,000 or 1.1% to $58.1 million at December 31, 2005 from $57.5 million at December 31, 2004. During 2005, the Company recorded purchases of available for sale securities of $13.3 million, consisting primarily of agencies and municipal bonds. Partially offsetting the purchases were $11.4 million of maturities and repayments that principally relates to mortgage-backed securities. The Company's deposits and borrowings primarily fund the securities portfolio.

Loans receivable. The loans receivable category consists primarily of single family mortgage loans used to purchase or refinance personal residences located within the Company's market area and commercial real estate loans used to finance properties that are used in the borrowers businesses or to finance investor-owned rental properties, and to a lesser extent commercial and consumer loans. Net loans receivable increased $18.2 million or 8.5% to $231.2 million at December 31, 2005 from $213.0 million at December 31, 2004. Included in this growth were increases in all types of loans including commercial, home equity and mortgage loans with growth of $13.2, $3.0, and $2.0 million respectively. The result was an increase to the yield on the Company's loan portfolio from 6.67% in 2004 to 6.75% in 2005.

FHLB stock. FHLB stock increased $63,000 or 4.7% to $1,414,000 at December 31, 2005 from $1,351,000 at December 31, 2004, primarily as a result of the increase in total assets of the bank that is used to calculate the minimum stock requirement.

Bank owned life insurance. Bank owned life insurance (BOLI) is universal life insurance, purchased by the Bank, on the lives of the Bank's officers. The beneficial aspects of these universal life insurance policies are tax-free earnings and a tax-free death benefit, which are realized by the Bank as the owner of the policies. BOLI increased by $209,000 to $5.6 million as of December 31, 2005 from $5.4 million at the end of 2004 as a result of the earnings of the underlying insurance policies.

Deposits. The Company considers various sources when evaluating funding needs, including but not limited to deposits, which represented 88.2% of the Company's total funding sources at December 31, 2005. Total deposits increased $9.5 million or 4% to $249.5 million at December 31, 2005 from $239.9 million at December 31, 2004.

For the year, the Company's noninterest-bearing demand deposits increased $3.5 million or 9.5%, with time deposits showing the largest increase of $20.6 million or 20.6%. Savings deposits and money market accounts both declined for the year by $12.4 million and $2.6 million respectively.

Borrowed funds. The Company utilizes short and long-term borrowings as another source of funding used for asset growth and liquidity needs. These borrowings primarily include FHLB advances, federal funds purchased and repurchase agreement borrowings. Borrowed funds increased $7.7 million or 30% to $33.3 million at December 31, 2005 from $25.5 million at December 31, 2004. FHLB advances increased $8.4 million or 35.5% and repurchase agreements increased $100,000. The increase in borrowed funds for the year reflects the Company's decision to complement deposits in the support of asset growth.

Stockholders' equity. Stockholders' equity increased by $2.5 million or 9.9% to $27.3 million at December 31, 2005 from $24.8 million at December 31, 2004. The net increase in total stockholders' equity can be attributed to net income of $3.7 million, partially offset by cash dividends of $1.2 million and an increase in accumulated other comprehensive loss of $648,000.

Changes in Results of Operations

2005 Results Compared to 2004 Results

General. The Company reported net income of $3.7 million and $3.3 million for 2005 and 2004, respectively. The $428,000 or 13% increase in net income between 2005 and 2004 can primarily be attributed to a increase in interest income of $1.7 million, and an increase in non-interest income of $340,000, which were partially offset by a increase in interest expense of $886,000 and an increase in non-interest expense of $459,000. Basic earnings per share increased by $.36 a share or 14.9% to $2.77 for 2005 from $2.41 for 2004.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resultant average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resultant average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average balances are calculated using monthly averages and the average loan balances include non-accrual loans and exclude the allowance for loan losses, and interest income includes accretion of net deferred loan fees. Yields on tax-exempt securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis utilizing a federal tax rate of 34%.

	For the Year Ended December 31, 2005			2004			2003		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
	(Dollars in thousands)			(Dollars in thousands)			(Dollars in thousands)		
Interest-earning assets:									
Loans receivable	$222,926	$15,041	6.75%	$204,191	$13,618	6.67%	$183,683	$12,847	6.99%
Investments securities	59,370	2,218	4.49%	54,413	2,004	4.25%	45,011	1,683	4.30%
Interest-bearing deposits with other banks	2,698	120	4.45%	5,723	111	1.94%	6,883	117	1.70%
Total interest-earning assets	284,994	17,379	6.21%	264,327	15,733	6.07%	235,577	14,647	6.32%
Noninterest-earning assets	16,926			15,030			12,327		
Total assets	$301,920			$279,357			$247,904		
Interest-bearing liabilities:									
Interest - bearing demand deposits	$ 9,371	75	0.80%	$ 8,759	56	0.64%	$ 8,623	61	0.71%
Money market deposits	15,016	297	1.98%	15,145	277	1.83%	13,355	259	1.94%
Savings deposits	69,680	1,047	1.50%	73,067	1,030	1.41%	57,413	828	1.44%
Certificates of deposit	115,969	4,101	3.54%	103,022	3,543	3.44%	98,512	3,758	3.81%
Borrowings	26,577	1,135	4.27%	20,630	863	4.18%	19,635	819	4.17%
Total interest-bearing liabilities	236,613	6,655	2.81%	220,623	5,769	2.61%	197,538	5,725	2.90%
Noninterest-bearing liabilities									
Other liabilities	39,682			34,236			27,773		
Stockholders' equity	25,625			24,498			22,594		
Total liabilities and stockholders' equity	$301,920			$279,357			$247,905		
Net interest income		$ 10,724			$ 9,964			$ 8,922	
Interest rate spread (1)			3.39%			3.46%			3.42%
Net yield on interest-earning assets (2)			3.92%			3.89%			3.89%
Ratio of average interest-earning assets to average interest-bearing liabilities			120.45%			119.81%			119.26%

(1) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
(2) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

	Year Ended December 31, 2005 vs. 2004 Increase (Decrease) Due to			Year Ended December 31, 2004 vs. 2003 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
		(In Thousands)			(In Thousands)	
Interest income:						
Loans Receivable	$ 1,249	$ 174	$ 1,423	$ 1,434	$ (663)	$ 771
Investment securities	211	3	214	404	(83)	321
Other interest-earning assets	(59)	68	9	(20)	14	(6)
Total interest-earning assets	1,401	245	1,646	1,818	(732)	1,086
Interest expense:						
Interest-bearing demand	4	15	19	11	(16)	(5)
Money market	(2)	22	20	79	(61)	18
Savings	(48)	65	17	563	(361)	202
Certificates	445	113	558	487	(702)	(215)
Other interest-bearing liabilities	249	23	272	212	(168)	44
Total interest-bearing liabilities	648	238	886	1,352	(1,308)	44
Change in net interest income	$ 753	$ 7	$ 760	$ 466	$ 576	$ 1,042

Net interest income. Net interest income, which is the Company's largest revenue source, is the difference between interest income on earning assets and interest expense paid on liabilities. Net interest income is affected by the changes in interest rates and the composition of interest earning assets and liabilities. Net interest income increased considerably by $760,000 or 7.6% to $10.7 million for 2005, compared to $10.0 million for 2004. This increase in net interest income can be attributed to an increase in interest income of approximately $1.7 million, offset partially by an increase in interest expense of $886,000.

Interest income. Interest income increased $1.7 million or 10.5% to $17.4 million for 2005, compared to $15.7 million for 2004. This increase in interest income can be attributed to an increase in interest earned on loans receivable of $1.4 million and interest earned on securities of $213,000.

Interest earned on loans receivable increased $1.4 million or 10.5% to $15.0 million for 2005, compared to $13.6 million for 2004. This increase was primarily attributable to an increase in the average balance of loans outstanding of $18.7 million or 9.2% to $222.9 million for the year ended December 31, 2005 as compared to $204.2 million for the year ended December 31, 2004. In addition to growth there was also an increase in the loan yield to 6.75% for 2005, compared to 6.67% for 2004.

Interest earned on securities increased $214,000 or 10.7% to $2.2 million for 2005, compared to $2.0 million for 2004. This increase was primarily attributable to an increase in the average balance of securities of $5.0 million to $59.4 million for the year ended December 31, 2005 as compared to $54.4 million for the year ended December 31, 2004.

Interest expense. Interest expense increased by $886,000 or 15.4% to $6.7 million for 2005, compared to $5.8 million for 2004. This increase in interest expense can be attributed to both an increase in the average balance of interest-bearing liabilities along with a 20 basis point increase in the rate paid on these liabilities. For the year ended December 31, 2005 the average balance of interest-bearing liabilities grew by $16.0 million to $236.6 million as compared to $220.6 million for the year ended December 31, 2004. Interest incurred on deposits grew by $614,000 for the year from $4.9 million in 2004 to $5.5 million for year-end 2005. This change was due to a shift in deposit growth from savings accounts to higher cost certificates. Interest incurred on FHLB advances, repurchase agreements and other borrowings increased $272,000 or 31.5% to $1.1 million for 2005, compared to $863,000 million for 2004. This increase was primarily attributable to an increase in the average balance of FHLB advances.

Loan Loss Provision. The provision for loan losses is an operating expense recorded to maintain the related balance sheet allowance for loan losses at an amount considered adequate to cover probable losses incurred in the normal course of lending. The provision for loan losses was $302,000 in 2005 as compared to $174,000 in 2004. The loan loss provision is based upon management's assessment of a variety of factors, including types and amounts of non-performing loans, historical loss experience, collectibility of collateral values and guaranties, pending legal action for collection of loans and related guaranties, and current economic conditions. The loan loss provision reflects management's judgment of the current period cost-of-credit risk inherent in the loan portfolio. Although management believes the loan loss provision has been sufficient to maintain an adequate allowance for loan losses, actual loan losses could exceed the amounts that have been charged to operations. The change in the loan loss provision in 2005 was principally a result of an increase in loan volume during the year.

Non-interest income. Non-interest income increased $340,000 or 19.1% to $2.1 million for 2005, compared to $1.8 million for 2004. This increase can be attributed to increases in fees and service charges of $177,000 and other income of $77,000. In addition there was a loss realized on the sale of investment securities that was not duplicated in 2005. Partially offsetting these increases was a $13,000 decline in the earnings on bank-owned life insurance.

Non-interest expense. Non-interest expenses increased $459,000 or 6.6% to $7.4 million for 2005, compared to $7.0 million for 2004. The growth can be attributed to increases in compensation and employee benefits, data processing and equipment expense which, increased $126,000, $88,000 and $76,000 respectively.

Compensation and employee benefits expense increased $126,000 or 3.7% to $3.6 million for 2005, compared to $3.4 million for 2004. This increase can be attributed to increases in payroll expenses, group health insurance and the cost employee education of $199,000, $13,000 and $12,000, respectively.

Data processing expense increased $88,000 or 16.3% to $626,000 for 2005, compared to $538,000 for 2004. The increase to data processing expense is a reflection of the Company's commitment to continually improve technology in order to enhance service to its customer base.

Provision for Income Taxes. The provision for income taxes increased $85,000 or 6.4% to $1.4 million for 2005, compared to $1.3 million for 2004. This increase was primarily the result of an increase in income before income taxes $513,000 or 11.2% to $5.1 million for 2005, compared to $4.6 million for 2004.

2004 Results Compared to 2003 Results

General. The Company reported net income of $3.3 million and $2.8 million for 2004 and 2003, respectively. The $475,000 or 17% increase in net income between 2004 and 2003 can primarily be attributed to a increase in interest income of $1.1 million, and an increase in non-interest income of $351,000, which were partially offset by a increase in interest expense of $44,000 and an increase in non-interest expense of $860,000. Basic earnings per share increased by $.34 a share or 14.23% to $2.41 at December 31, 2004 from $2.09 at December 31, 2003.

Net interest income. Net interest income, which is the Company's largest revenue source, is the difference between interest income on earning assets and interest expense paid on liabilities. Net interest income is affected by the changes in interest rates and the composition of interest earning assets and liabilities. Net interest income increased considerably by $1.0 million or 11.7% to $10 million for 2004, compared to $8.9 million for 2003. This increase in net interest income can be attributed to an increase in interest income of approximately $1.1 million, offset partially by an increase in interest expense of $44,000.

Interest income. Interest income increased $1.1 million or 7.4% to $15.7 million for 2004, compared to $14.6 million for 2003. This increase in interest income can be attributed to an increase in interest earned on loans receivable of $771,000 and interest earned on securities of $322,000.

Interest earned on loans receivable increased $771,000 or 6.0% to $13.6 million for 2004, compared to $12.8 million for 2003. This increase was primarily attributable to an increase in the average balance of loans outstanding of $20.5 million or 11.2% to $204.2 million for the year ended December 31, 2004 as compared to $183.7 million for the year ended December 31, 2003. An offset to the growth was a decline in the yield on loans to 6.67% for 2004, compared to 6.99% for 2003.

Interest earned on securities increased $322,000 or 19.1% to $2.0 million for 2004, compared to $1.7 million for 2003. This increase was primarily attributable to an increase in the average balance of securities of $9.4 million to $54.4 million for the year ended December 31, 2004 as compared to $45.0 million for the year ended December 31, 2003.

Interest expense. Interest expense increased slightly by $44,000 or less than 1% to $5.8 million for 2004, compared to $5.7 million for 2003. This increase in interest expense can be attributed to an increase in the average balance of interest-bearing liabilities of $23.1 million to $220.6 million for the year ended December 31, 2004 as compared to $197.5 million for the year ended December 31, 2003. Interest incurred on deposits stayed the same at $4.9 million for both 2004 and 2003. This lack of change was due to a shift in deposit growth from certificates to lower cost savings and demand deposit accounts along with an 11.7% increase in average interest-bearing liabilities. Interest incurred on FHLB advances, repurchase agreements and other borrowings increased $44,000 or 5.4% to $863,000 for 2004, compared to $819,000 million for 2003. This slight increase was primarily attributable to an increase in the average balance of FHLB advances.

Loan Loss Provision. The provision for loan losses is an operating expense recorded to maintain the related balance sheet allowance for loan losses at an amount considered adequate to cover probable losses incurred in the normal course of lending. The provision for loan losses was $174,000 in 2004 as compared to $315,000 in 2003. The loan loss provision is based upon management's assessment of a variety of factors, including types and amounts of non-performing loans, historical loss experience, collectibility of collateral values and guaranties, pending legal action for collection of loans and related guaranties, and current economic conditions. The loan loss provision reflects management's judgment of the current period cost-of-credit risk inherent in the loan portfolio. Although management believes the loan loss provision has been sufficient to maintain an adequate allowance for loan losses, actual loan losses could exceed the amounts that have been charged to operations. The change in the loan loss provision in 2004 was principally a result of an increase in loan volume during the year.

Non-interest income. Non-interest income increased $351,000 or 24.6% to $1.8 million for 2004, compared to $1.4 million for 2003. This increase can be attributed to increases in fees and service charges of $368,000 and the earnings on bank-owned life insurance of $20,000. Partially offsetting these increases were the net realized loss on sales of securities available for sale of $98,000.

Fees and service charges increased $368,000 or 35.6% to $1.4 million for 2004, compared to $1.0 million for 2003. This increase resulted from the Company introducing a new overdraft service in the second quarter of 2004.

Non-interest expense. Non-interest expenses increased $860,000 or 14.1% to $7 million for 2004, compared to $6.1 million for 2003. The growth can be attributed to increases in salaries and employee benefits, occupancy and advertising expense which, increased $357,000, $91,000 and $85,000 respectively.

Compensation and employee benefits expense increased $357,000 or 11.6% to $3.4 million for 2004, compared to $3.1 million for 2003. This increase can be attributed to increases to payroll expenses, the cost of health benefits and profit sharing expenses of $224,000, $54,000 and $49,000, respectively.

Data processing expense increased $68,000 or 14.5% to $538,000 for 2004, compared to $470,000 for 2003. The increase to data processing expense is a reflection of the Company's commitment to continually improve technology in order to enhance service to its customer base.

Occupancy expense increased $91,000 or 22.6% to $495,000 for 2004, compared to $404,000 for 2003. The increased occupancy expense was due in part to increased utility costs as well as leasehold improvements to the Mantua facility.

Advertising expense increased $85,000 or 50.4% to $254,000 for 2004, compared to $169,000 for 2003. The increase in advertising was due to the Company's commitment to enhance the marketing budget for Bank promotions.

Other expenses increased $165,000 or 16.5% to $1.2 million for 2004, compared to $1.0 million for 2003. The increase to other noninterest expense is a result in part to the rising cost of examination and auditing expense brought about by the continuing regulatory burdens on the banking industry.

Provision for Income Taxes. The provision for income taxes increased $199,000 or 17.6% to $1.3 million for 2004, compared to $1.1 million for 2003. This increase was primarily the result of an increase in income before income taxes $673,000 or 17.1% to $4.6 million for 2004, compared to $3.9 million for 2003.

Asset and Liability Management

The primary objective of the Company's asset and liability management function is to maximize the Company's net interest income while simultaneously maintaining an acceptable level of interest rate risk given the Company's operating environment, capital and liquidity requirements, performance objectives and overall business focus. The principal determinant of the exposure of the Company's earnings to interest rate risk is the timing difference between the re-pricing or maturity of interest-earning assets and the repricing or maturity of its interest-bearing liabilities. The Company's asset and liability management policies are designed to decrease interest rate sensitivity primarily by shortening the maturities of interest-earning assets while at the same time extending the maturities of interest-bearing liabilities. The Board of Directors of the Company continues to believe in strong asset/liability management in order to insulate the Company from material and prolonged increases in interest rates. As a result of this policy, the Company emphasizes a larger, more diversified portfolio of residential mortgage loans in the form of mortgage-backed securities. Mortgage-backed securities generally increase the quality of the Company's assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company.

The Company's Board of Directors has established an Asset and Liability Management Committee consisting of outside directors and senior management. This committee, which meets quarterly, generally monitors various asset and liability management policies and strategies, which were implemented by the Company over the past few years.

Interest Rate Sensitivity Simulation Analysis

The Company utilizes income simulation modeling in measuring its interest rate risk and managing its interest rate sensitivity. The Asset and Liability Management Committee of the Company believes that simulation modeling enables the Company to more accurately evaluate and manage the possible effects on net interest income due to the exposure to changing market interest rates, the slope of the yield curve and different loan and mortgage-backed security prepayment and deposit decay assumptions under various interest rate scenarios.

Earnings simulation modeling, assumptions about the timing and variability of cash flows are critical in net portfolio equity valuation analysis. Particularly important are the assumptions driving mortgage prepayments and the assumptions about expected attrition of the core deposit portfolios. These assumptions are based on the Company's historical experience and industry standards and are applied consistently across the different rate risk measures.

The Company has established the following guidelines for assessing interest rate risk:

Net interest income simulation. Given a 200 basis point parallel gradual increase or decrease in market interest rates, net interest income may not change by more than 10% for a one-year period.

Portfolio equity simulation. Portfolio equity is the net present value of the Company's existing assets and liabilities. Given a 200 basis point immediate and permanent increase or decrease in market interest rates, portfolio equity may not correspondingly decrease or increase by more than 20% of stockholders' equity.

The following table presents the simulated impact of a 200 basis point upward or downward shift of market interest rates on net interest income, and the change in portfolio equity. This analysis was done assuming that the interest-earning asset and interest-bearing liability levels at December 31, 2005 remained constant. The impact of the market rate movements was developed by simulating the effects of rates changing gradually over a one-year period from the December 31, 2005 levels for net interest income, and portfolio equity The impact of market rate movements was developed by simulating the effects of an immediate and permanent change in rates at December 31, 2005 for portfolio equity:

	Increase +200 BP	Decrease -200 BP
Net interest income - increase (decrease)	5.33%	(6.91)%
Portfolio equity - increase (decrease)	(3.16)%	(1.19)%

Allowance for Loan Losses. The allowance for loan losses represents the amount management estimates are adequate to provide for probable losses inherent in the loan portfolio as of the balance sheet date. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. At December 31, 2005, Middlefield's allowance for loan losses increased to $2.8 million from $2.6 million at December 31, 2004, and now represents 1.21% of the gross loan portfolio as compared to 1.22% for the previous period. The allowance for loan losses is established through a provision for loan losses, which is charged to operations. The provision is based on management's periodic evaluation of the adequacy of the allowance for loan losses, taking into account the overall risk characteristics of the various portfolio segments, the bank's loan loss experience, the impact of economic conditions on borrowers, and other relevant factors. The estimates used to determine the adequacy of the allowance for loan losses, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to significant change in the near term. The total allowance for loan losses is a combination of a specific allowance for identified problem loans, a formula allowance, and an unallocated allowance.

The specific allowance incorporates the results of measuring impaired loans as provided in Statement of Financial Accounting Standards ("FAS") No. 114, *Accounting by Creditors for Impairment of a Loan*, and FAS No. 118, *Accounting by Creditors for Impairment of a Loan--Income Recognition and Disclosures*. These accounting standards prescribe the measurement methods, income recognition and disclosures for impaired loans. The formula allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's determination of the amounts necessary for concentrations and changes in mix and volume of the loan portfolio, and consideration of historical loss experience.

The unallocated allowance is determined based upon management's evaluation of existing economic and business conditions affecting the key lending areas of the bank and other conditions, such as new loan products, credit quality trends, collateral values, specific industry conditions within portfolio segments that existed as of the balance sheet date, and the impact of those conditions on the collectibility of the loan portfolio. Management reviews these conditions quarterly. The unallocated allowance is subject to a higher degree of uncertainty because it considers risk factors that may not be reflected in the historical loss factors.

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses was adequate at December 31, 2005, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy and employment could result in increased levels of non-performing assets and charge-offs, increased loan loss provisions, and reductions in income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review a bank's loan loss allowance. The banking agencies could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

The following table sets forth information concerning the Middlefield's allowance for loan losses at the dates and for the periods presented.

	For the Years Ended December 31, 2005	2004	2003
	(Dollars in thousands)		
Allowance balance at beginning of period	$ 2,623	$ 2,521	$ 2,300
Loans charged off:			
Commercial and industrial	(103)	(61)	(75)
Real estate-construction	—	—	—
Real estate-mortgage:			
Residential	(15)	—	(32)
Commercial	—	—	—
Consumer installment	(61)	(57)	(37)
Total loans charged off	(179)	(118)	(144)
Recoveries of loans previously charged-off:			
Commercial and industrial	64	27	28
Real estate-construction	—	—	—
Real estate-mortgage:	—	—	—
Residential	17	3	—
Commercial	—	—	—
Consumer installment	14	16	22
Total recoveries	95	46	50
Net loans recovered (charged off)	(84)	(72)	(94)
Provision for loan losses	302	174	315
Allowance balance at end of period	$ 2,841	$ 2,623	$ 2,521
Loans outstanding:			
Average	$ 222,926	$ 204,191	$ 183,683
End of period	234,055	215,653	192,880
Ratio of allowance for loan losses to loans outstanding at end of period	1.21%	1.22%	1.31%
Net recoveries (charge offs) to average loans	(0.04)	(0.04)	(0.05)

The following table illustrates the allocation of Middlefield's allowance for probable loan losses for each category of loan for each reported period. The allocation of the allowance to each category is not necessarily indicative of future loss in a particular category and does not restrict our use of the allowance to absorb losses in other loan categories.

	At December 31,					
	2005		2004		2003	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
	(Dollars in Thousands)					
Type of Loans:						
Commercial and industrial	$ 1,151	27.60 %	$ 1,139	24.1 %	$ 568	21.8 %
Real estate construction	50	1.2	31	1.8	32	1.8
Mortgage:						
Residential	965	64.9	1,019	68.4	844	69.5
Commercial	297	3.5	145	3.2	228	4.1
Consumer installment	128	2.8	123	2.7	120	2.9
Unallocated	250	—	166	—	435	—
Total	$ 2,841	100 %	$ 2,623	100 %	$ 2,227	100 %

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Payments received on nonaccrual loans are recorded as income or applied against principal according to management's judgment as to the collectibility of principal.

A loan is considered impaired when it is probable the borrower will not repay the loan according to the original contractual terms of the loan agreement. Management has determined that first mortgage loans on one-to-four family properties and all consumer loans represent large groups of smaller-balance homogeneous loans that are to be collectively evaluated. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. A loan is not impaired during a period of delay in payment if the bank expects to collect all amounts due, including interest accrued at the contractual interest rate for the period of delay. Management evaluates all loans identified as impaired individually. The bank estimates credit losses on impaired loans based on the present value of expected cash flows, or the fair value of the underlying collateral if loan repayment is expected to come from the sale or operation of the collateral. Impaired loans, or portions thereof, are charged off when it is determined a realized loss has occurred. Until that time, an allowance for loan losses is maintained for estimated losses.

Unless otherwise required by the loan terms, cash receipts on impaired loans are applied first to accrued interest receivable, except when an impaired loan is also a nonaccrual loan, in which case the portion of the payment related to interest is recognized as income.

Nonperforming loans as a percentage of total net loans at December 31, 2005 increased to 0.78% from 0.68% for 2004. The bank had nonaccrual loans of $1,478,000 and $279,000 at December 31, 2005 and 2004, respectively. Interest income recognized on nonaccrual loans during all of the periods was insignificant. Management does not believe the nonaccrual loans or any amounts classified as nonperforming had a significant effect on operations or liquidity in 2005. Furthermore, management is not aware of any trends or uncertainties related to any loans classified as doubtful or substandard that might have a material effect on earnings, liquidity, or capital resources. Management is not aware of any information pertaining to material credits that would cause it to doubt the ability of borrowers to comply with repayment terms.

The following table summarizes nonperforming assets by category.

	At December 31,		
	2005	2004	2003
	(Dollars in thousands)		
Loans accounted for on a nonaccrual basis:			
Commercial and industrial	$ 859	$ —	$ —
Real estate-construction	—	—	—
Real estate-mortgage:			
Residential	607	279	372
Commercial	—	—	—
Consumer installment	21	—	—
Total nonaccrual loans	1,487	279	372
Accruing loans which are contractually past due 90 days or more:			
Commercial and industrial	248	239	4
Real estate-construction	—	—	—
Real estate-mortgage:	—	—	—
Residential	70	722	114
Commercial	—	206	—
Consumer installment	9	25	19
Total accruing loans which are contractually past due 90 days or more	327	1,192	137
Total non - performing loans	1,814	1,471	509
Real estate owned	—	—	—
Other non-performing assets	—	—	—
Total non-performing assets	$ 1,814	$ 1,471	$ 509
Total non-performing loans to total loans	0.78%	0.68%	0.26%
Total non-performing loans to total assets	0.58%	0.51%	0.19%
Total non-performing assets to total assets	0.58%	0.51%	0.19%

(1) Represents accruing loans delinquent greater than 90 days that are considered by management to be well secured and that are in the process of collection.

Liquidity and Capital Resources

Liquidity. Liquidity management for Middlefield is measured and monitored on both a short- and long-term basis, allowing management to better understand and react to emerging balance sheet trends. After assessing actual and projected cash flow needs, management seeks to obtain funding at the most economical cost to Middlefield. Both short- and long-term liquidity needs are addressed by maturities and sales of investments securities, loan repayments and maturities, and liquidating money market investments such as federal funds sold. The use of these resources, in conjunction with access to credit, provides the core ingredients for satisfying depositor, borrower, and creditor needs.

Middlefield's liquid assets consist of cash and cash equivalents, which include investments in very short-term investments (i.e. federal funds sold), and investment securities classified as available for sale. The level of these assets is dependent on Middlefield's operating, investing, and financing activities during any given period. At December 31, 2005, cash and cash equivalents totaled $5.8 million or 1.9% of total assets while investment securities classified as available for sale totaled $57.9 million or 18.6% of total assets. Management believes that the liquidity needs of Middlefield are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, FHLB advances, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable Middlefield to meet cash obligations and off-balance sheet commitments as they come due.

Operating activities provided net cash of $4.5 million, $4.0 million, and $3.5 million for 2005, 2004, and 2003, respectively, generated principally from net income of $3.7 million, $3.3 million, and $2.8 million in each of these respective periods.

Investing activities consist primarily of loan originations and repayments and investment purchases and maturities. These cash usages primarily consisted of loan originations of $18.3 million, as well as investment purchases of $13.3 million. Partially offsetting the usage of investment activities is $11.4 million of proceeds from investment security maturities and repayments. For the same period ended 2004, investing activities used $29.3 million in funds, principally for the net origination of loans and the purchase of investment securities of $22.7 million and $27.6 million, respectively. During the same period ended 2003, cash usages primarily consisted of loan originations of $17.9 million, as well as investment purchases of $33.0 million.

Financing activities consist of the solicitation and repayment of customer deposits, borrowings and repayments, treasury stock activity, and the payment of dividends. During 2005, net cash provided by financing activities totaled $16.7 million, principally derived from an increase in deposit accounts in general, and certificates specifically. Also contributing to this influx of cash was proceeds from other borrowings of $13.0 million. During 2004, net cash provided by financing activities totaled $25.7 million, principally derived from an increase in deposit accounts. During the same period ended 2003, net cash provided by financing activities was $33.4 million, principally derived from an increase in deposit accounts.

Liquidity may be adversely affected by unexpected deposit outflows, excessive interest rates paid by competitors, and similar matters. Management monitors projected liquidity needs and determines the level desirable, based in part on Middlefield's commitment to make loans, as well as management's assessment of Middlefield's ability to generate funds. Middlefield anticipates that it will have sufficient liquidity to satisfy estimated short-term and long-term funding needs.

Capital Resources. Middlefield's primary source of capital has been retained earnings. Historically, Middlefield has generated net retained income to support normal growth and expansion. Management has developed a capital planning policy to not only ensure compliance with regulations, but also to ensure capital adequacy for future expansion.

Middlefield is subject to federal regulations imposing minimum capital requirements. Management monitors both Middlefield's and the Bank's Total risk-based, Tier I risk-based and Tier I leverage capital ratios to assess compliance with regulatory guidelines. At December 31, 2005, both Middlefield and the Bank exceeded the minimum risk-based and leverage capital ratio requirements. Middlefield's Total risk-based, Tier I risk-based and Tier I leverage ratios were 14.41%, 13.16%, and 9.10%, and the Bank's were 13.83%, 12.58%, and 8.68%, respectively, at December 31, 2005.

Contractual Obligations:

(In thousands)	Total	Less Than 1 Year	1–3 Years	4–5 Years	After 5 Years
Short-term borrowings	$ 6,711	$ 6,711	$ —	$ —	$ —
Federal Home Loan Bank advances	26,578	4,092	15,642	4,565	2,279
Total	$ 33,289	$ 10,803	$ 15,642	$ 4,565	$ 22,279

Commitments to Extend Credit:

(In thousands)	Total Amounts Committed	Less Than 1 Year	1–3 Years	4–5 Years	After 5 Years
Standby letters of credit	$ 125	$ 125	$ —	$ —	$ —
Other commitments to extend credit[1]	45,678	45,678	—	—	—
Total	$ 45,803	$ 45,803	$ —	$ —	$ —

(1) Represents amounts committed to customers.

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments.

Commitments to extend credit, include loan commitments, standby letters of credit and do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

Market for Middlefield's Common Equity and Related Stockholder Matters

Middlefield had approximately 846 stockholders of record as of February 22, 2006. There is no established market for Middlefield common stock. The stock is traded very infrequently. Bid prices are quoted from time to time on the National Quotation Bureau's "pink sheets" under the symbol "MBCN." The following table shows the high and low bid prices of and cash dividends paid on Middlefield common stock in 2005 and 2004, adjusted for stock splits and stock dividends. This information does not reflect retail mark-up, markdown or commissions, and does not necessarily represent actual transactions.

	High Bid	Low Bid	Cash Dividends per share
2005			
First Quarter	$ 37.811	$ 37.769	$ 0.210
Second Quarter	$ 39.563	$ 39.531	$ 0.210
Third Quarter	$ 38.459	$ 38.412	$ 0.224
Fourth Quarter	$ 39.084	$ 38.885	$ 0.235
2004			
First Quarter	$ 29.245	$ 29.125	$ 0.190
Second Quarter	$ 29.895	$ 29.361	$ 0.190
Third Quarter	$ 32.267	$ 32.072	$ 0.200
Fourth Quarter	$ 34.130	$ 34.110	$ 0.210

"we're putting banking to work in our communities"

staff & directors

Staff

Main Office:

Louise Fenselon – 1984 – Teller
Bonnie Steele – 1985 – Customer Services
Diana Koller – 1998 – Teller
Summer Phillips – 1999 – Customer Services
Elizabeth Pixley – 2001 – Head Teller
Karah Vance – 2002 – Teller*
Jaime Dlugoz – 2004 – Teller*
Melody Askey – 2005 – Receptionist
Victoria Bacon – 2005 – Teller*
Cody Madsen – 2005 – Teller *
Dawn Semich – 2005 – Teller*

West Branch:

Patti Russo – 1982 – Customer Services
Rachel Lilly – 1985 – Head Teller
Kelly Gibney – 1987 – Teller
Amber Koscelnik – 2004 – Teller*
Cindy Bates – 2005 – Teller*
Jodi Ottaviano – 2005 – Teller
Rachel Reese – 2005 – Teller*
Sue Trumbull – 2005 – Teller
Kori Wilson – 2005 - Teller

Garrettsville Branch:

Kathy Vanek – 1998 – Branch Supervisor
Vickie Moss – 1998 – Teller
Colleen Steele – 1998 – Teller
Ashley Durst – 2001 – Teller
Michelle Lutz – 2001 – Head Teller
Janis Pollack – 2002 – Customer Services
Nicole Meszaros – 2005 – Teller*

Mantua Branch:

Joan Sweet – 2002 – Branch Supervisor
Rebecca Reinard – 2002 – Teller
Karey Finn – 2004 – Teller*
Jodie Lawless – 2004 – Teller

Chardon Branch:

Amanda DiMeolo – 2001 – Head Teller
Gretchen Mihalic – 2001 – Teller*
Jennifer Hess – 2003 – Customer Services
Kim Koynock – 2005 – Teller*
Beverly Palinsky – 2005 – Teller*

Orwell Branch:

Karen Graham – 2002 – Branch Supervisor
Sue Masink – 2005 – Teller
Tiffany Perkins – 2005 – Teller
Marguerite Schaden – 2005 – Teller*

Loan Department:

Helen Stowe – 1985 – Loan Adm. Asst.
Jennifer Gabrielson – 1997 – Consumer Loan Officer
Jane Armstrong – 1998 – Loan Collection Manager
Vivian Helmick – 1998 – Loan Adm. Asst.
Carolyn Fackler – 2001 – Loan Adm. Asst.
Sharon Clements – 2003 – Loan Officer
Sarah Brook – 2004 – Loan Adm. Asst.
Jamie Fleming – 2004 – Loan Adm. Asst.
Elaine James – 2005 – Loan Receptionist

Operations:

Karen Westover – 1983 – Bookkeeper
Pamela Malcuit – 1989 – Bookkeeper
Donna Williams – 1990 – Bookkeeper
Lauren Harth – 1995 – Audit Clerk*
Tara Morgan – 1997 – Proof Operator
Derrick Pilarczyk – 1999 – Facility Maintenance
Lisa Sanborn – 2000 – Bookkeeper
Jeremy Bailey – 2001 – Management Trainee

Financial Services:

Thomas Hart – 2004 – Financial Consultant

Officers

Thomas G. Caldwell – 1986
President and Chief Executive Officer

James R. Heslop, II – 1996
Executive Vice President
Chief Operating Officer

Teresa M. Hetrick – 1996
Senior Vice President
Operations/Administration

Jay P. Giles – 1998
Senior Vice President
Senior Commercial Lender

Donald L. Stacy – 1999
Senior Vice President
Chief Financial Officer

Nancy C. Snow – 1979
Vice President and Corporate Secretary
and West Branch Manager

Kathleen M. Johnson – 1971
Vice President
Chief Accounting Officer

Joann Vance – 1986
Vice President
Human Resource Administrator

Jack L. Lester – 1990
Vice President
Compliance and Security Officer

Alfred F. Thompson, Jr. – 1996
Vice President
Senior Retail Lender

** Part Time*

R. E. West – 1998
Vice President
Main Office Manager

Sharon R. Jarold – 2001
Vice President/Lending

Edward F. Kent – 2002
Vice President/Lending

Karen Branham – 1983
Assistant Vice President

Gail Neikirk – 1983
Assistant Vice President

Christine A. Polzer – 1989
Assistant Vice President
Network Administrator

Thomas Munson – 2003
Assistant Vice President/Lending

Timothy McCreary – 2004
Assistant Vice President
Chardon Branch Manager

Thomas R. Neikirk – 1994
Banking Officer

Marlin J. Moschell – 2000
Banking Officer

Directors

Donald D. Hunter – 1977
Chairman
Retired Retail Merchant

Richard T. Coyne – 1997
General Manager
Jaco Products
Vice President, Operations
Capital Plastics

Donald E. Villers – 1987
Retired: Copperweld Steel

Martin S. Paul – 1998
Chief Executive Officer
The Paul Feed & Supply
Company

Thomas C. Halstead – 1988
Co-Owner: Settlers' Farm

James R. Heslop, II – 2001
Executive Vice President and
Chief Operating Officer
Middlefield Banc Corp.
The Middlefield Banking
Company

George F. Hasman – 1989
Retired: Chairman &
President of
The Twinsburg Banking
Company

James J. McCaskey – 2004
President
McCaskey Landscape &
Design, LLC

Frances H. Frank – 1995
Secretary/Treasurer
The Frank Agency, Inc.

Carolyn J. Turk, C.P.A. – 2004
Regional Controller
Molded Fiber Glass
Companies

Thomas G. Caldwell – 1997
President and Chief
Executive Officer
Middlefield Banc Corp.
The Middlefield Banking
Company

shareholder information

Corporate Headquarters

The Corporation's headquarters is located at:

Middlefield Banc Corp.
15985 East High Street
P. O. Box 35
Middlefield, Ohio 44062
(440) 632-1666
(888) 801-1666

Form 10-K And 10-Q Availability

A copy of Middlefield Banc Corp.'s Annual Report on Form 10-K and Quarterly Reports on 10-Q filed with the Securities and Exchange Commission will be furnished to any shareholder, free of charge, upon written or e-mail request to:

Donald L. Stacy
Treasurer and CFO
Middlefield Banc Corp.
P. O. Box 35
Middlefield, Ohio 44062
or
dstacy@middlefieldbank.com

Market Makers

The symbol for Middlefield Banc Corp. common stock is MBCN and the CUSIP is 596304204.

Sweney Cartwright & Co.
George Geissbuhler,
Vice President
17 South High Street
Columbus, Ohio 43215
(614) 228-5391
(800) 334-7481

Ryan Beck & Company, Inc.
Chris Bayait
Managing Director
18 Columbia Turnpike
Florham, NJ 07932
(800) 342-2325

Notice Of Annual Meeting

The Annual Meeting of Shareholders of Middlefield Banc Corp. will be held at 1:00 p.m. on Wednesday, May 10, 2006, at Grandview Inn, 13404 Old State Road, Middlefield, Ohio.

Transfer Agent And Registrar

American Stock Transfer & Trust Company
59 Maiden Lane
Plaza Level
New York, NY 10038
(877) 366-6443

Independent Auditors

S. R. Snodgrass, A. C.
1000 Stonewood Drive, Suite 200
Wexford, Pennsylvania 15090-8399
(724) 934-0344

Internet Information

Information on The Middlefield Banking Company's products and services is available on the Internet at www.middlefieldbank.com.

Dividend Payment Dates

Subject to action by the Board of Directors, Middlefield Banc Corp. will pay dividends in March, June, September, and December.

Dividend Reinvestment And Stock Purchase Plan

Shareholders may elect to reinvest their dividends in additional shares of Middlefield Banc Corp.'s common stock through the company's Dividend Reinvestment Plan. To arrange automatic purchase of shares with quarterly dividend proceeds, please call (888) 801-1666.

Direct Deposit Of Dividends

The direct deposit program, which is offered at no charge, provides for automatic deposit of quarterly dividends directly to a checking or savings account with The Middlefield Banking Company. For information regarding this program, please call (888) 801-1666.

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mbc

middlefield banc corp.

15985 East High Street • Middlefield, Ohio • 888-801-1666
www.middlefieldbank.com

And Its Wholly-Owned Subsidiary

mb *The Middlefield Banking Company*

Main Office	***Garrettsville***	***Chardon***
15985 East High Street	8058 State Street	348 Center Street
440-632-1666	330-527-2121	440-286-1222
West Branch	***Mantua***	***Orwell***
15545 West High Street	10519 Main Street	30 South Maple Street
440-632-1666	330-274-0881	440-437-7200